

Rating Action: Moody's changes Orbit Group Limited's outlook to negative, affirms A2 issuer rating, assigns (P)A2 debt rating to planned bond issuance of between GBP250m and GBP450m

31 May 2018

London, 31 May 2018 -- Moody's Public Sector Europe (MPSE) today affirmed the A2 issuer rating on Orbit Group Limited (Orbit), and the A2 senior secured debt rating on Orbit Capital Plc, and changed the outlook to negative from stable. MPSE also assigned a debt rating of (P)A2 to Orbit Capital Plc's proposed issuance of between GBP250 million and GBP450 million in long-term senior secured bonds.

RATINGS RATIONALE

OUTLOOK CHANGE TO NEGATIVE FROM STABLE

The change in outlook to negative from stable reflects the credit risk stemming from Orbit's plans to materially increase capital expenditure, as well as the increased proportion of market sales in the group's development plans.

The forecast increase in capital expenditure weakens the housing association's liquidity cover metric in FY2018 from a projected 2.36x to 0.82x, pre-bond issuance. Moreover, the sustained high capex throughout the development plan drives low liquidity coverage over the next 3-4 years. Additionally, market sales revenues are forecast to increase to 42% of total turnover in FY2020, from 33% in FY2017, making Orbit one of the most exposed to commercial activities among rated housing associations. As margins from sales are generally lower than Orbit's social housing letting margin, total operating margin is set to remain low relative to peers, at 26%, through to FY2020.

AFFIRMATION OF THE A2 ISSUER RATING ON ORBIT GROUP LIMITED

The affirmation of the A2 issuer rating on Orbit reflects the entity's strong cash flow volatility interest cover at 2.2x and healthy social housing letting interest cover (SHLIC) at 1.6x in FY2017, which is in line with A2 peers. The rating is further supported by the organisation's strong market position in the Midlands, and its healthy unencumbered asset position which enhances its borrowing capacity.

Following the bond issuance, Orbit plans to use the proceeds to refinance existing loan facilities to simplify its debt structure and support its strategy. The upper limit of the bond issuance would increase Orbit's current debt position by approximately 10%, which would have a limited impact on its debt ratios; with debt to revenue and gearing increasing to 3.8x and 52% from 3.3x and 51%, respectively.

As per the application of Moody's Joint Default Analysis methodology for government-related issuers, Orbit's assigned baseline credit assessment (BCA) is a3. The final rating of A2 incorporates the one-notch uplift provided by Moody's assessment of a strong likelihood of support from the UK government.

RATIONALE FOR DEBT RATING

The provisional (P)A2 debt rating assigned to Orbit Capital Plc's planned bond issuance is derived from the A2 issuer rating of Orbit. The bonds are expected to be secured by a pledge on a portfolio of social housing or affordable rent properties of Orbit which may be valued at both Estimated Use Value -- Social Housing (EUV-SH) at 1.05x and Market Value Subject to Tenancy (MV-ST) at 1.15x.

Proceeds from the bond will be used to refinance some of the group's existing facilities and fund the group's strategy. The proposed bond issuance is planned to be drawn in one tranche in FY2019, with no retained element.

The rating assigned to the proposed bond issuance of between GBP250 million and GBP450 million is based on documentation received by Moody's as of the rating assignment date. In the event that the structure changes from the documentation submitted to us, Moody's will assess the impact that these differences may have on the ratings.

WHAT COULD CHANGE THE RATING -- UP/DOWN

While an upgrade is unlikely, the outlook could return to stable from one or a combination of the following: (1) a pulling back in planned capital expenditure, leading to an improved liquidity coverage metric, (2) a reduced risk profile as evidenced in lower exposure to sales, (3) improved profitability in Orbit's social housing letting business, allowing SHLIC to reach 2x, despite rising interest costs given the additional borrowing, or (4) a reduction in exposure to standalone derivatives.

Negative pressure on the rating could result from one or a combination of the following: (1) increased reliance on market sales revenue, (2) higher capital expenditure such that net capex is sustained above 35% of turnover, or (3) operating margin sustained at levels below peers. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government, or a downgrade of the UK sovereign rating would exert downward pressure on the rating.

The methodologies used in these ratings were European Social Housing Providers published in April 2018, and Government-Related Issuers published in August 2017. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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