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CREDIT OPINION
30 October 2023

Update

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RATINGS

Orbit Group Limited

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Orbit Group Limited (United Kingdom)

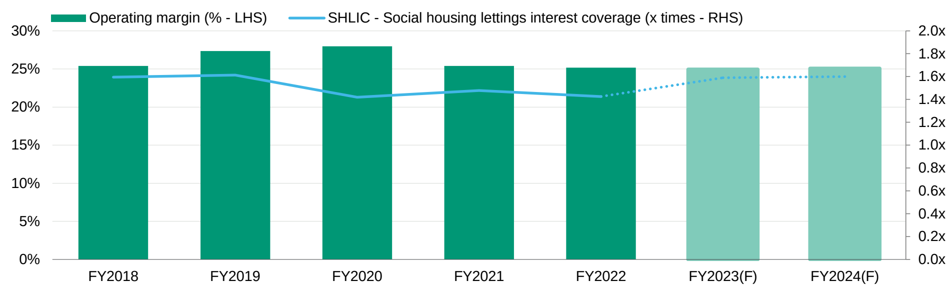
Update following outlook change to stable from negative

Summary

The credit profile of Orbit Group Limited (Orbit, A3 stable) reflects its strong financial performance, very strong liquidity, stable debt metrics, and straightforward governance structure. Counterbalancing its strengths are its sizeable development programme and high exposure to market sales (including first tranche shared ownership and outright sales). Orbit benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene in the event that Orbit faced acute liquidity stress.

Exhibit 1

Orbit's financial strength is expected to remain stable over the next few years



F = indicates forecast
Source: Orbit, Moody's Investors Service

Credit strengths

» Stable financial performance, expected to continue

» Very strong liquidity in addition to stable debt metrics and risk-averse debt structure

» Adept management and governance alongside robust risk management practices

» Supportive institutional framework in England

Credit challenges

» High market sales exposure, albeit with good performance to date and smaller development programme

Rating outlook

The stable outlook reflects the expected gradual reduction in inflation and associated cost pressures as well as the proactive actions taken by the issuer to mitigate the adverse effects of the weaker operating environment.

Factors that could lead to an upgrade

Upward pressure on the rating could result from a significant improvement in operating performance, a material reduction in debt or a significant increase in government support for the sector, especially significantly higher levels of capital grants.

Factors that could lead to a downgrade

Downward pressure on the rating could result from a prolonged weakening in operating performance, debt growing more quickly than forecasts, weaker liquidity or a failure to adapt strategies and risk appetite to mitigate weaker economic conditions. Lower government support for the sector or a dilution of the regulatory framework could also lead to downward pressure on the rating.

Key indicators

Exhibit 2
Orbit Group Limited

Orbit Group	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23 (F)	31-Mar-24 (F)
Units under management (no.)	42,417	43,470	44,753	45,702	46,529	46,320	46,402
Operating margin, before interest (%)	25.4	27.3	28.0	25.4	25.2	24.9	25.1
Net capital expenditure as % turnover	24.9	49.1	47.0	10.2	50.3	23.7	33.8
Social housing letting interest coverage (x times)	1.6	1.6	1.4	1.5	1.4	1.6	1.6
Cash flow volatility interest coverage (x times)	2.1	0.7	0.3	1.8	0.5	2.1	1.7
Debt to revenues (x times)	3.4	4.5	4.5	4.8	4.2	4.1	4.1
Debt to assets at cost (%)	48.8	51.1	50.0	48.6	48.8	49.4	49.0

Source: Orbit, Moody's Investors Service

Detailed credit considerations

On 25 October 2023, Moody's affirmed Orbit's ratings and changed its outlook to stable from negative. The change in outlook followed Moody's change in outlook of the Government of the United Kingdom's Aa3 rating to stable from negative on 20 October 2023.

Orbit's rating combines: (1) a baseline credit assessment (BCA) for the entity of baa1 and (2) a strong likelihood of extraordinary support coming from the national government in the event that Orbit faced acute liquidity stress.

Baseline credit assessment

Stable financial performance, expected to continue

Although Orbit has recorded historically lower operating margins than rated peers, due to its high exposure to market sales which typically has lower profitability than social housing, it is now more or less in line with A3 peers. The profitability of the sector has deteriorated over the past 5 years due to the one percent annual rent cut in place from fiscal 2017 to 2021, increased fire safety and building quality expenditure, and inflation more recently. Orbit's operating margin has stayed stable over this period however, demonstrating its strong management and cost control. In fiscal 2022, Orbit recorded an operating margin of 25% (excluding fixed asset sales), which was above the A3 rated peer median of 23%, and we expect its margin to remain relatively stable over the medium term.

The operating margins from Orbit's social housing letting business are strong - with an average margin of 39% over the past four years and only a small deterioration over this period, from 40% in fiscal 2019 to 37% in fiscal 2022. Orbit has been pro-active in completing fire safety works and started work on achieving EPC-C standards on stock in fiscal 2017, which means it has only a moderate level of expenditure remaining on these aspects. Over 80% of its stock is now at EPC-C.

Margins achieved on first tranche shared ownership and outright sales have also been decent, with the former recording a margin of 15% and the latter 14% in fiscal 2022 which is more or less in line with the sector, and consistent with Orbit's results in prior years. Orbit is expecting to meet or exceed its margin targets on sales in fiscal 2023, which is set at around 14%. Over the medium term this may become more challenging due to the housing market downturn, as well as high cost inflation, however we note that Orbit exercises strong cost control on its development sites, which enables it to pause development if market conditions are not favourable.

Orbit's interest coverage is good, with social housing lettings interest coverage at 1.4x as of fiscal 2022, above the A3 peer median of 1.2x. We expect this metric to remain strong in line with its stable debt metrics and financial performance. We also note it has sufficient EBITDA-MRI interest cover covenant headroom, with over 100bps headroom in its tightest year.

Very strong liquidity in addition to stable debt metrics and risk-averse debt structure

As of 30th September 2022, Orbit held £0.5 billion in cash and immediately available facilities, with over 2x coverage of the following 24 months of net cash needs. We expect its liquidity coverage to remain strong, in line with its liquidity policy which includes the need to retain a minimum level of liquidity of 12 months net cash needs in cash and immediately available facilities, and 24 months in cash and committed (but unsecured) facilities. It also has additional borrowing capacity of another £950 million, based on its unencumbered asset position.

Orbit's debt to revenues metric has improved in recent years - moving from 4.5x in fiscal 2020 to 4.2x in fiscal 2022, as its sales have ramped up over the past two years from 28% to 34% of turnover, as well as its disposals programme. The latter has generated over £190 million in receipts from fiscal 2020 to fiscal 2022, which has reduced the amount of debt that Orbit has required to fund its capital expenditure of £300 million over the same period. We expect its debt to revenues metric to stabilise at between 4.0x to 4.1x over the next three years. We also expect gearing to remain stable at 49% over the same period.

Orbit has benefited from its large portfolio of standalone and embedded swaps as interest rates have risen, with 99% of its debt fixed or hedged to fixed rates with a very low mark to market position. It also has limited refinancing risk with only 13% of drawn debt due for refinancing within the next five years.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong institutional framework governing English housing associations (HAs) reflected in an Operating Environment score of a3 and a Regulatory Framework score of a1. These scores are assigned at a national level and reflect the following credit considerations:

The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and by undertaking biennial In-Depth Assessments (IDAs) for large and complex HAs. The regulator has a strong track record of intervention in cases of mismanagement or financial stress with powers to provide financial assistance and/or make manager appointments where there has been a breach of regulatory standards.

The operating environment for English HAs remains supportive. Demand for social housing remains very high and the government has committed to increased capital grant on more flexible terms for new social housing. English HAs retain some expenditure flexibility and have a track record of reducing costs to mitigate lower income.

However, due to very high rates of inflation, the government has intervened on social rent policy with a 7% ceiling on social rent increases to be implemented from April 2023 for a minimum of one year, resulting in an adverse differential between rental income and cost growth, driving lower margins and interest coverage. The intervention introduces policy volatility to the sector as the ceiling will supersede the allowable increase of consumer price inflation (CPI) plus 1% under the current rent standard, which is in place until March 2025.

Adept management and governance alongside robust risk management practices

Orbit has been in operation for over 50 years, growing a portfolio which currently comprises of around 45,000 units focused predominantly in the Midlands, East of England, and South East regions. Orbit is one of the UK's largest developers of social housing and has a strong presence within the markets it operates which is a credit strength. Orbit's size reflects a large balance sheet that can better provide resilience to potential financial stresses, relative to smaller housing associations.

Orbit's governance structure is simple, consisting of the parent company - Orbit Group Limited - the Registered Provider - Orbit Housing Association Limited - and three other subsidiaries, Orbit Homes (2020), Orbit Treasury Limited and Orbit Capital plc. Orbit Homes provides design and build services to the group, and the two other subsidiaries are the treasury vehicles for the group.

Orbit's financial, debt and investment management is adept in enabling strong oversight and managing financial and operational risk through well-articulated policies and practices. Risk management is detailed, with generally conservative golden rules and risk appetites codified and reported against on a frequent basis. One of the golden rules addresses Orbit's risk appetite for market sales, with a cap of 40% of turnover on these tenures. We consider this to be high risk for the sector, however note that performance on these tenures is good, as discussed above.

High market sales exposure, albeit with good performance to date and smaller development programme

Orbit plans to develop 5,800 new homes between fiscal 2023-2027, down from its previous programme of 8,800 in 2021. It has gradually decreased its development programme over time as market conditions have weakened, demonstrating its proactive risk management. The structure of the development programme is weighted towards market sales, with 40% first tranche shared ownership and 20% outright sales, with the remainder being social rented properties. This is a somewhat riskier development programme than typical for the sector, considering demand for outright sales and shared ownership can be volatile, and the housing market is now in a downturn. However, we note that Orbit retains a high level of control over its development (with 83% of units classed as "controllable," meaning that Orbit can pause development if required), its performance on the market tenures has been solid and stable and it continues to maintain low levels of unsold stock. Its projected net capex represents around 28% of turnover over the next three years; a manageable level. Its decent SHLIC also counterbalances some of this risk - demonstrating that the business can cover its interest expenses from its margins on social housing lettings, limiting its reliance on returns from market sales.

Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. However, the process can be protracted and is reliant on HAs agreeing to merge, which could be more challenging in a weakening operating environment. Recent history has shown that the UK government is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors increasing exposure to non-core social housing activities in the sector, that add complexity to HA operations, and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more challenging. In addition, our assessment that there is a very high default dependence between Orbit and the UK government reflects their strong financial and operational linkages.

ESG considerations

Orbit Group Limited's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score

CIS-2
Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Orbit's **CIS-2** reflects that ESG risks have a limited impact on its rating. Orbit faces limited carbon transition risks as the majority of its stock already meets required energy efficiency standards. Its high social risks - in line with the rest of the sector - are mitigated by its strong governance and management. In addition, the supportive regulatory framework for the sector also mitigates ESG risks.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-2	S-3	G-2
Neutral-to-Low	Moderately Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental
Orbit has limited exposure to environmental risks (**E-2**). English housing associations have the legislative requirement to improve the energy efficiency of their existing houing stock by 2035 (carbon transition risks), leading to increased expenditure. However, we assess that Orbit has a low exposure to this risk as the vast majority of its housing stock already meets the required efficiency standards.

Social
Orbit has material exposure to social risks (**S-3**) through sector-wide legislative requirements to improve the safety of its existing housing stock (responsible production risks) which weights on expenditure and operating margins, and the impacts of cost of living or affordability pressures on social tenants (demographic and societal trends) which led to the UK government capping social rent increases below inflation in fiscal 2024 in England, which will also have a negative impact on margins.

Governance
We assess its G issuer profile score as neutral to low (**G-2**). Governance in the sector is generally fit for purpose, with good oversight of business risks, strong financial planning and risk management processes, detailed reporting and simple organisational structures. The regulatory framework also supports good governance in the sector.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

Output of the Baseline Credit Assessment Scorecard
The assigned BCA of baa1 is the same as the scorecard-indicated BCA outcome.

The methodologies used in this rating are European Social Housing Providers, published in April 2018, and Government-Related Issuers, published in February 2020.

Exhibit 5
Fiscal 2022

Orbit Group			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	46,529	a
Factor 3: Financial Performance			
Operating Margin	5%	25.2%	a
Social Housing Letting Interest Coverage	10%	1.4x	baa
Cash-Flow Volatility Interest Coverage	10%	0.5x	b
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.2x	ba
Debt to Assets	10%	48.8%	ba
Liquidity Coverage	10%	2.1x	aa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	a	a
Scorecard - Indicated BCA Outcome			**baa1**
Assigned BCA			**baa1**

Source: Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
ORBIT GROUP LIMITED	
Outlook	Stable
Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	A3
ORBIT CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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