MOODY'S
INVESTORS SERVICE

CREDIT OPINION
5 February 2021

New Issue

Rate this Research

RATINGS

Onward Group Limited

Domicile	United Kingdom
Long Term Rating	A1
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.

Contacts

Jeanne Harrison +44.20.7772.1751
VP-Senior Analyst
jeanne.harrison@moodys.com

Sam McDonald +44.20.7772.1401
Associate Analyst
sam.mcdonald@moodys.com

Sebastien Hay +34.91.768.8222
Senior Vice President/Manager
sebastien.hay@moodys.com

Onward Group Limited (United Kingdom)

New issuer

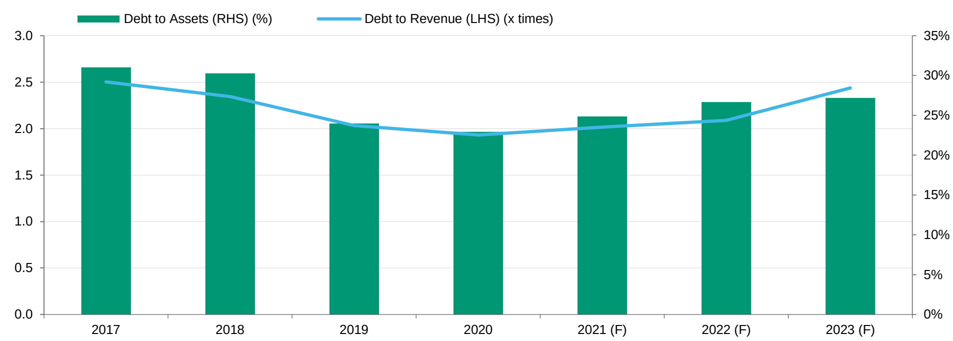
Summary

The credit profile of Onward Group Limited (Onward, A1 stable) is supported by the housing association's ("HAs") very low debt and exceptional debt metrics, strong interest cover ratios, and its conservative strategy with a focus on social housing lettings. The credit profile also incorporates its weak profitability compared to peers in addition to our assumption of a strong likelihood that the government of the United Kingdom (Aa3 stable) would intervene in the event that the association faced liquidity stress.

Exhibit 1

Onward's debt metrics will remain very strong despite an increase in borrowing

Debt to assets at cost (%), debt to revenues (x times), fiscal 2017-2023(F)



Note: F=Forecast
Source: Onward, Moody's

Credit strengths

» Very strong balance sheet with low debt, strong liquidity

» Conservative strategy with focus on social housing, moderate capital expenditure

» Strong interest cover ratios

» Supportive institutional framework in England

Credit challenges

» Weak profitability

Rating outlook

The stable outlook on Onward balances its planned increase in debt and weak operating performance with its very strong balance sheet and moderate development ambition. Our expectation that interest cover ratios will remain strong and market sales exposure will remain moderate also support the stable outlook.

Factors that could lead to an upgrade

» Positive pressure on the rating could result from a combination of significantly improved operating margins sustained above 30%, improved liquidity with liquidity cover maintained above 2.0x, and interest cover ratios sustained about 3.0x.

Factors that could lead to a downgrade

» A strategic shift and higher risk appetite resulting in significantly higher debt, capital expenditure, and market sales compared to forecast would exert negative pressure on the rating. A material erosion in interest cover ratios would also exert negative pressure. Lastly, a dilution of regulatory framework or support for the sector from the UK government, or a weakening of the credit quality of the UK government would also exert negative pressure on the rating.

Key indicators

Exhibit 2

Onward Homes Limited

	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21 (F)	31-Mar-22 (F)
Units under management (no.)	40,791	33,883	34,222	35,094	35,143	35,523
Operating margin, before interest (%)	24.8	27.5	23.6	17.3	20.0	18.7
Net capital expenditure as % turnover	(12.6)	(8.2)	(0.8)	7.2	23.9	20.6
Social housing letting interest coverage (x times)	3.0	3.1	1.6	2.5	2.3	2.4
Cash flow volatility interest coverage (x times)	-	2.7	1.5	2.3	2.4	3.1
Debt to revenues (x times)	2.5	2.3	2.0	1.9	2.0	2.1
Debt to assets at cost (%)	31.0	30.3	24.0	22.9	24.9	26.7

Source: Onward, Moody's Investors Service

Detailed credit considerations

The credit profile of Onward, as expressed in an A1 stable rating, combines (1) a Baseline Credit Assessment (BCA) of a2, and (2) a strong likelihood of extraordinary support from the national government in the event that the entity faces liquidity distress.

Very strong balance sheet with low debt, strong liquidity

Despite a planned increase in borrowing over the next few years, Onward will retain debt metrics among the strongest of UK-rated housing associations. As of fiscal 2020, the group had £301 million of debt, equivalent to 1.9x revenue and 23% debt to assets at cost (gearing). In order to fund growth, Onward plans to increase its debt to £424 million by fiscal 2023 but debt metrics will remain very strong. Debt to revenues will rise to 2.4x by fiscal 2023 and gearing will rise to 27% but remain broadly aligned to the medians of Onward's A1-rated peers at 30% for gearing (fiscal 2020 median) and 2.0x for debt to revenues.

Onward's exceptional debt metrics are in part driven by the organisation's conservative historical strategy. Unlike most of its rated UK peers, Onward's strategy has not been focused on growth over the last few years. Because borrowing is driven by development of new homes and Onward had a minimal development programme, in addition to its high share of amortising debt, the group's debt has fallen to £301 million from £452 million in fiscal 2017. The reduction in debt makes the group an outlier for the sector and has ensured a very strong starting position to increase its debt and development targets going forward.

Onward is undertaking a refinancing exercise which has the following aims: 1) to increase the amount of funding available to the group, 2) to simplify the debt profile by consolidating subsidiary debt of Contour Homes into that of Onward Homes and 3) to align covenants and release covenant headroom The refinancing will be credit positive for the group as it will simplify its debt profile, increase headroom and liquidity, and reduce its borrowing cost and interest rate risk.

Liquidity will remain strong. Liquidity coverage, which assess immediately available liquidity against two years' forward-looking cash need, stood at 1.8x in fiscal 2020 compared to an A1-rated peer median of 1.4x (fiscal 2020). The group's liquidity policy is aligned with peers, calling for 18 months excluding both capital grant and 50% of sales income.

Conservative strategy with focus on social housing, moderate capital expenditure

Onward's credit strength is supported by its continued focus on low-risk social housing lettings, moderate development targets with modest diversification into market sales (outright sales and first tranche shared ownership). In fiscal 2020, 92% of Onward's income was derived from social housing lettings compared to a rated peer median of 79% of income.

Similar to its rated peers, Onward has increased its development target as part of a ten-year programme. The annual target for completions will be 500 homes compared to 147 new homes in fiscal 2020, with a target tenure split of 40% affordable rent, 40% shared ownership, 1% supported housing and 19% outright sales. Though the increase in the target is material, Onward's development ambition and capital expenditure will remain moderate compared to peers. Net capital expenditure (capex) to turnover was 7% in fiscal 2020 compared to a rated peer median of 34% (fiscal 2020). Net capex to turnover will increase, averaging 19% over the next three years, but remain below peer medians.

Onward's exposure to market sales will increase but also remain moderate compared to peers. Market sales accounted for only 3% of turnover in fiscal 2020. The percentage will increase gradually over the next three years reaching 9% by fiscal 2023, a level of exposure we deem moderate.

In addition to a conservative strategy focused on social housing lettings, the group structure has been collapsed and governance streamlined, a credit positive. Onward group was established in April 2018 from five individual housing associations. The simplified group structure supports more efficient decision making and resource deployment in addition to more effective controls.

Strong interest cover ratios

Onward will maintain strong interest cover ratios compared to rated peers, a credit strength, despite the group's comparatively weak profitability. The group reported social housing lettings interest cover (SHLIC) of 2.5x in fiscal 2020 which is in line with the A1-rated peer group median of 2.5x (fiscal 2020) and well above the overall rated peer median of 1.3x (median: fiscal 2020). SHLIC will remain strong over the next three years, averaging 2.3x.

The cash flow volatility interest cover (CVIC) ratio is also expected to remain robust driven by the group's stable operating cash flows. Onward's CVIC for fiscal 2020 was 2.3x, up from 1.5x in fiscal 2019 (impacted by one-off breakage cost). Going forward, CVIC will average 2.6x over the next three years compared to the rated peer median of 1.7x (fiscal 2020).

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong regulatory framework governing English HAs. 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. In response to the pandemic, the regulator adapted some aspects of its oversight temporarily, for example, extending its liquidity monitoring, briefly pausing the programme of IDAs and delaying regulatory submissions to reduce the operational burden on 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 has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs now benefit from a return to inflation-linked rent increases from April 2020 for five years. In addition, the government has committed to increased capital grant on more flexible terms for new social housing.

Counterbalancing the improvements, we expect policy to drive increased borrowing and development risk in the sector as it responds to the government's objective to deliver a significant increase in the construction of new homes.

Weak profitability

Onward's operating margin will remain weak compared to peers, a key credit challenge. The group's operating margin stood at 17% in fiscal 2020, among the lowest of rated housing associations, compared to a rated peer median of 25%, driven by underlying weak profitability on core social housing lettings in addition to one-off repairs costs and higher depreciation. Onward's social housing lettings operating margin fell to 20% in fiscal 2020, down from 24% the year earlier, compared to a rated peer median of 32% (fiscal 2020). Though exposure to market sales will remain moderate, the group also underperformed compared to peers on its market sales margin which was 8% in fiscal 2020 compared to a rated peer median of 20%.

Going forward, the operating margin will remain weak compared to peers averaging 18% over the next three years driven by higher fire safety and management costs on its social housing lettings and low margins on its market sales.

Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers of redress available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. 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 in the increasing exposure to non-core social housing activities in the sector, which add complexity to HA operations, and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more difficult. In addition, our assessment that there is a very high default dependence between Onward and the UK government reflects their strong financial and operational links.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Onward

We take account of the impact of environmental (E), social (S), and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Onward, the materiality of ESG to its credit profile is as follows:

Environmental considerations are not material to Onward's credit profile. In line with the rest of the UK, the sector's main environmental risk exposures relate to water shortage and flood risk. Flood risk is managed by county and national authorities, and therefore the financial burden of adapting to increased flood risk will not fall on Onward.

Social risks are material to Onward's credit profile. In particular, the sector is exposed to risks stemming from socially-driven policy agendas affecting social rents, benefits and capital grants in addition to the impact of demographic trends on demand which are captured in our assessment of the operating environment. We view the coronavirus outbreak as a social risk under our ESG framework given its impact on health and safety. Overall, we expect the outbreak to cause ongoing operational disruption for HAs but do not expect a material credit impact as higher arrears and lower market sales receipts will be offset by cash savings from reduced capital spending on development and repairs. HAs are also impacted by customer relations and product quality. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards with many HAs planning on increasing spending on the quality of their existing stock. Onward's operating margin in fiscal 2020 was lower due to higher fire safety expense on its existing stock and the group expects higher spend on safety to continue to depress the operating margin over the next two years.

Governance considerations are also material to Onward's credit profile and is captured in our assessment of governance and management. For Onward, governance and management are fit for purpose with effective forward planning and risk management. The structure of the group has been collapsed which simplifies strategic planning, controls, and resource allocation.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

Rating methodology and scorecard factors

The assigned BCA of a2 is the same as the scorecard-suggested score.

Exhibit 3
Onward's 2020 scorecard

Onward Group Limited			
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%	35,094	a
Factor 3: Financial Performance			
Operating Margin	5%	17.3%	baa
Social Housing Letting Interest Coverage	10%	2.5x	aa
Cash-Flow Volatility Interest Coverage	10%	2.3x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	1.9x	aa
Debt to Assets	10%	22.9%	a
Liquidity Coverage	10%	1.8x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**a2**
Sources: Onward, Moody's			

Source: Onward Group, Moody's Investors Service

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

Ratings

Exhibit 4

Category	Moody's Rating
ONWARD GROUP LIMITED	
Outlook	Stable
Issuer Rating -Dom Curr	A1

Source: Moody's Investors Service

REPORT NUMBER 1262298

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Moody's INVESTORS SERVICE