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CREDIT OPINION

27 January 2023

Update

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RATINGS

Onward Group Limited

Domicile	United Kingdom
Long Term Rating	A1
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

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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Onward Group Limited (UK)

Update to credit analysis

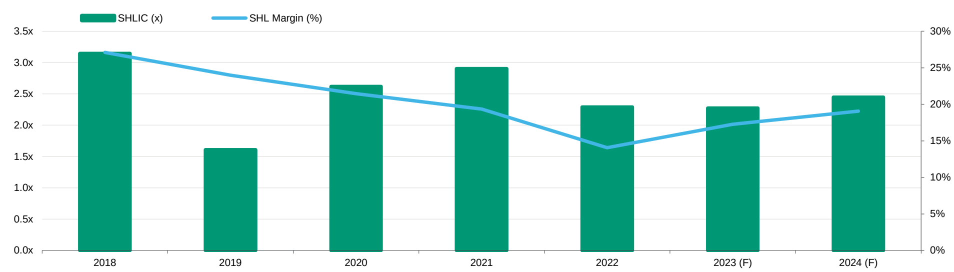
Summary

The credit profile of Onward Group Limited (Onward, A1 negative) is supported by the housing association's 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 negative) would intervene in the event that the association faced liquidity stress.

Exhibit 1

Onward's social housing lettings interest cover remains strong thanks to its low debt

SHLIC (x, LHS), social housing lettings margin (%, RHS), FY2018-FY2024 (F)



Source: Onward Group Limited, Moody's Investors Service

Credit strengths

» Very strong balance sheet with low debt, strong liquidity

» Conservative strategy with focus on social housing, moderate market sales exposure

» Strong interest cover ratios

» Supportive institutional framework in England

Credit challenges

» Very weak profitability and rising capital spend

Rating outlook

The negative outlook reflects Onward's high exposure to weaker economic and financial conditions in the UK. A 7% ceiling on social rent increases in England combined with high cost inflation will weigh on operating margins over the next 12 to 18 months. At the same time, rising interest rates and tightening financing conditions will further weaken interest coverage ratios. A decline in house prices would also affect profitability and surpluses from market sales and further weaken Onward's credit profile.

Factors that could lead to an upgrade

A rating upgrade is unlikely due to the negative outlook. The negative outlook could be stabilised if Onward is able to maintain relatively stable financial metrics over the medium term. This could be driven by operating performance improving more than anticipated, including the ability to contain cost pressures, and reductions in development plans leading to lower debt than previously anticipated.

Factors that could lead to a downgrade

The ratings could be downgraded as a result of one or a combination of the following: a failure to adapt strategy to mitigate against weaker economic conditions; a sustained weakening in operating margin and interest coverage ratios; increases in debt beyond that currently anticipated; significant deterioration in liquidity; significant scaling up in market sales exposure or market sales underperformance; or any weakening of the regulatory framework or dilution of the overall level of support from the UK government.

Key indicators

Exhibit 2

Onward Group Limited

	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.)	33,883	34,222	35,094	35,232	35,617	36,150	36,703
Operating margin, before interest (%)	27.5	23.6	18.4	17.5	13.4	15.5	18.1
Net capital expenditure as % turnover	(8.2)	(0.8)	7.2	12.7	7.3	7.8	38.4
Social housing letting interest coverage (x times)	3.1	1.6	2.6	2.9	2.3	2.3	2.4
Cash flow volatility interest coverage (x times)	2.7	1.5	2.2	3.2	2.9	3.4	3.6
Debt to revenues (x times)	2.3	2.0	1.9	2.9	2.5	2.3	1.9
Debt to assets at cost (%)	30.3	24.0	23.0	24.1	29.4	25.3	27.5

Source: Onward Group Limited, 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 2022, the group had £394 million of debt, equivalent to 2.5x revenue and 29% debt to assets at cost (gearing). In order to fund growth, Onward plans to increase its debt to £564 million by fiscal 2025 but debt metrics will remain strong. Debt to revenues will be somewhat volatile but remain strong, averaging 2.4x over the next three years. Gearing will increase by 6 percentage points to 35% by fiscal 2025 but remain strong relative to the rated peer median of 49% for fiscal 2022.

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. Since 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 fell to £301 million in fiscal 2020 from £452 million in fiscal 2017. The reduction in debt over this period 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 embarked on a refinancing exercise at the start of fiscal 2022 which aimed to: 1) 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 was a credit positive for the group as it simplified its debt profile, increased headroom and liquidity, and reduce its borrowing cost and interest rate risk.

We expect liquidity will remain strong. Liquidity coverage, which assess immediately available liquidity against two years' forward-looking cash need, stood at a very strong 2.8x in fiscal 2022. 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 market sales exposure

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 2022, 90% of Onward's income was derived from social housing lettings compared to a rated peer median of 76% of income.

Onward's exposure to market sales will increase but also remain moderate compared to peers. Total sales, including outright sales and shared ownership, accounted for only 4% of turnover in fiscal 2022. The percentage will increase gradually over the next two years reaching 13% by fiscal 2024, 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.

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. Onward is supported by its relatively stronger balance sheet, which underpins its lower interest costs. The group reported social housing lettings interest cover (SHLIC) of 2.3x in fiscal 2022, considerably higher than the rated peer median of 1.2x (fiscal 2022). SHLIC will remain strong over the next three years, averaging 2.2x.

Similarly, the cash flow volatility interest cover (CVIC) ratio is expected to remain very strong and among the highest of rated HAs driven by the group's stable operating cash flows. Onward's CVIC for fiscal 2022 was 2.9x, down from 3.2x in fiscal 2021. Going forward, CVIC will average 2.7x over the next three years compared to the rated peer median of 1.8x (fiscal 2022) as the housing association benefits from stable cash flows from its core social housing business.

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 presently 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 one year. The ceiling of 7% will likely result 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.

Very weak profitability and rising capital spend

Onward's operating margin will remain weak compared to peers, a key credit challenge. The group's operating margin stood at 13% in fiscal 2022, among the lowest of rated housing associations, compared to a rated peer median of 23%, 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 14% in fiscal 2022, down from 19% the year prior, compared to a rated peer median of 27% (fiscal 2022). Though exposure to market sales will remain moderate, the group improved on its market sales margin in fiscal 2022, increasing to 15% from 1% in fiscal 2021 and in line with the rated peer median of 16%. Going forward, the operating margin will remain weak compared to peers averaging 17% 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.

Combined with the increasing costs, Onward has increased its development target as part of a ten-year programme. The group's current programme consists of nearly 3,800 homes over the next five years with a target tenure split of 54% affordable rent, 37% shared ownership, 4% supported housing and 5% outright sales. As a consequence of increased development, debt and capital expenditure (capex) will increase. Moreover, capex will be high and volatile compared to peers. Net capex to turnover was low at only 7% in fiscal 2022 compared to a rated peer median of 28% (fiscal 2022). Net capex to turnover is projected to increase sharply from 8% in fiscal 2023 to 93% in fiscal 2025 as spend on development rises. However, we note that net capex will be lower than projected if Onward decide not to build the level of units currently assumed in the plan. Onward has some flexibility with its development with 39% being committed over the next five years.

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 Onward and the UK government reflects their strong financial and operational linkages.

ESG considerations

Onward 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

Moderately negative exposure to environmental risks due to carbon transition risks caused by the legislative requirement to improve the energy efficiency of existing housing stock. Moderately negative exposure to social risks due to legislative requirements to improve the safety of existing housing stock, and the vulnerability of the sector to changing government policy to improve affordability to low-income demographics through its rent setting, including a consultation on a ceiling for social rent increases. Low exposure to governance risks due to good standards of management and governance and supportive regulatory framework.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL
E-3
Moderately Negative

SOCIAL
S-3
Moderately Negative

GOVERNANCE
G-2
Neutral-to-Low

Source: Moody's Investors Service

Environmental
Moderately negative exposure to environmental risks, primarily due to carbon transition risk from the legislative requirement for English housing associations to improve the energy efficiency of their existing housing stock by 2035, leading to increased expenditure. We consider that Onward has a material exposure to this risk due to a relatively high proportion of its stock requiring retrofit.

Social
Moderately negative exposure to social risks. This is due to moderately negative exposure to responsible production risks and demographic and societal trends risks. Responsible production risks include the legislative requirement to improve the safety of its existing housing stock which will increase expenditure over the medium term. Demographic and societal trends risks reflect the vulnerability of the sector to government policy which controls rent setting in England and Wales. The government's recent intervention on social rent policy with a 7% ceiling on social rent increases policy volatility to the sector and will have a negative impact on financial performance.

Governance
Limited exposure to governance risks. 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

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

Exhibit 5

Onwards' 2022 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%	35,617	a
Factor 3: Financial Performance			
Operating Margin	5%	13.4%	baa
Social Housing Letting Interest Coverage	10%	2.3x	aa
Cash-Flow Volatility Interest Coverage	10%	2.9x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	2.5x	a
Debt to Assets	10%	29.4%	a
Liquidity Coverage	10%	2.8x	aa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			**a2**
Assigned BCA			**a2**

Source: Moody's Investors Service, Onward Group Limited

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 6

Category	Moody's Rating
ONWARD GROUP LIMITED	
Outlook	Negative
Baseline Credit Assessment	a2
Issuer Rating -Dom Curr	A1
ONWARD HOMES LIMITED	
Senior Secured -Dom Curr	A1

Source: Moody's Investors Service

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