MOODY'S
PUBLIC SECTOR EUROPE

Rating Action: Moody's affirms Optivo's A2 stable issuer rating and assigns A2 debt rating to Optivo Finance plc's GBP250 million issuance

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London, 01 March 2018 -- Moody's Public Sector Europe, ("MPSE") has today affirmed Optivo's A2 issuer rating with a stable outlook, and assigned A2 rating to Optivo Finance plc's proposed GBP250 million senior secured bonds with a stable outlook.

RATINGS RATIONALE

RATIONALE FOR THE ISSUER RATING

Optivo's A2 issuer rating is supported by robust profitability, sufficient interest coverage ratios, and a strong liquidity position. The rating also takes into account a moderate, but rising level of debt, an expected increase in development activity, and integration risk from the recent merger.

Optivo is a profitable organisation, with an operating margin projected to remain above 30% over the next five years. Surpluses from the core business of providing social rented housing should be sufficient to cover interest expenses by approximately 1.5x in FY2018 -- a ratio MPSE expects to remain stable in the medium-term.

However, the rating is constrained by the projected medium-term weakening of Optivo's debt metrics. As the organization pursues a development plan which aims to deliver 1,500 homes per year, Optivo's debt-to-assets ratio will rise steadily from 41% at FYE2017 to 50% at FYE2022. While about 60% of units developed will be destined for either social rented or key worker accommodation, the remaining 40% are intended for outright sale or shared ownership, exposing the housing association to the cyclical housing market.

Optivo's strong liquidity position mitigates the risk of cash shortfall which could stem from the development or sales programme. Projected immediately available liquidity for end of FY2018 is more than sufficient to cover the next two years of forecast net cash need.

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

RATIONALE FOR THE DEBT RATING

The A2 rating assigned to Optivo Finance plc's anticipated GBP250 million bond issuance is derived from Optivo's A2 issuer rating. Optivo Finance plc is a wholly owned subsidiary of Optivo.

The issuance is expected to be comprised of GBP150 million and GBP100 million retained, which may be issued at any time in the following three years. The proceeds will be used to repay a variable rate credit facility, increasing the proportion of Optivo's fixed rate debt, as well as to finance development expenditure.

As per the Loan Agreement, the issuance will be secured by pledge on a portfolio of social housing properties held by Optivo. The security will consist of properties valued at both Existing Use Value -- Social Housing (EUV-SH) at 1.05x and Market Value Subject to Tenancy (MV-ST) at 1.15x. Moody's views this threshold of asset coverage as offering limited enhancement for bondholders and as insufficient to lift the ratings of the bonds over that of the Group itself.

The rating is assigned 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 the rating agency, MPSE will assess the impact that these differences may have on the ratings.

RATIONALE FOR THE STABLE OUTLOOK

The stable outlook reflects MPSE's expectation that Optivo's credit metrics will continue to perform in-line with

A2 peers, and that the framework of regulatory and extraordinary support will remain robust.

WHAT COULD CHANGE THE RATING -- UP/DOWN

Positive pressure on the rating could result from one or a combination of the following (1) SHLIC coverage structurally at or above 1.8x, (2) a durable strengthening of the CVIC to, or over, 2.0x, (3) liquidity coverage metric rising to, and remaining above, 2x.

Negative pressure could arise from one or a combination of the following (1) a shift towards increasingly market-sales oriented development, (2) an acceleration or deterioration in the debt trajectory, (3) a deterioration in the operating margin and weakening in interest coverage metrics, (4) a weakening in the liquidity position.

The methodologies used in these ratings were European Social Housing Providers published in July 2016, 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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