MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
6 March 2018

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RATINGS

Optivo

Domicile	United Kingdom
Long Term Rating	A2
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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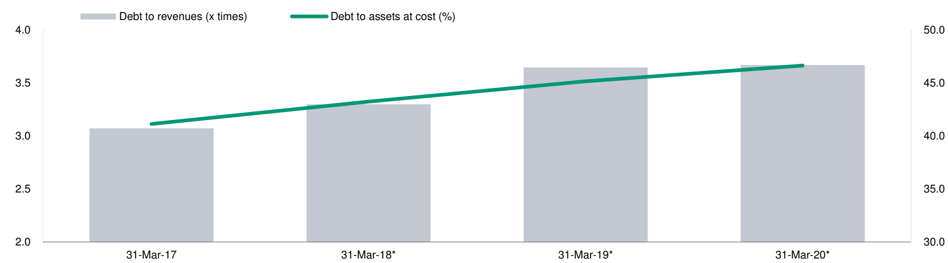
Optivo

Update to credit analysis

Summary Rating Rationale

The credit profile of Optivo (A2, stable) reflects a business model supported by a core of low-risk social-housing letting, expected strong interest coverage and margins at par with the median of Moody's rated housing associations (HAs). The rating also takes into account the strong likelihood that the UK government (Aa2, stable) would intervene in the event that the association faces acute liquidity stress. Optivo's rating also incorporates credit challenges represented by rising debt levels in the medium term and exposure to the cyclical housing market through shared ownership units, a small portfolio of market rent, and planned market sale properties.

Exhibit 1
Optivo's debt metrics are expected to rise over the next few years



Source: Moody's, Optivo pro forma 2017 accounts, Optivo business plan

Credit Strengths

» Profitable core business, supporting appropriate interest coverage

» Healthy liquidity position and policies

» Strong regulatory framework

Credit Challenges

» Upscale in development programme will increase debt, albeit from a moderate level, and raise exposure to sales and development risk

» Implementation and strategic risks surrounding merger

» Operating environment remains challenging but policy is more stable

Rating Outlook

The stable outlook on Optivo reflects the currently stable operating environment, which is unlikely to undergo further material change in the medium-term, and the stable outlook on the sovereign rating.

Factors that Could Lead to an Upgrade

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.

Factors that Could Lead to a Downgrade

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.

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 also exert downward pressure on the rating.

Key Indicators

Exhibit 2

Optivo

	31-Mar-16	31-Mar-17	31-Mar-18*	31-Mar-19*	31-Mar-20*
Units under management (no.)	41,903	41,896	43,551	43,924	45,398
Operating margin, before interest (%)	28.0	35.0	31.9	30.6	32.1
Net capital expenditure as % turnover	40.2	9.3	48.5	45.8	42.2
Social housing letting interest coverage (x times)	1.6	1.8	1.5	1.5	1.5
Cash flow volatility interest coverage (x times)	2.0	2.5	1.8	1.9	2.0
Debt to revenues (x times)	3.6	3.1	3.3	3.6	3.7
Debt to assets at cost (%)	45.1	41.1	43.2	45.2	46.6

2016-2017 Optivo pro forma accounts, *2018-2020 Optivo business plan
Source: Moody's, Optivo

Detailed Rating Considerations

Optivo's A2 rating combines (1) a baseline credit assessment (BCA) for the entity of a3 and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

Optivo was created in May 2017 by the merger of AmicusHorizon Ltd and Viridian Housing. The FY2016 and FY2017 numbers in this report refer to Optivo's pro forma accounts, which combine the historical accounts of AmicusHorizon and Viridian Housing, and the forward-looking numbers are based on Optivo's forecasts and business plan. The first year for which Optivo will report as an amalgamated entity will be the fiscal year ending March 2018.

On March 1st Optivo announced it's intention to issue a £250 million bond, of which £100 million is expected to be retained. The issuance 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. The forecast credit metrics in this report take this issuance into account.

PROFITABLE CORE BUSINESS, SUPPORTING APPROPRIATE INTEREST COVERAGE

Approximately three quarters of Optivo's revenue stems from its core business of providing social rented homes. The margin derived from social letting is robust, at around 30% in FY2017 (from the pro forma accounts) and forecast to remain at this level for FY2018.

The profitability of this core business supports Optivo's Social Housing Letting Interest Cover (SHLIC) which stood at 1.8x in FY2017 (FY2017 peer median: 1.8x), and will remain sufficiently high averaging 1.5x over the next five years. As Optivo works through the implementation of planned efficiencies from merger, profitability in the core business should increase, supporting the SHLIC.

Optivo has some diversification in rented products includes a small portfolio of market rent, modest amount of student accommodation, key worker accommodation, in addition to less profitable specialized care and support products. In FY2018, revenues from sales will remain moderate, at 10% of total revenue, although this will grow as a proportion of total. Overall operating margin should remain strong averging 32% from FY2018-FY2022, underpinned by the core business.

HEALTHY LIQUIDITY POSITION AND POLICIES

Optivo's unencumbered asset position was estimated at £1.1 billion at the time of merger in the spring of 2017. Since this time, Optivo has used a portion of these unencumbered assets to put in place additional credit facilities which has reinforced the housing association's liquidity cover metric, estimated at 1.5x in FY2018. Optivo's unencumbered asset position remains relatively strong, forecast at £729 million by March 2018 and sufficient to cover the additional £540 million of debt which the organisation plans to take on by FY2021.

Moreover, Optivo's treasury policies are clear and robust, which will likely ensure that adequate liquidity levels are maintained. The policy specifies that cash be maintained at two months' cash needs plus the ISDA cash requirements[1], with cash and facilities secured to meet twelve months cash needs. Furthermore, sufficient cash, facilities, and forecast reliable surpluses - net of scheduled loan repayments - must be available to cover contractually committed development spend.

STRONG REGULATORY FRAMEWORK

The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Regulator of Social Housing (previously Homes and Communities Agency). The Regulator of Social Housing maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and undertaking In-Depth Assessments of entities where deemed necessary. Additionally, the Regulator of Social Housing has powers to make board member and manager appointments where there has been a breach of Regulatory Standards. From October 2017, The Regulator of Social Housing will charge fees for social housing regulation, as a means of enhancing the independence and maintaining the effectiveness of the regulator.

UPSCALE IN DEVELOPMENT PROGRAMME WILL INCREASE DEBT, ALBEIT FROM A MODERATE LEVEL, AND RAISE EXPOSURE TO SALES AND DEVELOPMENT RISKS

Optivo's development programme targets 1,500 units of starts per year, and while this had also been the target of the pre-merger business plan, the pace at which Optivo reaches this target has accelerated. This acceleration has been driven by the more rapid identification of development projects that fulfill the requirements set by the organisation's Board and management. In addition to this, a greater cost per unit has been factored in by the planning team.

As a result, net capex will increase to an average of 46% of turnover from FY2018-FY2021, significantly higher than the average 35% of turnover for the same time horizon, forecast a year ago. Moreover, in order to fund the development, Optivo's debt-to-assets at cost will deteriorate from 43% in FYE2018 to 50% in FY2022. While this higher level of gearing is not inconsistent with the current rating level, this debt trajectory is a constraining factor in Optivo's credit profile.

Although gearing will increase, Optivo's policy is to maintain moderate interest rate risk, and is reflected in the current debt structure. As of February 2018, approximately 82% of Optivo's debt is effectively fixed rate (combination of floating debt fixed by either standalone swaps or embedded fixes and fixed rate debt). The swap portfolio amounts to a relatively large notional value of £485 million (albeit down from over £600 million a year ago), which had a negative mark-to-market as of January 31st, net of thresholds, of £108 million which was met with ample property security (£237 million) and a small amount of cash (£0.4 million). The proportion of fixed rate debt will increase post-bond issuance, further decreasing Optivo's interest rate risk.

In terms of tenure mix of the development programme, 48% of the units to be built over the next four years are intended for social rented accommodation, which should support growth in the social rented revenue stream. However, sales as a percent of total revenue, including outright sales and first tranche shared ownership sales, will increase sharply from 10% as of FY2018 to 24% in

FY2021, further exposing the housing association to the cyclical housing market. Mitigating concerns of less stable future cash flows, Optivo's Cash Flow Volatility Interest Cover, remains strong into the medium term averaging 1.9x over FY2018-2021.

IMPLEMENTATION AND STRATEGIC RISKS SURROUNDING MERGER

In the first few years of Optivo's existence, implementation risk surrounding the merger is key for Optivo's creditworthiness. Business cultures, data and IT systems may clash and lead to delays and overspend in the integration process. From what can be seen at this point, with less than a year as a merged entity, integration milestones in terms of operations have been met. Fully integrated IT systems are forecast to be operational by the end of May 2018, the staff restructure will also be completed around the same time and the group will close the former Viridian head office in Clapham later this calendar year.

The first year of financial results and updated business plan, available in Q3 2018, will provide a further indication of Optivo's performance as a new housing association. Optivo forecasts £5 million of integration costs to occur in FY2018, with £1 million in FY2019. Moreover, the development pipeline is expanding at a faster rate then previously anticipated, the new Board's approach to development will continue to be a credit factor.

OPERATING ENVIRONMENT REMAINS CHALLENGING BUT POLICY IS MORE STABLE

We do not expect additional material adverse policy shifts for the sector and considers the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to negatively impact revenues, especially the effects of the 1% annual decrease in social rents (until FY2020) and Universal Credit (a pillar of broader welfare reform measures). However, HAs have demonstrated resilience to adverse policies to date and been proactive to mitigate the impact. A reduction of capital grant for new social housing over the last five years has led to increased exposure to market sales activity, which has more than doubled since 2012 to reach 18% of turnover for Moody's-rated HAs in FY2017.

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 (Aa2 stable) 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 Optivo and the UK government reflects their strong financial and operational linkages.

Rating Methodology

European Social Housing Providers, July 2016 (190944)

Government Related Issuers, August 2017 (1047378)

Ratings

Exhibit 3

Category	Moody's Rating
OPTIVO	
Outlook	Stable
Issuer Rating -Dom Curr	A2
OPTIVO FINANCE PLC	
Outlook	Stable
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

Endnotes

1 Optivo's treasury policy stipulates a target of maintaining sufficient security in place to withstand a parallel 1% fall in interest rates of all maturities, or sufficient cash is held immediately available for this purpose.

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