

CREDIT OPINION

7 November 2018

✓ Rate this Research

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.

Contacts

Cynthia Mar +44.20.7772.1666
Analyst
cynthia.mar@moodys.com

Matt Fawcett +44.20.7772.5326
Associate Analyst
matt.fawcett@moodys.com

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

CLIENT SERVICES

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

Optivo (United Kingdom)

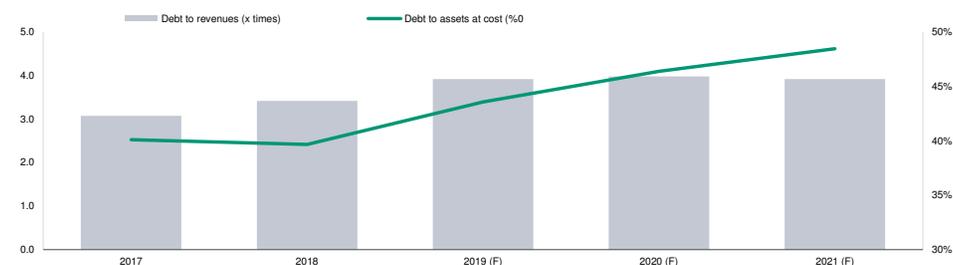
Update to credit analysis

Summary

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 operating margins at par with the median for the housing associations (HAs) we rate. The credit profile also takes into account the strong likelihood that the [Government of United Kingdom \(Aa2 stable\)](#) would intervene in the event that the association faces acute liquidity stress. Credit challenges include rising debt levels in the medium term and exposure to the cyclical housing market through shared ownership units and planned market sale properties.

Exhibit 1

Optivo's debt metrics are likely to rise over the next few years to fund the development programme



Sources: Moody's Investors Service, Optivo's financial statements (2017-18), Optivo's business plan (2019-21[F])

Credit strengths

- » Profitable core business, which supports interest coverage
- » Sufficient liquidity and sound policies
- » Strong regulatory framework

Credit challenges

- » Scaling up of the development programme increases exposure to sales and development risk
- » Debt increasing, albeit from a moderate level
- » Operating environment remains difficult, but policy is more stable

Rating outlook

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

Factors that could lead to an upgrade

Positive pressure on Optivo's rating could result from one or a combination of the following: (1) social housing letting interest cover (SHLIC) coverage structurally at or above 1.8x, (2) strengthening of the cash flow volatility interest cover (CVIC) to or above 2.0x on a sustained basis, (3) liquidity coverage metric rising to and remaining above 2.0x, (4) a material scaling down of development, and particularly sales, ambitions.

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 in debt growth, (3) a deterioration in the operating margin and weakening of interest coverage metrics, and (4) a weakening in liquidity.

In addition, a weaker regulatory framework, dilution of the overall level of support from the UK government or a downgrade of the sovereign rating could also strain Optivo's rating.

Key indicators

Exhibit 2

Optivo						
	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19 (F)	31-Mar-20 (F)	31-Mar-21 (F)
Units under management (no.)	41,903	41,896	42,133	42,141	43,432	43,542
Operating margin, before interest (%)	28.0	35.0	30.5	27.4	22.5	25.3
Net capital expenditure as % turnover	40.2	9.3	29.2	73.9	67.5	63.5
Social housing letting interest coverage (x times)	1.6	1.8	1.8	1.5	1.3	1.3
Cash flow volatility interest coverage (x times)	2.0	2.5	1.7	1.7	1.9	1.7
Debt to revenues (x times)	3.6	3.1	3.4	3.9	4.0	3.9
Debt to assets at cost (%)	45.1	40.1	39.7	43.6	46.4	48.4

Optivo's pro forma accounts (2016), Optivo's financial statements (2017-18), Optivo's business plan (2019-21).
Sources: Moody's Investors Service, Optivo

Detailed credit considerations

Optivo's A2 rating combines (1) a Baseline Credit Assessment (BCA) of a3, and (2) a strong likelihood of extraordinary support from the UK government in case of acute liquidity stress.

Baseline credit assessment

Profitable core business, which supports interest coverage

Around 81% of Optivo's revenue comes from its core business of providing social rented housing. The margin derived from social letting is robust, at around 32% in fiscal year ending 31st March 2018, and after a slight dip in the next couple of years, is forecast to remain at this level in FY2021 and beyond. The profitability of this core business supports Optivo's SHLIC, which stood at 1.8x in FY2018 (A2 peer median for FY2018: 1.9x).

Optivo has some diversification in rented products, which includes a small portfolio of market rent, a modest amount of student accommodation, key worker accommodation and the less-profitable specialized care and support products. In FY2018, revenue from sales remained moderate at 11% of total revenue, but this proportion will grow. Despite an increase in lower-margin sales activities and an increased sustainability budget over the next few years, the operating margin will remain aligned with that of Optivo's peer group.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Optivo was created from the merger of two housing associations (AmicusHorizon and Viridian) in May 2017. With over a year as a merged entity, the association has met integration milestones in terms of operations. During 2017-18, as a result of integrating Optivo's main housing management and finance systems, the association incurred a one-off merger cost of £2.1 million. Fully integrated IT systems are now operational, the staff restructuring was largely completed in September 2018 and the group expects to close the former Viridian head office in Clapham later this calendar year. As Optivo works through the implementation of planned efficiencies from the merger, profitability in the core business will increase, supporting the SHLIC. From March 2020 onwards, Optivo forecasts delivery of £10 million per annum in recurring savings as a result of the merger.

Sufficient liquidity and sound policies

Optivo's level of unencumbered assets is strong, providing additional borrowing capacity of £820 million as of July 2018. The housing association's unencumbered assets cover the additional £618 million of debt that it plans to take on by FY2021. In FY2018, Optivo used a portion of its unencumbered assets to put in place additional credit facilities, reinforcing the housing association's liquidity cover metric, forecast at 1.0x in FY2019. As of July 2018, Optivo's liquidity is made up of £71 million in cash and £502 million in undrawn, immediately available facilities.

Moreover, Optivo's recently reviewed treasury policy is clear and robust, which will likely ensure that adequate liquidity is maintained. The policy specifies that £50 million in immediately available cash will be maintained, an amount which will be monitored daily and reviewed quarterly with regard to debt servicing and capital expenditure needs, as well as the housing association's ISDA cash requirement.¹ A second liquidity test requires that cash and secured facilities meet forecast cash needs for 12 months. Furthermore, sufficient cash, facilities, reserved asset sales and forecast reliable surpluses (net of scheduled loan repayments) must be available to cover all contractually committed development spending.

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 is charging fees for social housing regulation to enhance the independence and maintain the effectiveness of the regulator.

Scaling up of the development programme increases exposure to sales and development risk

Optivo's development programme targets 1,500 units of starts per year, and approximately 7,000 units are expected to be built over the next five years (equating to 17% of existing stock). While this was the target of the pre-merger business plan, the pace at which Optivo is approaching this target has accelerated, driven by the more rapid identification of development projects that fulfil the requirements set by the organisation's board and management. In addition to this, a higher cost per unit has been factored in by the planning team. Both of these factors contribute to higher net capital expenditure than previously projected. Net capex rises to an average of 69% of turnover over FY2019-22, significantly higher than the average 35% turnover for the same period forecast a year ago.

As announced with the 2018 UK budget, Optivo will receive around £50 million of grant over the next five years for affordable housing as a strategic partner with Homes England. Details of this partnership have yet to be hammered out. This will be in addition to the £57 million of grant which Optivo will receive as a strategic partner with the Greater London Authority (GLA). The grant from the GLA will fund homes in the London Affordable and Living Rent tenures, as well as shared ownership. Overall, these partnerships mitigate political risk in the sector, as the links between government and housing associations remain an important component of the overall credit profile. Securing additional grant is credit supportive for Optivo, and may slow the accumulation of debt and decrease the amount of cross-subsidy needed from sales. However, by committing to higher development targets, housing associations raise their economic risk.

In terms of the tenure mix of the development programme, 50% of properties to be built over the next five years are intended for social rented accommodation (3,400 units), which supports growth in the social rented revenue stream. The development programme also includes a significant component of sales, with around 40% of the total programme dedicated to shared ownership (2,800 units), and the remaining for open market sales (600 units).

Sales revenue as a percentage of total, including outright sales and first-tranche shared ownership sales, will increase sharply to 29% in FY2022 from 11% in FY2018, further exposing Optivo to the cyclical housing market. Optivo has a strong focus on building properties in the London area, with 60% of the programme expected to be in and around the capital. The more volatile nature of the housing market in London and South East is a credit concern for the HAs developing in these areas². Mitigating concerns of less stable future cash flow, Optivo's cash flow volatility interest cover is forecast to remain strong into the medium term, averaging 1.8x over FY2018-21. However, the development pipeline is expanding at a faster rate than previously expected, the board's approach to development will remain a credit factor.

Debt increasing, albeit from a moderate level

In March 2018, Optivo issued a £250 million bond, of which £100 million has been retained. The proceeds from the issuance are being used to repay a variable-rate credit facility, increasing the proportion of Optivo's fixed-rate debt, and to finance development spending.

Looking forward, to fund development, Optivo's debt-to-assets at cost ratio will deteriorate to 51% as of the end of FY2022, from 40% as of the end of FY2018. While this higher level of gearing is not inconsistent with the current rating level, this debt trajectory is a constraint to Optivo's credit profile.

Although gearing will increase, Optivo's policy is to maintain moderate interest rate risk, which is reflected in the current debt structure. Following the bond issuance in March 2018, around 97% of Optivo's net debt was fixed by a combination of fixed-term loans, derivatives (both standalone and embedded swaps) and cash balances. The swap portfolio amounts to a relatively large notional value of £425 million (down from over £600 million a year ago), which had a negative mark-to-market as of June 2018, of which £142 million was met with ample property security (£292 million) and a small amount of cash (£0.4 million).

Operating environment remains difficult, but policy is more stable

We do not expect additional material adverse policy shifts for the sector and expect the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to hurt revenue, especially 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 in mitigating the impact. A reduction in capital grant for new social housing over the last five years has led to increased exposure to market-sales activity, which more than doubled since 2012 to reach 18% of turnover for the HAs we rated in FY2017.

Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers of redressal available to the regulator in case 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 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 Optivo and the UK government reflects their strong financial and operational links.

Rating methodology and scorecard factors

The assigned BCA of a3 is aligned with the scorecard-suggested BCA of a3.

Exhibit 3

Optivo BCA Scorecard - FY2018

Optivo			
Baseline Credit Assessment	Sub-factor Weighting	Value	Score
Scorecard			
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	42,133	a
Factor 3: Financial Performance			
Operating Margin	5%	30.5%	a
Social Housing Letting Interest Coverage	10%	1.8x	a
Cash-Flow Volatility Interest Coverage	10%	1.7x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.4x	baa
Debt to Assets	10%	39.7%	baa
Liquidity Coverage	10%	1.2x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			a3

Source: Optivo, Moody's Investors Service

The methodologies used in this rating are [European Social Housing Providers](#), published in April 2018 and [Government Related Issuers](#), published in June 2018.

Ratings

Exhibit 4

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% decline in interest rates of all maturities, or sufficient cash is held immediately available for this purpose.
- 2 See research piece: [Migration and rental trends expose London and South East to house price pressures](#).

Moody's Public Sector Europe is the trading name of Moody's Investors Service EMEA Limited, a company incorporated in England with registered number 8922701 that operates as part of the Moody's Investors Service division of the Moody's group of companies.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody's.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

CLIENT SERVICES

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