

## ARC Ratings, S.A. affirms the final, public 'AAA(sf)' to 'BB+(sf)' ratings accorded to the A-D tranches of the Credit Protection Deed provided by York 2019-1 CLO DAC, and places all tranches on stable outlook

London, 27 August 2020 - ARC Ratings, S.A. (ARC) has affirmed the final, long-term public ratings of 'AAA(sf)' to 'BB+(sf)' accorded to the A-D tranches of the Credit Protection Deed provided by York 2019-1 CLO DAC to Santander UK PLC (Santander), and has placed all tranches on stable outlook.

The above ratings relate to the credit risk the protection seller is exposed to on the Reference Portfolio.

<u>ORIGINATOR</u>	<u>CLASS / TRANCHE</u>	<u>ATTACHMENT POINT (31 JULY 2020)*</u>	<u>RATING CLASS</u>	<u>RATING</u>	<u>OUTLOOK</u>	<u>NEXT REVIEW DATE</u>
Santander UK PLC	Tranche A	31.3%	Synthetic CLO	AAA(sf)	Stable	27 August 2021
Santander UK PLC	Tranche B	21.8%	Synthetic CLO	A(sf)	Stable	27 August 2021
Santander UK PLC	Tranche C	18.4%	Synthetic CLO	BBB+(sf)	Stable	27 August 2021
Santander UK PLC	Tranche D	12.0%	Synthetic CLO	BB+(sf)	Stable	27 August 2021

\*ARC updated the tranche amortisation in the interim report given the portfolio's amortisation.

### TRANSACTION OVERVIEW

The portfolio Reference Obligation Notional Amount is GBP 1.94bn as at 31 July 2020 with a Scheduled Redemption Date of 20 March 2027 and a Final Redemption Date of 20 March 2029.

The portfolio is primarily comprised of loans to SMEs, with the majority (66.8%) secured against Commercial Real Estate (CRE) and 13.1% is unsecured; the largest borrower exposures by industry sector are Healthcare (19.0%), Lodging and Restaurants (18.6%), Business Services (14.4%), Retail (10.6%) and Real Estate (9.4%). ARC notes that the percentage of loans with a one-year probability of default greater than 5% has increased to 21.5% (in excess of the 10% threshold), as at 31 July 2020, and as such has breached the Subordination Event trigger. This has resulted in a switch from pro-rata amortisation of tranches A, B and C to fully sequential.

The updated Reference Registry, dated 31 July 2020, contains the forbearance measures requested and received by the underlying Obligors. ARC notes that whilst a notable proportion originally requested forbearance, some have already resumed normal or increased repayments. Furthermore, ARC notes that only a very small proportion of these included interest and that none of the measures included an extension to the original maturity date.

## **RATING RATIONALE**

The rating action predominantly reflects the significant credit enhancement available to each tranche which reduces concerns regarding possible downgrades of the senior tranches in the medium term.

Key rating drivers include:

- **Covid-19 and Internal Ratings:** Following the outbreak of Covid-19 and the deterioration of SMEs and the Commercial Real Estate ('CRE') market, as discussed in ARC's Press Release dated 01 June 2020, Santander have conducted a number of rating reviews on the underlying loans and as such for these loans, the updated Reference Registry does reflect their credit quality more accurately. However, ARC has applied additional stresses to ratings which have not been updated by Santander since April 2020, as the impact on SMEs and the economic climate have not, in ARC's opinion, been reflected in these internal ratings. Despite this, ARC drew a large degree of comfort from the amount of credit enhancement available for each rated tranche, which is sufficient to protect them against expected losses at their respective rating level. Therefore, Covid-19 is not a key driver for this rating action but ARC notes that the situation surrounding Covid-19 is constantly developing thus, ARC will continue to monitor the transaction and market developments through regular surveillance along with future reviews and will determine, where necessary, if any rating action is required. This is because a deterioration in the market is, in ARC's opinion, likely to have a combined impact of increasing arrears/defaults as well as causing a decrease in potential recoveries in an enforcement scenario.
- **Tranche Amortisation:** As indicated above, the amortisation of the portfolio has switched to fully sequential following the Subordination Event. Nevertheless, in the absence of any losses since the original rating in June 2019, available credit enhancement, as a percentage of the portfolio of loans, has increased for all of the rated (A-D) tranches. This is credit positive to the transaction as it means the current ratings have become less sensitive to market and economic variability (this is demonstrated by the transaction's ability to withstand ARC's additional stressed scenarios in light of Covid-19). Due to the aforementioned uncertainties relating to Covid-19, SMEs and the CRE market, combined with the proportion of the portfolio currently subject to forbearance measures, ARC has determined that, at this time, the tranches of this Credit Protection Deed should not be subject to further positive rating action.
- **Cashflow Analysis:** ARC's cashflow analysis determined that the rated tranches were able to withstand their respective level of defaults under varying scenarios including front, stable and rear default vectors as well as front, stable and rear recovery vectors. In addition to the aforementioned scenarios, ARC also considered the impact of the forbearance measures on the rated tranches. Whilst the forbearance measures themselves did not impact the rated tranches, the possibility of forbearance escalating to arrears/defaults provided ARC with a sufficient degree of concern to not consider any further positive rating action at this time.

## **SENSITIVITY ANALYSIS**

ARC has run sensitivity tests to determine to what extent the portfolio would need to deteriorate in order for ARC to take rating action. The table below shows the impact of increasing the weighted average default probability in conjunction with a decrease in the weighted average base recovery rate for each asset comprising the underlying portfolio on the ratings of the tranches.

Change in tranche ratings	Increase in the WA Default Probability (%)	Decrease in the WA Recovery Rate of the portfolio (%)
All tranches pass at current rating levels	10%	10%
All tranches pass at current rating levels	15%	15%
All tranches pass at current rating levels	20%	20%

#### KEY TIPPING POINTS

##### Positive Turning Points

- Recovery of the UK's economy and the CRE market.
- Decrease in the portfolio's probability of default, caused by an improvement in the internal ratings beyond ARC's modelled scenarios.

##### Negative Turning Points

- Increase in the portfolio's probability of default, caused by a decrease in the internal ratings beyond ARC's modelled scenarios.
- A further deterioration of the market, thus reducing collateral values and thus potential recoveries.

#### RELATED CRITERIA

##### Methodology

ARC Ratings' Global Structured Finance Methodology (September 2019)

ARC Ratings' Global Collateralised Loan Obligation (CLO) Rating Criteria (February 2020)

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