ARC Ratings, S.A. affirms the public, final long-term 'AAA(sf)' to 'BB(sf)' ratings to the A-E Credit Protection Deed tranches issued by Fitzroy 2018-1 CLO DAC, all with stable outlooks

London, 28 September 2020 - ARC Ratings, S.A (ARC) affirms the final, public ratings of 'AAA(sf) to 'BB(sf)' accorded to the Credit Protection Deed tranches sold by Fitzroy 2018-1 CLO DAC ('Fitzroy' and 'Protection Seller') to Santander UK PLC ('Santander' and 'Protection Buyer'), all with stable outlooks.

The above public credit ratings address the credit risk the Protection Seller is exposed to on the reference portfolio.

Issuer	Class / Tranche	Attachment Points	Rating Class	Rating	Outlook	Next Review Date
Fitzroy 2018-1 CLO DAC	Tranche A	25%-100%	CLO	AAA(sf)	Stable	28 September 2021
Fitzroy 2018-1 CLO DAC	Tranche B	20%-25%	CLO	AA(sf)	Stable	28 September 2021
Fitzroy 2018-1 CLO DAC	Tranche C	14%-20%	CLO	A(sf)	Stable	28 September 2021
Fitzroy 2018-1 CLO DAC	Tranche D	10%-14%	CLO	BBB(sf)	Stable	28 September 2021
Fitzroy 2018-1 CLO DAC	Tranche E	5%-10%	CLO	BB(sf)	Stable	28 September 2021

TRANSACTION OVERVIEW

The transaction is a synthetic securitisation with risk transfer achieved via purchase of credit protection for each of the rated tranches. The portfolio is currently still in the Replenishment Period with a Replenishment Cut-Off Date of 1 October 2021. The portfolio currently has a total notional amount of GBP 1.08bn and a Scheduled Termination Date of 15 June 2042.

The portfolio is comprised of senior secured, first-lien project finance loans primarily concentrated in the United Kingdom (95.3%) and the Renewable energy sector (50.9%), more specifically onshore and offshore wind power generation projects. The second largest concentration in the portfolio is in Private Finance Initiatives (26.7%) comprising of assets in various sub-sectors, including healthcare and education. ARC draws comfort from the portfolio's industry exposure, particularly its renewable energy exposure which has been the most resilient energy source to Covid-19 lockdown measures according to the IEA; in the first quarter of 2020. The global use of renewable energy in all sectors increased by 1.5% relative to the first quarter in 2019, with renewable electricity generation increasing by approximately 3%. Despite supply chain disruptions, wind and hydro power are anticipated to continue to be key contributors to renewable electricity generation, which is expected to rise by almost 5% in 2020. In addition, wind power is expected to increase the most in absolute terms among all renewables, owing to its supply chain which is more globally interconnected than other renewables.

The other positions in the portfolio represent a diversified set of project finance assets across sectors such as hospitals and telecommunication infrastructure. These assets along with the aforementioned renewable energy assets have shown resilience in light of Covid-19 due to their defensive non-cyclical nature which resultantly has seen them not being negatively affected.

RATING RATIONALE

The ratings predominantly reflect the significant credit enhancement available to each tranche to absorb losses with there being a suitable buffer to reduce concerns regarding possible downgrades of the tranches in the medium-term. The aforementioned is bolstered by the composition of the underlying portfolio, which forms the core part of ARC's model.

Key Rating Drivers:

- **Weighted Average Asset Credit Quality:** Santander's internal rating scale utilised in grading the portfolio assets has remained unchanged since the last review. However, Santander did conduct internal rating reviews on the majority of the underlying's assets as a result of Covid-19. Resultantly, the weighted average credit rating of the portfolio has slightly migrated from 'A-/BBB+' in August 2019 to 'BBB+/BBB' as at 28 August 2020. Noting that, only 3 projects are on Santander's watchlist, and those, representing just 4.2%, are only on the first stage (least severe) of the watchlist. Whilst this is credit negative to the transaction, the tranches do benefit from a significant amount of subordination. Thus, ARC does not anticipate that the credit quality of the portfolio will deteriorate beyond the protection provided to each tranche at the current rating levels in the short to medium-term. However, ARC will continue to monitor the transaction and economic developments through regular surveillance and will determine, where necessary, if any rating action is required should the portfolio's probability of default significantly deteriorate, especially in light of Covid-19 and Brexit.
- **Industry Diversification:** Whilst the portfolio's assets are concentrated in the Renewable energy sector (50.9%), this remaining unchanged as the largest industry over the past 12 months, any concentration risk is mitigated by the defensive nature of the sector and the diversification of the remaining portfolio assets that have also shown resilience in light of the outbreak of Covid-19. Furthermore, the relatively strong performance of the assets over the past twelve months is captured in the low weighted average one year probability of default of the portfolio which is 0.16%, this however, represents a 0.03 percentage point increase since the last review in September 2019.
- **Country Diversification**: ARC notes the geographic concentration to the UK (95.3%). However, the culmination of the renewables exposure and the geographical concentration is a sizeable strength to the transaction, owing to the UK government's commitment to renewable energy sources. Recent government data revealed that renewable energy made up 47% of the UK's electricity generation in the first three months of the year (30% of which was generated by wind power). This is in line with the UK's net zero target to reduce the country's net emissions of greenhouse gases by 100% relative to 1990 levels by 2050. Given Santander's investment strategy which is focused on strong sterling-denominated projects, the Replenishment Criteria restricts projects not located in the United Kingdom to 20% of the Maximum Reference Portfolio Amount which ensures the UK will be the largest country exposure.
- **Tranche Amortisation:** ARC's model determined whether the rated tranches of the Credit Protection Deed fully amortised and therefore, were not utilised to meet the protection payments from the Protection Seller to the

Protection Buyer in the event of losses occurring, at their respective rating levels. ARC's analysis of the portfolio assessed the portfolio under various scenarios including front, stable and back loaded default vectors.

SENSITIVITY ANALYSIS

ARC has run sensitivity tests to determine to what extent the portfolio would need to deteriorate in order for the rating to be downgraded. The table below shows the impact of increasing the weighted average default probability as well as a decrease in the WA base recovery rate for the underlying portfolio on the ratings of the tranches.

Change in any of the tranches respective ratings?	Increase in the WA Default Probability (%)	Decrease in the WA Recovery Rate of the portfolio (%)
Tranche A – Downgrade one notch Tranches B, C, D, E – No change	10%	10%
Tranche A – Downgrade one notch Tranches B, C, D, E – No change	15%	15%
Tranche A – Downgrade two notches Tranche B – Downgrade one notch Tranches C, D, E – No change	20%	20%

KEY TIPPING POINTS	
Positive Turning Points – Positive change in the weighted average credit quality of the portfolio through the acquisition of higher rated assets in sectors most resilient to Covid-19 lockdown measures or the upwards rating movements in the current portfolio.	Negative Turning Points – Greater exposure to infrastructure assets most volatile to the economic contraction caused by Covid-19 as a result of portfolio replenishments, such as assets in the transportation sector, wherein demand and revenues may still be affected post-Covid which in turn, negatively impacts the portfolio's loss rate beyond ARC's modelled scenarios.

RELATED CRITERIA AND RESEARCH

ARC Ratings` Global Structured Finance Rating Criteria (September 2019)

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

THIS DISCLOSURE IS FOR INFORMATION PURPOSES ONLY

ARC Ratings, S.A.

11 Hollingworth Court

Turkey Mill, Ashford Road

Maidstone, Kent ME14 5PP

UNITED KINGDOM

Phone: +44 (0)1622 397350

E-mail: arcratings@arcratings.com

Site: www.arcratings.com

Key Contacts:

Sophie Crofts Senior Structured Finance Analyst Lead Analyst sophie.crofts@arcratings.com	Garth Campbell Structured Finance Analyst Back-up Analyst garth.campbell@arcratings.com	Mark Vrdoljak Head of Structured Finance mark.vrdoljak@arcratings.com	Philip Walsh Chief Ratings Officer & Panel Chairperson philip.walsh@arcratings.com

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