

Global Credit Research - 13 Mar 2014

## Ratings

| Category      | Moody's Rating |
|---------------|----------------|
| Outlook       | Stable         |
| Issuer Rating | Aaa            |

## Contacts

| Analyst                    | Phone           |
|----------------------------|-----------------|
| Jennifer A. Wong/London    | 44.20.7772.5454 |
| Roshana Arasaratnam/London |                 |
| David Rubinoff/London      |                 |

## Key Indicators

### Waarborgfonds Sociale Woningbouw

|                                     | 2008    | 2009    | 2010    | 2011      | 2012    |
|-------------------------------------|---------|---------|---------|-----------|---------|
| Total assets (Euro millions) [1]    | 453,100 | 476,171 | 483,248 | 1,048,149 | 529,595 |
| Total capital funds (Euro millions) | 452,078 | 475,719 | 482,421 | 497,186   | 526,891 |
| Return on average assets (%)        | 6.6     | 5.1     | 1.4     | 1.9       | 3.8     |
| Recurring earning power (%)         | 6.6     | 5.1     | 1.4     | 1.9       | 3.8     |
| Net interest margin (%)             | 4.5     | 4.3     | 4.3     | 4.1       | 3.7     |
| Cost/ income ratio (%)              | 23.8    | 28.4    | 57.0    | 38.2      | 30.9    |

[1] In 2011 WSW temporarily held EUR 550 million in liquidity on its balance sheet. This amount was associated with assistance for an association in distress (Vestia)

## Opinion

### SUMMARY RATING RATIONALE

The Aaa issuer rating for Waarborgfonds Sociale Woningbouw (WSW) reflects the entity's strong linkages with the Dutch government, which acts as a back stop provider to WSW, reflecting the importance of social housing in the Netherlands. The rating also reflects the several layers of security that WSW can resort to in order to meet its guarantee obligations. The rating also takes into account a strong regulatory framework for the social housing sector. The regulator Centraal Fonds voor de Volkshuisvesting (CFV) monitors and intervenes in weak housing associations, before the WSW guarantee is triggered.

On 11 March 2014, the outlook on WSW's rating was changed to stable from negative, in line with the change of outlook on the Government of the Netherlands' Aaa rating to stable. Concurrently, WSW's Aaa issuer rating was also affirmed.

National peer comparison

We rate three Dutch guarantee funds in the narrow Aaa to Aa1 range. Stichting Waarborgfonds BVE (BVE) is rated Aa1 because it does not have a government backstop, unlike WSW and Stichting Waarborgfonds Eigen Woningen (WEW), both rated Aaa.

### Credit Strengths

Credit strengths for WSW include:

- Government-defined mandate to guarantee debt issued by Dutch housing associations
- A robust guarantee structure including risk capital and callable capital
- WSW and CFV actively monitor creditworthiness of housing associations. CFV has track record of proactively intervening in financially weaker housing associations

### **Credit Challenges**

Credit challenges for WSW include:

- Guarantee (including government back stop) has never been tested
- Largest housing associations constitute a large exposure compared to WSW's risk capital
- Some smaller housing associations are currently experiencing financial distress

### **Rating Outlook**

On 11 March 2014 the outlook was changed to stable from negative. On 7 March 2014, the Government of the Netherlands rating outlook was changed to stable from negative. Given the strong macroeconomic and funding linkages between the sovereign and WSW, the outlook for WSW's rating was also changed to stable.

### **What Could Change the Rating - Down**

A withdrawal of the government backstop would exert downward pressure on WSW's Aaa rating. Moreover, a weakening of WSW's support system, a dilution of the importance of social housing in the Netherlands and/or an alteration in the risk profile of its housing associations members could exert downward pressure on the rating. Furthermore, a downgrade in the sovereign rating would result in a downgrade for WSW's issuer rating given the strong linkages and supportive structure discussed.

### **Issuer Profile**

WSW is a not-for-profit entity, founded in 1983. It guarantees payment of interest and principal on loans taken out by Dutch housing associations for activities carried out in the field of social housing. The guarantee arrangement enables associations to borrow at a lower cost, with the savings ultimately being passed to tenants via lowest-cost rents. Debt guaranteed by WSW carries a zero risk weighting in the Netherlands and several other jurisdictions.

Social housing plays a prominent role in the Netherlands. Roughly a third of the Dutch housing stock is social housing. More than half of housing units in large cities such as Amsterdam and Rotterdam are social housing. In contrast to other countries where social housing is concentrated in suburbs, most neighbourhoods in the Netherlands are diversified. Social housing tenants are represented by low, middle and also high income earners.

### **DETAILED RATING CONSIDERATIONS**

The rating assigned to WSW reflects the application of Moody's Joint Default Analysis (JDA) rating methodology for government related issuers (GRIs). In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for the entity and then considers the likelihood of support coming from the national government to avoid an imminent default by WSW, should this extreme event ever occur.

### **Baseline Credit Assessment**

WSW's BCA of aa1 reflects the following factors:

#### **Institutional Framework**

A housing association must be a member of WSW to benefit from its guarantee (379 of 386 or 98% of housing associations are members as of 2012). The guarantee agreement requires an association to pledge its assets to WSW, such that it assumes ownership of a property, when the guarantee is triggered. Consequently, WSW steps into the role of the housing association when a guarantee is triggered. When this occurs, WSW also assumes a debt liability, which is recorded on its balance sheet.

WSW has three layers of security that it can resort to in order to meet its guarantee obligation. The first layer of security is EUR480.9 million in own-source capital (as of December 2012). Of this, the vast majority was invested in highly rated, liquid securities. In addition, WSW can request callable capital from its members, if its risk capital were insufficient to meet its guarantee obligations. As a third layer of security, WSW can call on its government backstop, in the event of a severe stress scenario.

If WSW's risk capital shrinks to less than 0.25% (EUR219 million in 2012) of outstanding guarantees, then it can request callable capital from its members. They are required to make available funds equal to 3.85% of their outstanding WSW-guaranteed loans. If one housing association is unable to pay, then the other members are not obliged to cover the shortfall. WSW may act on its projections and in its best judgment and is not required to wait until a shortfall actually occurs. Housing associations record their potential capital contributions to WSW as a contingent liability on their balance sheets. 3.85% of outstanding guaranteed loans equaled EUR3.3 billion of callable capital as of December 2012.

If for any reason the first two lines do not prove (or were not anticipated) to be adequate to meet WSW's commitments, it would call on its contractual back stop agreements with Dutch local and the central governments. These contributions would be made on a 50/50 basis by the municipalities (in proportion to the amount of loans guaranteed by WSW within their respective jurisdictions) and by the central government. Under these contracts, WSW can demand unlimited support to ensure that (i) its reserve to guaranteed loans ratio returns to 0.25%, and that (ii) all participants' loan obligations are covered.

According to the back stop agreement, these loans have to be provided no later than on the 15th day of the second month following the month in which the capital falls short of guidelines. Theoretically it could take up to 75 days before the funds are transferred to WSW. We believe that this risk is mitigated by WSW's EUR526.9 million risk capital and its ability to call on capital from its members. We also believe that the Dutch government sees the social housing sector as a pillar of the Dutch welfare state.

The WSW guarantee structure has never been tested, although several associations have experienced financial distress. We believe this track record reflects the intervention and restructuring that CFV, a government entity, and WSW have performed for several entities experiencing financial distress. The recent bailout of Woningstichting Geertruidenberg (WSG, not rated) is an example of CFV intervention in a financially weak housing association. CFV also maintains a restructuring fund which is specifically designated for associations that find themselves in financial distress. All associations pay into the fund and in 2013 the payment was 4% (EUR 508 million) of annual rent income. CFV could raise the levy to 5% of annual rent income if it deemed it appropriate.

We have observed several changes on the regulatory landscape during 2012 and 2013. Under the coalition agreement housing associations are now allowed to increase rents depending on the tenants income. This means, amongst other things, that associations can raise rents 4% above inflation for tenants earning more than EUR43,000. New regulation also limits the use of derivatives. Housing associations are only allowed to enter into payer swaps and caps and the maturity should be no longer than 10 years. We are also aware of plans to separate social housing activities from associations' commercial activities.

#### Financial Performance

WSW has two sources of revenue: guarantee fees and interest income related to its risk capital. Guarantee fees were EUR12.5 million and interest income stood at EUR18.0 million in 2012. Both remained stable compared with 2011. The result after tax improved significantly to EUR29.7 million from EUR14.8 million, the previous year. This occurred because of realised and unrealised value changes related to WSW's risk capital.

Operating costs remained a manageable EUR13.3 million in 2012, up slightly from EUR9.1 million the previous year. The cost increase is accredited to the hiring of both full time and temporary staff, higher overhead costs and fees to auditors and legal advisers. They were hired as part of an investigation into a particular housing association.

WSW is currently in discussion with the tax authorities on the amount of corporation tax it will have to pay retroactively from 2008. This discussion is about whether amounts added to its contingency reserve (risk capital) should be tax deducted. WSW calculates that the tax bill for 2008 to 2011 would amount to EUR13.9 million, or less than half of pre-tax income in 2012.

#### Debt and Liquidity

WSW's has no outstanding debt. Total guaranteed obligations were EUR87.4 billion in 2012. WSW forecasts its

guarantee obligation will increase gradually and reach EUR91.7 billion by 2017. WSW also forecasts that interest and principal repayments accumulated for the five largest housing associations will amount to EUR2.2 billion in 2013, only to decrease gradually. This analysis indicates that WSW would have to resort to callable capital if the largest associations failed simultaneously. We have seen no evidence to suggest that this scenario is likely. WSW expects that demand for guaranteed loans over the next few years will be lower than previously forecast.

WSW may provide and has provided guarantees on short-term liquidity loans to housing associations facing "temporary liquidity deficits" (e.g. cash margin calls on hedges, refinancing non-guaranteed debt or potentially other contractual payments which WSW does not guarantee in the first instance). Guarantee exposures related to the liquidity loans are not likely to be significant compared to the overall principal guaranteed by WSW. In our view, the risks are however higher with the short-term liquidity loans because these loans are most likely to be requested by entities facing financial challenges.

In 2012, WSW introduced an internal rating model, which was developed together with an external ratings agency. The model is used to assign a rating to each housing association by considering quantitative and qualitative factors. These include ratios such as debt service coverage and variable rate debt as a percentage of total debt. The model also considers location, asset type, executive oversight and tolerance for risk, only to name a few. WSW has guaranteed outstanding EUR10 billion of debt issued by housing associations with a rating in the weakest third rating range.

WSW's investment policy concentrates on the preservation of capital. Investments are limited to currencies of EU countries. A minimum of 30% of investments should be in government bonds and all investments should be rated at least Aa. An investment does not have to be sold if its rating falls below Aa. Concentration to a single debtor is limited to 10% of total liquidity portfolio.

#### Governance and Management

WSW publishes its annual financial statements in the second quarter of the following year and includes multi-year projections of resources and key contingent obligations. The accounts and the annual report are independently audited. Internal control and supervision are carried out by (1) the Supervisory Board, holding regular meetings throughout the year with the Executive Board and (2) an internal control officer.

As agreed in the backstop agreements with the central government and municipalities, WSW submits a five-year forecast of its cash flow at least once a year. The forecasts must be updated every six months, if a need for loans from the backstop providers has been identified.

In 2012, WSW reviewed its policy and processes and made changes, including assigning a more central role to the core activity of risk management and established a special risk management department for monitoring exceptional risks.

#### **Extraordinary Support Considerations**

Moody's assigns a very high likelihood of extraordinary support from the central government, reflecting WSW's government-defined mandate and strong financial links to the Dutch state, as well as the importance assigned by the government to the smooth functioning of the sector. The back stop agreement with the central government is in place "...to prevent liquidity shortages of the Social Housing Guarantee Fund at all times".

Moody's also assigns a very high default dependence between the WSW and the central government, reflecting that a failure in this sector would likely coincide with a failure of the tight web of government policy itself.

#### **ABOUT MOODY'S SUB-SOVEREIGN RATINGS**

##### National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in October 2012 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings."

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's

creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

#### Baseline Credit Assessment

Moody's baseline credit assessment incorporates the Government Related Issuer's (GRI) intrinsic credit strength and accounts for all aspects of the entity's existing (or anticipated) activities, including benefits (such as regular subsidies or credit extension) and/or detriments associated with the government relationship. In effect, the baseline credit assessment reflects the likelihood that a GRI would require extraordinary support.

#### Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 - 70%), high (71 - 90%) and very high (91 - 100%).

#### Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).



© 2014 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. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATION") 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 FOR RETAIL INVESTORS TO CONSIDER MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS IN MAKING ANY 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.

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.

MIS, 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 MIS have, prior to assignment of any rating, agreed to pay to MIS 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.moodys.com](http://www.moodys.com) under the heading "Shareholder Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

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 657AFSL 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 clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.