Credit Opinion: Waarborgfonds Sociale Woningbouw

Global Credit Research - 26 Jul 2012

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating	Aaa

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Key Indicators

Waarborgfonds Sociale Woningbouw

	2006	2007	2008	2009	2010
Total assets (Euro 000's)	409,403	424,260	453,100	476,171	483,248
Total capital funds (Euro 000's)	407,428	423,285	452,078	475,719	482,421
Return on average assets (%)	4.2	3.8	6.6	5.1	1.4
Recurring earning power (PPI % avg. assets)	4.0	3.8	6.6	5.1	1.4
Net interest margin (%)	4.6	4.5	4.5	4.3	4.3
Cost/ income ratio (%)	30.3	31.9	23.8	28.4	57.0

Opinion

SUMMARY RATING RATIONALE

The Aaa issuer rating of Waarborgfonds Sociale Woningbouw (WSW) reflects the high importance of social housing in the Netherlands and WSW's particular role as financial guarantor to this system. The rating also reflects:

- WSW's strong links with the Dutch state and the sound principles underlying its procedures;

- The stringent membership criteria, WSW's active role in monitoring members' financial performance and its multi-layered measures to call additional capital as required to bolster its satisfactory liquidity position;

- The rating also incorporates a very high likelihood of extraordinary support from the central government of the Netherlands (Aaa, negative outlook) that reflects WSW's government-defined mandate, the importance assigned by the government to the smooth functioning of the sector and the government's intention to prevent liquidity shortages at WSW at all times.

On July 24, 2012 Moody's changed the outlook on WSW's issuer rating to negative from stable, following the change in the outlook on the Government of the Netherlands' ratings.

Peer comparison

WSW is in the highest end of the narrow range of Aaa to Aa1 of strong guarantee funds in the Netherlands. The stability of its clients in the social housing sector, the monitoring of housing associations by both the regulator and WSW, and the availability of multiple capital sources in case a call on its guarantee were ever to occur make it particularly robust.

Credit Strengths

Credit strengths for WSW include:

- Government-defined mandate to provide guarantees to lenders for Dutch housing associations (HAs)

- Securing of WSW guarantees of HA loans on specific properties and by individual HAs for each loan

- Obligation of all member HAs to pay in additional capital to WSW if capital-to-guarantee portfolio ratio falls below 0.25% and unlimited obligation of the Dutch state and municipalities to provide interest-free loans to WSW to ensure this level

- 96% participation by Dutch HAs

- Generally good financial fundamentals of Dutch HAs, but potential cash flow pressures from operations and margin calls under derivatives contracts in limited cases

- Established monitoring procedures to ensure that only creditworthy HAs are guaranteed

- No guarantees have been called since inception

Credit Challenges

Credit challenges for WSW include:

- Potential exposure to greater risks due to increasing involvement by Dutch HAs in commercial property development and construction of new social housing

- Untested nature of the full range of support mechanisms for Dutch social housing, including contractual provisions of backstoppers

- Increasing individual exposures against WSW's own liquidity reserve

Rating Outlook

The negative outlook on WSW mirrors the negative outlook on the Netherlands' sovereign rating. The financial and operational linkages between the central government and WSW reflect strong government support for the HA sector benefiting from guarantee funds.

What Could Change the Rating - Up

A stabilisation of the outlook on WSW's rating would require a stabilisation of the sovereign rating.

What Could Change the Rating - Down

Given that the negative outlook on WSW mirrors the negative outlook on the Netherlands' sovereign rating, a downgrade of the Netherlands' sovereign ratings would likely result in a downgrade of WSW based on the strong linkages and supportive structure. A weakening of ownership or support structure, or an alteration in the risk profile of the sector in which WSW operates could exert downward pressure on the rating.

Recent Developments

Moody's placed the outlook on WSW's issuer rating on negative outlook on July 24, 2012. This rating action was driven by the strong link between the sovereign and WSW given (i) the government's backstop agreement with WSW and (ii) the government's strong policy interest in and overview of the social housing sector.

Moody's also lowered WSW's Baseline Credit Assessment (BCA) to 2 from 1 due to increasing individual guarantee exposures against WSW's reserves and some pressure on the sector's cash flows expected for the future.

Issuer Profile

Founded in 1983 by the NWR, the Netherlands' national housing council, and the NCIV, the country's umbrella organisation for HAs, WSW guarantees payment of interest and principal on loans taken out by domestic HAs for activities carried out in the field of social housing. The guarantee arrangement enables local HAs to borrow at a lower cost, with the saving ultimately being passed to tenants via lowest-cost rents.

WSW is a not-for-profit entity and debt with its guarantee carries a BIS risk weighting of 0% in the Netherlands and several other jurisdictions.

Social housing plays a prominent role in the Netherlands, making up roughly a third of the housing stock in the Netherlands and more than half of housing units in large cities such as Amsterdam and Rotterdam. In contrast to other countries where social housing is often concentrated in suburbs, most neighbourhoods in the Netherlands are more diversified; and single family houses account for almost 50% of the social housing stock. Tenants include substantial middle-income and some higher income residents, as well as lower income populations usually associated with this sector.

For a number of years, social housing in the Netherlands and the roles and responsibilities of housing associations have been undergoing significant political consultation and reform. Recurrent themes are to draw additional investment by 'sweating' what many view as rich balance sheets of the HAs, and to use this investment for urban renewal and social benefits through in 'place shaping'. Recent decisions affirming the general approach to social housing removes a major uncertainty regarding state aid under EU regulations.

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 2 (equivalent to Aa1) on a scale of 1-21, where 1 represents the lowest credit risk, reflects the following factors:

Institutional Framework

An HA must be a member of WSW to benefit from its guarantee. At the end of 2010, 398 of the Netherlands' 414 HAs (96%) were members of WSW.

WSW's three options for dealing with calls on its guarantees in the event of one or more member HAs experiencing financial distress, are described below.

WSW has EUR 482 million of own-source capital with EUR 465 million invested in highly rated, liquid debt securities and an additional EUR 2.8 million in cash and EUR 13.6 million of other assets to cover one-off or repeated non-payments by a member. In this event, WSW would make the payment to the lending institution and write down the amount as a liability. A part of the WSW guarantee agreement requires HAs to make a reverse mortgage pledge to WSW, which is invoked if WSW has to intervene. This pledge allows WSW to realign its balance sheet by taking ownership of pledged properties and eventually to recoup its outlay sales of these assets. Before taking these steps, WSW would (but is not obliged to) inform the Central Fund for Social Housing (Centraal Fonds voor de Volkshuisvesting or CFV), a government entity which supervises the entire sector; both entities would then intervene in the management of the non-paying HA to resolve the issues that caused the inability to service debt. The HA could then also be restructured. WSW was able to cover 5.0% of its maximum debt service commitment of approximately EUR 9.6 billion for 2011 or 0.6% of its total guarantee portfolio via own-source capital.

Were failures to be more widespread, and in WSW's judgement potentially greater than it can meet whilst maintaining its 0.25% internal capital limit, WSW can call capital from its member housing associations, which are required to make available 3.85% of the outstanding debt of their WSW-guaranteed loans and capital would be provided on a joint-and-limited basis. WSW may act on its projections and in its best judgment; and it need not wait until a shortfall actually occurs. Housing associations note their potential capital contribution to WSW in proportion to their share of the total guaranteed loans as a contingent liability on their balance sheets. WSW had direct access to EUR 3.3 billion of participant HAs' callable capital as of year-end 2010. WSW notes that its participants held EUR 4.1 billion of financial assets in 2010. Moody's anticipates that requests for capital from members would have to be met from these amounts, asset sales or additional borrowing.

Counting the access to callable capital in addition to its own capital, WSW could cover 39.1% of its maximum debt service commitment for 2011, or 4.4% of its total guarantee portfolio.

If for any reason the first two lines of resources do not prove, or were not anticipated, to be adequate to meet WSW's commitments, WSW would invoke additional capital calls from its contractual "backstop" agreements with local and central government. These contributions would be made on a 50/50 joint-and-unlimited 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 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 up to a maximum of 75 days).

In addition to WSW's multiple lines of financial support, it would not be alone in addressing the needs of distressed housing associations. The CFV maintains a reserve specifically designated for the provision of funds to HAs that find themselves in financial distress. To date, the CFV has provided support for the restructuring of 18 HAs and support for specific projects in two cases. Whilst this amount is not dedicated to WSW's guarantee responsibilities, it is likely that some or all of this funding would be mobilised to the particular circumstances that could trigger the WSW guarantee.

WSW notes that, since its establishment in 1983, there has never been a call on its guarantee by a borrower, a call by WSW to its participants to renew its capital base nor a call by WSW to the local-government or central-government backstoppers.

In Moody's view, the potential for delays under the mechanics outlined above has been mitigated by a) the time afforded by the internal capital buffer, which so long as individual exposures would not overwhelm it in a brief period, would allow the mechanics to play out during a complicated distress scenario and b) statements by the government that the national interest of the HA sector would motivate it to provide timely payment if other aspects of support run into difficulties (see section Extraordinary Support below).

In the face of continuing volatility in global financial markets and what have been gradual increases in payment exposures by individual HAs (due to consolidation in the sector and some tendency toward shortening maturities under guarantee), WSW has been working to assure the sufficiency of the buffer-reserve and to clarify the timing of payment protocols within its members and the government, were a call needed. Moody's will assess any improvements to the guarantees issued by WSW, which could limit exposure, the timing of the backstops and the payment protocols of members and the government for their impact on WSW's ability to meet its guarantees, particularly with application that might be extended to capital market debt.

Financial Performance

WSW has two sources of revenue, commissions and investment earnings on reserved capital. Interest income and commissions increased compared to 2009 and operating expenses were slightly reduced, allowing for a surplus of EUR 6.7 million in 2010 (compared to EUR 23.6 million in previous year).

WSW's own-source capital reserve ("base capital") of EUR 482.4 million is available to provide liquidity for general operating purposes.

Commissions ("discount fees") are charged to members as compensation for their guarantees. Fees are charged annually on amounts outstanding. Collections rose to EUR 8.5 million in 2010, up from EUR 7 million in 2009, in line with the growth in newly granted guarantees.

WSW's operating costs amounted to EUR 8.9 million in 2010, down from EUR 9.4 million in 2009. The decrease is mainly due to lower overhead costs, including substantially reduced project costs due to the completion of major projects in 2009. Fee income was almost sufficient to cover operating costs in 2010, following two years during which WSW had to resort to investment income to cover costs. Overall, costs have generally been well contained, particularly in relation to the level of guarantees outstanding. It is likely, however, that increased monitoring due to even marginal levels of financial distresses in the sector and undertaking of any broader role for WSW in the financing of social housing could place further pressures on costs.

WSW is currently in discussion with the tax authorities on the amount of corporation tax it will have to pay retroactively to 2008. Moody's anticipates that the final assessments, if they are material, will have to be compensated by adjustments to charges, so as to meet WSW's ongoing capacities to meet projections for increased guarantees.

Debt and Liquidity

WSW's has no debt of its own. Total guaranteed obligations stood at EUR 85.3 as of 2010 and are projected to reach EUR 99.1 billion by 2015, an increase of about 16% compared to 2010.

HAs pledge as collateral to WSW those properties financed by the WSW-guaranteed loans. Housing associations remain liable for recovery of any shortfall after perfection of security

In the case of non-payment of debt service by a HA, WSW would have the right to step in under the loan and provide the same terms and conditions; and the loan would not be accelerated. In practice, this allows WSW to act as a stop-gap payment provider of interest until the finances of the HA are stabilised, which when achieved reduces the risk of WSW having to pay the full principal amount of any loan. In practice, this is supported by the dominant position of the sector banks which have the same ownership and interests as the backstoppers. The share of these banks in newly issued guarantees per year has increased to 92% in 2010 from 81% in 2007.

WSW monitors its members' cash-flow obligations for both interest and principal (repayments) in its estimates of reserves. While the size of individual maturities has to date remained below WSW's base capital, Moody's notes that the trend of increasing exposure could hamper the benefit of WSW's cash reserve. In addition to guaranteeing long-term debt and in accordance with the backstoppers, WSW may provide and has provided guarantees on liquidity loans with a minimum maturity of two years to housing associations facing unforeseen liquidity needs, 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. WSW imposes strict monitoring on these housing associations.

While guarantee exposures to the liquidity loans are not likely to be significant when compared to the overall principal guaranteed by WSW, the shorter term maturities of the liquidity loans could add significantly to near-term concentration risks and therefore could increase pressure on the sufficiency of WSW's own-source capital. Whilst WSW monitors these exposures in its risk reviews of its members, such exposures are dynamic and their impact less predictable than standard long-term lending.

WSW's main source of risk is the quality of the housing-association loans it guarantees which amounted to EUR 85.3 billion at the end of 2010. To assess and monitor asset quality, WSW assigns an internal credit rating with a credit risk model which examines the housing market, the finances of individual HAs and their managerial quality. Poor performers can be denied guarantees for new borrowing. All of WSW participants were considered creditworthy in 2010 and 2011.

In addition to WSW's risk assessment, the CFV has its own monitoring system for the complete HA sector. As part of this, the CFV undertakes an assessment of the sector twice a year, where it reviews each HA's performance in the previous year and forecasts for the following five years.

The agreement on state aid between the central government and the European Commission will limit the use of WSW's guarantee to funding for social housing investments with some margin for associated commercial and other infrastructure costs. The agreement will also better match social rent levels to those qualifying based on need for support. Moody's view is that this will not change the overall credit strengths of WSW or the importance of social housing in the Netherlands.

Governance and Management

WSW publishes its annual financial statements in the first 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 i) the Supervisory Board, holding regular meetings throughout the year with the Executive Board, on top of the submission of quarterly reports, and ii) an internal control officer.

As agreed in the backstop agreements with the central government and municipalities, WSW must submit a five-year forecast of its cash flow (including amounts that may have to be provided to restore capital to prescribed levels of guarantee to contingent obligations) at least once a year. The forecasts must be updated every six months whenever the need for loans from the backstoppers has been identified.

Profit is retained and kept as reserves to strengthen capital. Investment guidelines are prudent with around 54% of the securities portfolio invested in Aaa-rated securities; with a lowest permitted rating of A1. Approximately 85% of the portfolio has a maturity of ten years or less. The funds are managed by a third party, within strict guidelines. Over the medium term, Moody's expects continuity in the prudent budget orientation and investment decisions seen in the past.

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 backstop agreements with the government and the relevant municipalities are aimed at "prevent[ing] the liquidity shortages of the Social Housing Guarantee Fund at all times" (as noted in the pre-ambles to the agreements).

Moody's also assigns a very high default dependence between the GRI and the central government, reflecting that a failure in this sector would likely be co-incident 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 March 2011 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.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, in cases where foreign-currency denominated securities benefiting from special characteristics are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

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%).