MOODY'S
PUBLIC SECTOR EUROPE

Credit Opinion: Waarborgfonds Sociale Woningbouw

Global Credit Research - 14 Sep 2015

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aaa

Contacts

Analyst	Phone
Jeanne Harrison/Moody's Investors Service EMEA LTD	44.20.7772.5454
Benisek, Stanislav/Moody's Investors Service EMEA LTD	
David Rubinoff/Moody's Investors Service EMEA LTD	

Opinion

SUMMARY RATING RATIONALE

The Aaa issuer rating for Waarborgfonds Sociale Woningbouw (WSW) reflects WSW's strong linkages with the Government of the Netherlands (Aaa, stable) which include the central and local government backstop agreements which prevent WSW from suffering liquidity shortages, oversight exercised by the Dutch central government, and public policy mandate to support investment in Dutch housing associations (HAs).

National peer comparison

WSW's rating is aligned with the rating assigned to Waarborgfonds Eigen Woningen (WEW), a guarantee fund for the Dutch private housing sector. WSW and WEW are rated one notch above Stichting Waarborgfonds BVE (WBVE), a guarantee fund for Dutch adult and vocational education institutions. WSW and WEW benefit from explicit backstop agreements with the Dutch central and municipal governments whereas WBVE does not benefit from an explicit backstop agreement.

Credit Strengths

Credit strengths for WSW include:

- Backstop agreement with the Dutch central and local governments to prevent liquidity shortages

- Government oversight of both WSW and the wider housing association sector by the Authority Housing Corporations (AHC)

- A multi-tiered structure including risk capital and callable capital would be utilised before calling on government liquidity support

Credit Challenges

Credit challenges for WSW include:

- Guarantee (including government backstop) has never been tested

- Changes to Dutch social housing framework and policy generating uncertainty in the sector

Rating Outlook

The rating is stable.

What Could Change the Rating - Down

WSW's rating is fundamentally linked to the sovereign rating of the Government of the Netherlands (Aaa, stable). Consequently, a downgrade in the sovereign rating would result in a downgrade for WSW's issuer rating. The withdrawal of the backstop guarantee would result in significant downward pressure. In addition, a shift in government policy resulting in weaker support or oversight of WSW could result in downward pressure on the rating.

Issuer Profile

WSW is a not-for-profit entity, founded in 1983. WSW guarantees payment of interest and principal on loans taken out by Dutch housing associations for social housing activities. The guarantee arrangement enables associations to borrow at a lower cost, with the savings ultimately passed on to tenants via lower rents.

Social housing plays a prominent role in the Netherlands making up roughly a third of the housing stock and more than half of housing units in large cities such as Amsterdam and Rotterdam. 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

Moody's considers WSW to be a government-related issuer. The WSW's credit strength is inextricably linked to that of the Government of the Netherlands due to its clear public policy mandate, direct oversight by the government, and backstop agreement provided by the central government. As such, its rating is derived primarily from the strength of the Government of the Netherlands (Aaa, stable) without assigning a Baseline Credit Assessment (BCA) as is described in Moody's rating methodology for government-related issuers entitled "Government-Related Issuers", published in October 2014.

BACKSTOP AGREEMENT WITH THE DUTCH CENTRAL AND LOCAL GOVERNMENTS TO PREVENT LIQUIDITY SHORTAGES

WSW benefits from a contractual backstop agreement with the Dutch central and local governments to prevent liquidity shortages at all times, the primary driver for its credit quality. If needed, 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. If a municipality were unable to unwilling to pay its share, the central government would provide 100% of funding required.

WSW would call on its backstop agreements only in the unlikely event that its risk capital and callable capital (see below) are inadequate to meet its commitments. Under the terms of the backstop agreement, WSW can demand unlimited support to ensure that (i) its reserve to guaranteed loans ratio returns to 0.25%, and (ii) all participants' loan obligations are covered. At year end 2014, WSW's risk capital covered 0.57% of its guaranteed loans, more than double the amount which would trigger the backstop agreement.

The government monitors its exposure and WSW's financial health through annual five-year cash flow forecasts, which are a condition of the backstop agreement. Detailed forecasts facilitate forward-looking oversight of WSW's financial position.

The backstop agreement includes a clearly delineated timeline for liquidity support. 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 EUR485 million (as of December 2014) risk capital and its ability to call on capital from its members. Furthermore, WSW has credit facilities of almost EUR1 billion through two banks, KBL and BNG.

GOVERNMENT OVERSIGHT INCLUDING MONITORING OF WSW AND HOUSING ASSOCIATIONS BY THE AUTHORITY HOUSING CORPORATIONS

Government oversight of WSW is set to strengthen reinforcing the view that the social housing sector continues to be a key pillar of the Dutch welfare state. WSW will be formally monitored by the newly-created Authority Housing Corporations (AHC), a government entity. Under legislation which took effect in July 2015, WSW's recently strengthened risk management framework will be part of a governmental decree. Significant policy changes have to be approved by the government, and it has the authority to dismiss the entire Supervisory Board of WSW and appoint new board members in cases of non-compliance or mismanagement.

The legislation formalises the oversight of WSW as well as its role as the primary facilitator of restructuring cases in the social housing sector. Changes to the institutional framework also include abolishing The Central Fund for Social Housing (Centraal Fonds voor de Volkshuisvesting or CFV) which had acted a supervisor for the wider social housing sector, a responsibility which now sits with the AHC. The AHC will perform detailed risk analysis at the entity level for the sector.

In addition to the scrutiny provided by the AHC, the WSW monitors the financial health of member housing associations. WSW assigns internal credit ratings utilising its credit risk model which assesses numerous factors including the housing market, the finances of individual HAs, their managerial quality and compliance with WSW's risk policy and requirements. WSW's credit assessment of housing associations is used internally to manage its risk.

ROBUST RISK MANAGMENT FRAMEWORK AND MULTI-TIERED STRUCTURE MINIMISE LIKELIHOOD OF CALLING ON GOVERNMENT LIQUIDITY SUPPORT

WSW manages its risk exposure with an intention to call on the government backstop only in a worst-case scenario, and has several layers of security it can employ prior to exercising its option for liquidity support under the backstop agreement. The first layer of security is EUR485 million in own-source capital (as of December 2014). Of this, the vast majority is invested in highly rated, liquid securities.

The second layer of financial security is its ability to call capital from its members if its risk capital diminishes to less than 0.25% (EUR213 million in 2014) of outstanding guarantees. Members are required to make available funds equal to 3.85% of their outstanding WSW-guaranteed loans, held as contingent liabilities on their balance sheets. As of 31 December 2014, 3.85% of outstanding guaranteed loans equaled EUR3.2 billion of callable capital.

The final layer of security and source of funds is the ability to call on its government backstop, in the event of a severe stress scenario.

WSW adopted a new risk management framework in 2013 which includes detailed risk appetite parameters, including a cap of EUR3.5 billion on guaranteed loans for any one housing association. The newly-defined limit will mitigate concentration risk and, by WSW's calculations, result in a 99% likelihood that the WSW would be capable of funding calls on its guarantees without resorting to liquidity support from the central government.

GUARANTEE (INCLUDING GOVERNMENT BACKSTOP) HAS NEVER BEEN TESTED

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 or central government backstop agreements. The WSW guarantee structure has never been tested, although several associations have experienced financial distress. We believe this track record reflects the strong intervention and restructuring capabilities of the government and the WSW which have stepped in for several entities experiencing financial distress. The bailout of Woningstiching Geertruidenberg (WSG, not rated) is an example of a government intervention in a financially weak housing association.

WSW has no outstanding debt. Total guaranteed obligations were EUR85.1 billion in 2014. WSW expects a weakening in the demand for loan guarantees over the next few years which will result in a decrease in guaranteed loan obligations from EUR85.1 billion in 2014 to EUR82.5 billion by 2018. This is partly due to cash flow pressures with the introduction of a new landlord levy by government, as well as a broad tempering of risk appetite in the sector following recent legislative changes.

CHANGES TO THE DUTCH SOCIAL HOUSING REGULATORY FRAMEWORK AND POLICY GENERATING UNCERTAINTY IN THE SECTOR

The Dutch government has taken proactive steps to de-risk the sector following high profile failures in the market, including the financial collapse of Vestia in 2012 which had to obtain an emergency EUR1.6 billion government-backed loan to meet a margin call on its derivatives portfolio. Legislation approved in December 2014 will result in further changes to the risk profile of housing associations whose debt is guaranteed by the WSW. Changes affecting housing associations include a streamlining of regulatory responsibility for the sector, a strict separation of commercial activities from the core business operations, and strengthened influence from municipalities over housing associations' strategies.

For the WSW, the changes will result in a shift in the risk profile for its guaranteed debt, as housing associations will no longer be able to use WSW government-guaranteed debt for riskier commercial activities. In addition, the legislation incorporates increased responsibility for the WSW as the official arbiter in restructuring cases, and increased oversight of the WSW by the government through regulation by the newly-created Authority Housing Corporations.

The current political climate is driven by a view that Dutch housing associations' strategies should be focused on core activities rather than riskier commercial business streams, and that the sector should have increased scrutiny of its activities, including increased influence from municipalities and tenants. There are also restrictions around 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.

While the risk profile of HAs will be reduced by the limiting of commercial activities and restrictions around derivatives, their cash flows are negatively impacted by the landlord levy imposed from 2013 on housing associations, an annual fee on the sector which will reach EUR1.7 billion by 2017. The fee is paid from rental income directly to the central government and was introduced as a means of mitigating the pressures on public finances. A policy allowing greater revenue flexibility through the ability to increase rents depending on the tenants' income partially offsets the detrimental financial impact of the levy, but the net effect on cash flows of these two policies is a weakening of the financial strength of housing associations relative to forecasts.

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 ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in June 2014 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

Baseline credit assessments (BCAs) are opinions of entity's standalone intrinsic strength, absent any extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

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%).

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 http://www.moodys.com for the most updated credit rating action information and rating history.

MOODY'S
PUBLIC SECTOR EUROPE