Credit Opinion: Waarborgfonds Sociale Woningbouw

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Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aaa

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Key Indicators

Waarborgfonds Sociale Woningbouw

	2008	2009	2010	2011	2012	2013
Total assets (Euro millions) [1]	453,100	476,171	483,248	1,048,149	529,595	525,654
Total capital funds (Euro millions)	452,078	475,719	482,421	497,186	526,891	512,283
Return on average assets (%)	6.6	5.1	1.4	1.9	3.8	-2.8
Recurring earning power (%)	6.6	5.1	1.4	1.9	3.8	-0.7
Net interest margin (%)	4.5	4.3	4.3	4.1	3.7	3.5
Cost/ income ratio (%)	23.8	28.4	57.0	38.2	30.9	139.3

[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 backstop 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 stringent membership and borrowing criteria for members and the strong regulatory framework for the social housing sector. The regulator Centraal Fonds voor de Volkshuisvesting (CFV), along with WSW, monitors and intervenes in weak housing associations, before the WSW guarantee is triggered.

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 backstop agreements with the Dutch central government (and municipal governments in the case of WSW), but WBVE does not benefit from a backstop agreement.

Credit Strengths

Credit strengths for WSW include:

- Strong institutional framework and government-defined mandate to guarantee debt issued by Dutch housing associations

- A robust guarantee structure including risk capital and callable capital

- Active monitoring of housing associations in conjunction with the Central Fund for Social Housing (CFV)

- Stable operating performance, costs controlled but added responsibilities may add pressures

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

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

Rating Outlook

The rating is 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 support.

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.

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 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

WSW's rating combines (1) a baseline credit assessment (BCA) for the entity of aa1, and (2) a very high likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

STRONG INSTITUTIONAL FRAMEWORK AND GOVERNMENT-DEFINED MANDATE TO GUARANTEE DEBT ISSUED BY DUTCH HOUSING ASSOCIATIONS

WSW was established in 1983 by the National Housing Council (NWR) and the NCIV, the country's umbrella organization for housing associations. It guarantees payment of interest and principal on loans taken out by Dutch housing associations (HAs) for activities carried out in the field of social housing and its objective is to maintain the guarantee system and ensure HAs have access to lower cost funding. In order to benefit from the WSW guarantee, a housing association must be a member of WSW (371 of 380 or 98% of Dutch housing associations are members as of 2013). 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.

Moreover, WSW benefits from contractual back stop agreements with the central and Dutch local governments (described below). 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.

A ROBUST GUARANTEE STRUCTURE INCLUDING RISK CAPITAL AND CALLABLE CAPITAL

WSW has three layers of security that it can resort to in order to meet its guarantee obligation. The first layer of security is EUR487 million in own-source capital (as of December 2013). 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 is government backstop, in the event of a severe stress scenario.

If WSW's risk capital shrinks to less than 0.25% (EUR216 million in 2013) of outstanding guarantees, then it can request callable capital from its members. Members 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. As of 31 December 2013, 3.85% of outstanding guaranteed loans equaled EUR3.2 billion of callable capital.

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 backstop agreements with the central and local governments. Under these contracts, 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. 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.

According to the backstop 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 EUR487 (December 2013) 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. We also believe that the Dutch government sees the social housing sector as a pillar of the Dutch welfare state.

ACTIVE MONITORING OF HOUSING ASSOCIATIONS IN CONJUNCTION WITH THE CENTRAL FUND FOR SOCIAL HOUSING (CFV)

WSW regularly monitors the financial health of member housing associations. Following several cases of HAs not being able to meet margin calls on its derivatives portfolios since 2009, WSW has strengthened its review of HA's treasury policies and activities. 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. 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 and compliance with WSW's risk policy and requirements. 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, interest coverage, loan-to-value and solvency ratios. 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.

Moreover, WSW works with the Central Fund for Social Housing (Centraal Fonds voor de Volkshuisvesting or CFV), a government entity which supervises the entire sector. 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. Whilst the CFV has in the past focused on a housing association's solvency, its monitoring of the sector is now more extensive, including reviews of internal policies and cash flows.

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. As of year-end 2011, this amounted to EUR 118.6 million (2011), though the reserve was depleted to support Vestia and is now being replenished. The reserve is funded through a levy on the sector that the CFV can raise as a percentage of the housing associations' rental income. While this levy was set at 1% in the past, the CFV increased this to 5% (the maximum levy) from 2013 in order to fund the exceptionally high support agreed for one housing association (Vestia) in 2012. In 2013, the payment was 4% (EUR 508 million) of annual rent income; however, we expect that this levy will decline from this maximum rate. Whilst the reserve amount is not dedicated to WSW's guarantee responsibilities, the Vestia case has shown that it can be mobilised to the particular circumstances that could otherwise trigger the WSW guarantee.

With recent changes to the Dutch Housing Act and evaluation of the restructuring roles of WSW and CFV, the government mandate to manage restructuring of HAs now lies with WSW, working with CFV (which is being restructured and brought closer to the Ministry of Housing). To this end, WSW has established a special risk management department, which currently actively monitors 19 HAs, two of which are undergoing restructuring (Vestia and WSG).

STABLE OPERATING PERFORMANCE, COSTS CONTROLLED BUT ADDED RESPONSIBILITIES MAY ADD PRESSURES

WSW has two sources of revenue: guarantee fees and interest income related to its risk capital. Guarantee fees were EUR 14.1 million and interest income EUR17.5 million in 2013, fairly stable compared with the year previous (guarantee fees of EUR12.5 million and interest income of EUR18.0 million). Net income declined however (loss of EUR14.6 million) because of unrealised losses related to WSW's risk capital.

Operating costs remained a manageable EUR14.0 million in 2013, up slightly from EUR 13.3 million the previous year. The cost increase was primarily due to an increase in staff costs with an increase in staffing along with reorganisation charges to manage WSW's added responsibilities. 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 rising levels of financial distresses in the sector, and the undertaking of any broader role for WSW in the financing of social housing could place further pressures on costs. Furthermore, over the next few years guarantees are expected to decline, though WSW also intends to increase fees.

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-government or central-government backstoppers. 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 and WSW have performed for several entities experiencing financial distress. The recent bailout of Woningstiching Geertruidenberg (WSG, not rated) is an example of CFV intervention in a financially weak housing association.

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.

LARGEST HOUSING ASSOCIATIONS CONSTITUTE A LARGE EXPOSURE

WSW's has no outstanding debt. Total guaranteed obligations were EUR86.2 billion in 2013. WSW expects that demand for guaranteed loans over the next few years will be lower than previously forecast with guarantee obligations forecast to decline to roughly EUR85.1 billion by 2017. This is partly due to cash flow pressures with the introduction of a new landlord levy by government, which is estimated to be equivalent to 11% of HA rental income in 2013 (EUR 1.7 billion). WSW also forecasts that interest and principal repayments accumulated for the five largest housing associations will amount to EUR1.8 billion in 2015, 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.

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

We have observed several changes on the regulatory landscape over the last few years. 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. The Dutch government has also introduced a landlord levy on housing associations, which introduces some pressures on HA cashflows (though this is partly mitigated by the ability of HAs to increase rents).

There are also plans to separate social housing activities from associations' commercial activities. In addition, the roles of CFV and WSW are also being redefined, with CFV being restructured and financial supervision to be under the purview of the Ministry of Housing, while restructuring responsibilities will be mandated to WSW. These changes, however, are still to be finalised in legislation, which we expect to occur next year.

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 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

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%).