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CREDIT OPINION
20 July 2018

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RATINGS

Waarborgfonds Sociale Woningbouw

Domicile	Netherlands
Long Term Rating	Aaa
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Waarborgfonds Sociale Woningbouw (Netherlands)

Update to credit analysis

Summary

The credit profile of Waarborgfonds Sociale Woningbouw (WSW, Aaa stable) 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 corporations. The rating also takes into account an expectation of the first call on a WSW guarantee in 2019, and a higher likelihood of calls on guarantees and use of WSW's risk capital, due to changes in the resolution framework for distressed housing corporations.

Credit strengths

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

» Government oversight of WSW and housing corporations by the Authority Housing Corporations (AHC)

» Robust risk management framework and multi-tiered structure minimise likelihood of calling on government liquidity support

» Legislation de-risks housing corporations, limits non-core activities

Credit challenges

» Use of risk capital for the first time to resolve problem cases, changes to resolution framework make calls on guarantee and use of risk capital more likely

Rating outlook

The outlook is stable.

Factors that could lead to a downgrade

» A downgrade in the sovereign rating

» The withdrawal of the backstop guarantee would result in significant downward pressure

» A shift in government policy resulting in weaker support or oversight of WSW

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 corporations. Social housing plays a prominent role in the Netherlands making up roughly one third of the housing stock. The guarantee arrangement enables housing corporations to borrow at a lower cost, with the savings ultimately passed on to tenants via lower rents. As of December 2017, 321 of 330 (97%) of housing corporations in the Netherlands have WSW guarantees on €81.1 billion of loans, down from €82.3 billion in 2016.

WSW's rating is on a par 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 WMBO (WMBO), 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 WMBO does not benefit from an explicit backstop agreement.

Detailed credit 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 June 2018.

Backstop agreement with the Dutch central government 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 2017, WSW's risk capital covered 0.43% of its guaranteed loans. Since its inception in 1983, there has never been a call on 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 €351 million (unaudited estimate as of December 2017, inclusive of provision for resolution of problem cases Humanitas and WSG) risk capital and its ability to call on capital from its members. Furthermore, WSW has access to a KBL facility which is repurchase agreement for €434 million accessible within three hours.

Government oversight of WSW and housing corporations by the Authority Housing Corporations

Government oversight of WSW has strengthened following legislation passed in 2015, supporting the view that the social housing sector continues to be a key pillar of the Dutch welfare state. Under measures introduced as part of the Housing Act, WSW is now formally monitored by the Authority Housing Corporations (AHC), a government entity, with its risk management framework 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 Housing Act established the AHC as the government body responsible for regulating and monitoring risk in the social housing sector, both at the entity and sector levels. In addition, the WSW monitors the financial health of member housing corporations. Because most of the sector is effectively monitored by both organisations, the WSW and AHC have worked together to establish a consistent risk assessment framework to ease the regulatory burden for HCs. Under the new framework, expected to be finalised at the end of 2018, WSW will lead on assessing financial risk and the AHC will lead on assessing risks associated with governance, but information will be shared between the two organisations.

The WSW has strengthened oversight of housing corporations which have a guarantee in the last three years, with an aim to manage its risk more effectively and to be more transparent and engaged with its members. It assigns internal credit ratings utilising its credit risk model which assesses numerous factors including the housing market, the finances of individual housing corporations, their managerial quality and compliance with WSW's risk policy and requirements.

Robust risk management 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 €351 million in own-source capital (unaudited estimate as of December 2017). The WSW's investment portfolio primarily consists of highly-rated (Aaa or Aa) government bonds, with an objective to preserve capital and to offset inflation.

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% (€203 million in 2017) 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 2017, 3.85% of outstanding guaranteed loans equaled €3.1 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's risk management framework includes detailed risk appetite parameters, including a cap of €3.5 billion on guaranteed loans for any one housing corporation. The limit mitigates concentration risk and, by WSW's calculations, results 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.

Legislation de-risks housing corporations, limits non-core activities

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 €1.6 billion government-backed loan to meet a margin call on its derivatives portfolio. The Housing Act has resulted in credit positive changes to the risk profile of housing corporations whose debt is guaranteed by the WSW. Changes affecting housing corporations include a streamlining of regulatory responsibility for the sector, restrictions on use of derivatives, a separation of commercial activities, and strengthened influence from municipalities over housing corporations' strategies.

The current political climate is driven by a view that Dutch housing corporations' 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. For the WSW, the changes will result in a shift in the risk profile for its guaranteed debt, as housing corporations will no longer be able to use WSW government-guaranteed debt for riskier commercial activities.

Use of risk capital for first time to resolve legacy problem cases, changes to the resolution framework make calls on guarantees and use of risk capital more likely

WSW expects to use its risk capital for the first time in 2019 to rescue two housing corporations in distress (see below). In addition to changes applicable to housing corporations, the Housing Act included changes to the resolution framework for housing corporations in financial difficulty. The government appointed WSW the official arbiter of restructuring problem cases, and redefined government's priorities and obligations for cases of distressed housing corporations. Prior to the legislation, the government would bail out an insolvent housing corporation, with the cost of the rescue collected from the sector in advance through a levy. The system resulted in the rescue of the legal entity, with no potential for bankruptcy of the entity. The government's view was that the lack of potential for bankruptcy led to moral hazard risk.

Under the new legislation, the government will provide financial support only for social housing assets deemed necessary by the local government to meet housing need, with any residual loss potentially leading to calls on the guarantee. The change is likely to lead to more calls on WSW guarantees, with the WSW responsible for debt servicing on the guaranteed loans. Although calls on the guarantees are credit negative, we view the risk as manageable because 1) the WSW has strong visibility over any problem cases through monitoring of its members, 2) the WSW negotiates resolutions directly with the government and has advance warning of potential claims, 3) losses are covered by the sector under either approach, either through a levy charged by the government or through callable capital exercised by WSW, and 4) WSW is responsible for debt servicing only under the terms of the guarantee, with creditors not allowed to accelerate their loans under the agreement in cases of insolvency, thus limiting the potential for material cash outflows.

Although the Housing Act has limited the amount of risk housing corporations can engage in, there are some legacy cases of distressed housing associations expected to be resolved in 2019 which will result in use of WSW's risk capital and calls on the guarantee for the first time. Over the medium-term, resolution of problem cases may result in a call for capital from its members, credit negative developments.

Humanitas Housing Foundation (Humanitas) will merge with Woonbron housing corporation in mid-2019 with WSW utilising €125 million of its risk capital to facilitate the merger. Humanitas's failure follows unsuccessful attempts to resolve its financial problems stemming from extensive borrowing, poor governance, and challenges with its care provision dating back to 2010. The WSW has worked with Humanitas over many years attempting to resolve its issues as per its established process: in the first instance through a recovery plan, then a restructuring plan and finally a request to the government for financial support if recovery and restructuring plans are unsuccessful. The government and WSW have agreed on the resolution plan, and WSW expects a call on the guarantee as a result in mid-2019, including use of its risk capital for the first time. Risk capital is not expected to deplete to a level which would require use of callable capital as a result of the Humanitas rescue.

Woonstichting Geertruidenberg (WSG) is another financially unsustainable housing corporation which is expected to be rescued in early 2019, with WSW spending an estimated €65 million of its risk capital to facilitate the rescue. WSG's assets and liabilities will be split up and merged with eight separate housing corporations. WSG's problems arose from extensive pre-recession land purchases which resulted in losses and incomplete projects when the property market crashed in the Netherlands in 2009, in addition to unprofitable contracts for care activities. The government has agreed to provide a subsidy of approximately €300 million to rescue WSG which will be collected in advance through a levy on the sector. It is also likely that there will be a call on guarantees provided by WSW, though the cost to WSW has not been finalised.

Over the medium term (next five years) there is potential for WSW to need to call on its members to renew its capital due to obligations under guarantees which have been called as a result of the new resolution process, in order to bring its risk capital back to the minimum of 0.25% of outstanding loans. The WSW will consider negotiating terms with the government and its members in order to maintain its risk capital at current levels, rather than the minimum, in order to mitigate against risks associated with the new resolution framework.

Rating methodology and scorecard factors

Government-Related Issuers, June 2018

Ratings

Exhibit 1

Category	Moody's Rating
WAARBORGFONDS SOCIALE WONINGBOUW	
Outlook	Stable
Issuer Rating	Aaa

Source: Moody's Investors Service

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