Research Update:

Dutch Social Housing Guarantee Fund WSW 'AAA' Rating Affirmed; Outlook Stable

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Overview

- Waarborgfonds Social Woningbouw (WSW) remains committed to strengthening the social housing guarantee system in the Netherlands after receiving its first guarantee claim in 2018.
- We expect the COVID-19 pandemic will have a limited impact on the Dutch social housing sector, owing to continued strong demand and support packages from the central government to help financially vulnerable tenants.
- We are affirming our 'AAA' rating on WSW, since we still see an almost certain likelihood of support that the Dutch government will provide timely support to WSW, reflecting the entity's critical role and integral link with the state.
- The stable outlook reflects that on the Netherlands and our expectations that recently established and enhanced mechanisms to the guarantee system will ensure sufficient buffers in WSW's operations.

Rating Action

On July 3, S&P Global Ratings affirmed its 'AAA' long-term issuer credit rating on Dutch social housing guarantee provider Waarborgfonds Social Woningbouw (WSW). The outlook is stable.

Rationale

WSW is a not-for-profit foundation that guarantees loans to Dutch social housing associations. We consider WSW to have a critical public policy role for the Dutch government by keeping the funding costs of social housing associations low. Furthermore, even though the participating housing associations and WSW are self-owned foundations, the state has demonstrated its integral link with these entities through the backstop agreement that gives WSW unlimited access to state funding if needed. Overall, we base our ratings on our classification of WSW as a government-related entity with an almost certain likelihood of receiving extraordinary government support. Consequently, we equalize our rating on WSW with that on the sovereign.

Following implementation of the revised Housing Act in 2015, WSW received its first ever guarantee claim in 2018, related to two housing associations, Woningstichting Geertruidenberg (WSG) and Stichting Humanitas Huisvesting (SHH). In 2019, the associated guarantee resolution procedures provided clarity and predictability for WSW's operations. As part of the resolution process, it was agreed that WSW could choose which loans to take over and service from the two entities. To limit the pressure on liquidity, WSW prioritized picking loan contracts with maturities spread out over 30-40 years. Since 2019, WSW's annual cash outflows have increased somewhat as result of SHH and WSG's restructuring and the correction of payments for their loans. However, the annual changes are small and will not have a material impact on WSW's total obligations.

In response to the restructuring of the two housing associations and the transfer of annual payment obligations to WSW, the foundation's management decided to increase the minimal capital requirement to 0.65% of outstanding guaranteed debt from 0.25%. However, since management forecasts a decrease in risk capital due to annual cash outflows from the guarantee claims, WSW will need capital injections to maintain the required risk capital level. These contributions will come from the participating housing associations. WSW has received no formal objections from any of the participants or an indication of unwillingness or inability to pay.

Furthermore, WSW has taken additional steps to enhance the resilience and financial strength of the guarantee system, partly by building upon the strategic program it has developed with key stakeholders. In addition, WSW's management continues to expand the joint assessment framework, which was implemented in 2019. The aim of the framework is to assess and monitor the housing associations in a more efficient way to reduce the administrative burden on the housing associations. To strengthen monitoring of the sector, WSW has implemented new financial ratios to evaluate the financial strength of the participants. As part of assessing the credit quality in the sector, WSW puts all housing associations into one of three risk categories ranging from low to high risk. As of year-end 2019, the number of entities in the high-risk category had decreased to four, from six one year before. In addition, the overall credit quality of the sector has improved.

The desire to increase the robustness of the guarantee system primarily stems from the revised Housing Act implemented in 2015. Rather than providing financial backing to housing association entities, the government will, under the new law, only provide support to activities considered vital to the general economic interests. As a result of the amendment, WSG was only granted partial resolution support in the restructuring process. This decision implied that the residual support had to come from WSW since it guarantees the housing association's loans, resulting in the first guarantee call in WSW's history. At the same time, SHH did not receive any resolution support. In light of these developments, both SHH and WSG are contesting the decision to refuse full resolution support. WSW expects the legal proceedings will be concluded within three years and the outcome could have an impact on the value of its outstanding guarantee obligations.

We do not expect COVID-19 will have a material impact on the Dutch social housing sector. In line with many other countries, the Dutch government has implemented support packages to mitigate the financial impact on the economy. One support package aims to alleviate the pressure on financially vulnerable citizens by providing income compensation, reducing the risk of inability to pay rents, thereby limiting the pressure on housing associations' cash flows. Furthermore, the underlying demand for social housing in the Netherlands remains high, fueled by a shortage of affordable housing in many areas around the country. Consequently, WSW expects the market value of the housing associations' properties will remain generally stable.

A key component underpinning the strength of the guarantee system is WSW's own investment portfolio. The objective of the portfolio is to sustain the capital level, accounting for inflation, by investing in highly rated bonds. The portfolio is managed in line with conservative financial policies, as demonstrated by strict regulations on which assets the organization can invest in and maximum holding limits based on asset risk. The maximum holding per issuer is 10%, except for eurozone sovereign debt. As of midyear 2020, the portfolio composition comprises 'AAA' rated bonds (43%) and 'AA' rated bonds (57%). Furthermore, the average portfolio duration is about 5.3 years.

WSW continues to engage in vertical supervision in collaboration with the Dutch Authority for Housing Associations. The framework is structured to uphold uniform and transparent oversight of the housing associations to ensure satisfactory sector standards. The agreement signed with the Authority in 2018 specifies that WSW should be concerned primarily with the business model of the housing associations, while the Authority oversees their governance. The arrangement increases the strength of the risk framework by ensuring that the supervision process is more robust and that communication between WSW and the Authority is efficient.

Our current assessment of WSW's creditworthiness incorporates three layers of support to withstand potential guarantee claims from the participating housing associations. The first line of support comprises WSW's own risk capital, which is intended to cover any guarantee claims under normal circumstances. The next layer constitutes the housing association members' committed capital. Each housing association is obliged to pay up to 3.85% of the value of outstanding guaranteed debt if WSW's capital is insufficient to pay guarantee claims. As of Dec. 31, 2019, this amounted to about €3 billion. As a last resort, WSW has a backstop agreement with the central government and local authorities. This support materialises if the risk capital falls below 0.25% of guaranteed debt, in which case WSW receives unlimited access to interest-free loans. Under the terms of the backstop agreement, there can be at most a 75-day delay between a request to the central government and municipalities for capital, and the funds becoming available. However, we understand from the government that these funds will be made available in a timely manner. WSW's decision to increase the minimum risk capital ratio to 0.65% reduces the risk of its risk capital falling below 0.25% and triggering the backstop agreement.

The third tier of support is a key component underpinning our view of an almost certain likelihood of WSW receiving extraordinary support from the state and local authorities. We do not consider the financial issues experienced by SHH and WSG as systematic, and we believe that WSW's risk capital and member contributions will be enough to cover any potential guarantee calls in the next few years. Our opinion of an almost certain likelihood of government support reflects our assessment of WSW's:

- Critical public policy role for the government, based on our view that its main purpose is to indirectly provide a key public service by keeping the funding costs of social housing associations low. Furthermore, WSW is a not-for-profit private foundation that guarantees loans provided by lenders to Dutch social housing associations; and
- Integral link with the Dutch government. We view WSW as having a special public status, given the government's ultimate responsibility for ensuring that WSW can meet its obligations. While we believe a default of WSW would not necessarily impair market access for the Dutch government, it could have a detrimental effect on the reputation and market access of entities similar to WSW, and their access to public-sector funding in general.

Outlook

The stable outlook reflects that on the Netherlands and our expectations that recently established and enhanced mechanisms to the guarantee system will ensure sufficient buffers in WSW's operations. Moreover, we assume that WSW's importance and relationship with the Dutch government will not weaken.

Downside scenario

We could lower the ratings by one or several notches if we observe delays in support from WSW's members and the government, potentially leading us to revise our view on WSW's role for or link with the central government. Significant further losses or systematic stress in the Dutch social housing sector could also put pressure on our ratings if WSW's callable capital appears insufficient, and no additional support from the state is forthcoming. A downgrade or outlook revision could also result from a similar ration action on the sovereign.

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

The Netherlands 'AAA/A-1+' Ratings Affirmed; Outlook Stable, May 15, 2020

Ratings List

Ratings Affirmed	
Waarborgfonds Sociale Woningbouw	
Issuer Credit Rating	AAA/Stable/--