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Research Update:

Netherlands-Based Healthcare Guarantee Fund Waarborgfonds voor de Zorgsector 'AAA' Rating Affirmed; Outlook Stable

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Overview

- Waarborgfonds voor de Zorgsector (WFZ) has a critical public policy role in Netherlands through providing guarantees on loans to healthcare providers, and the Dutch government is ultimately responsible for WFZ's obligations.
- We therefore see an almost certain likelihood that the Dutch government would provide timely and sufficient extraordinary support to WFZ in the event of financial distress, and we equalize our rating on WFZ with that on the sovereign.
- We are therefore affirming our 'AAA' long-term issuer credit rating on WFZ.
- The stable outlook on WFZ reflects that on Netherlands.

Rating Action

On July 17, 2018, S&P Global Ratings affirmed its 'AAA' long-term issuer credit rating on Dutch healthcare guarantee fund Waarborgfonds voor de Zorgsector (WFZ). The outlook is stable.

Rationale

The affirmation points to our assumption of an almost certain likelihood that the Dutch government would provide timely and sufficient extraordinary support to WFZ in the event of financial distress. We do not believe such support could be reduced, given the long-standing backstop agreement between WFZ and the state. As a result, we equalize our rating on WFZ with our long-term rating on Netherlands (unsolicited AAA/Stable/A-1+)

Our assessment is based on the following two key factors:

- WFZ's critical public policy role in enabling the provision of accessible and affordable health care, through providing guarantees on loans to health care providers. WFZ is an independent, not-for-profit guarantee fund, whose main and key purpose is to safeguard the funding of the Dutch health care sector. Its primary method of achieving this is by selectively guaranteeing loans made to participating health care providers, which helps them access more affordable finance, especially in

a context of growing pressure on Dutch health care providers' financials. In addition, WFZ also seeks to promote good financial management among its participants. WFZ administers a legacy portfolio of loan guarantees that were previously issued by the government.

- WFZ's integral link with the Dutch government is the result of WFZ having a special public status, given the government's ultimate responsibility for ensuring WFZ can meet its obligations. The government created WFZ, provided its initial capital, and is ultimately liable for all WFZ's financial obligations. Although WFZ has a degree of operational autonomy, the government has effectively determined WFZ's broad purpose and overall strategy. While we believe a default of WFZ would not necessarily impair market access for the Dutch government itself, it could have a detrimental impact on the reputation and market access for other similar entities, and hence the access to funding of public sectors in general.

Given that WFZ enables healthcare providers to access finance at relatively affordable rates, it plays a central role in enabling the government to meet a key public policy objective of ensuring that the Dutch population has access to effective and affordable healthcare. That said, Netherlands' healthcare system is mostly private, with a mandatory insurance scheme that is paid by all residents that have access to the service. With the low margins and lack of own funds in the sector, it is essential for WFZ to provide affordable long-term funding to enable health providers to make investments, mostly on large fixed assets like buildings. Such fixed assets are pledged to WFZ as part of the guarantee agreement, but the market value is usually lower than the amount of guarantee, given restrictions on use of the assets. WFZ applies certain eligibility criteria for its guarantees, based on its credit analysis of the participating health care providers and their business plans, and only provides guarantees for long-term investment, rather than working capital. In addition, it maintains ongoing credit surveillance on its participants and holds regular discussions directly with senior management.

With the current cost pressures, there has been a steady decline in the volume of investment in the institutional healthcare sectors. Providers of institutional healthcare are faced with changes in the pattern of demand and prospects of falling revenues. In addition, healthcare providers are having to contend with the pressure on revenues due to the more explicit procurement role played by health insurers. For the main part of institutional healthcare providers, there are continued problems with overcapacity and existing real estate that is lying idle rather than new investment plans. The declining investment activity in the healthcare buildings is also reflected in the annual volume of new WFZ guarantees. In 2017, guarantees were issued for €247 million of new long-term loans. This is similar to the volume in the preceding year of €229 million. Nevertheless, the volume of guarantees issued was more than €1 billion (per year) a few years ago.

Also, we recognize the integral link that WFZ has with the Dutch government, reflecting what we view as WFZ's special public status. Nevertheless, with the strain on the healthcare sector, we expect the total volume of guarantees for

WFZ to decrease. Including contractually agreed repayments on loans, WFZ's total outstanding guarantees on long-term loans amounted to approximately €7.6 billion at year-end 2017, which is a net decrease of €382 million (-4.8%) compared with 2016. Going forward, we expect the decline in the total volume of guarantees to continue as the decrease of investments by healthcare institutions will reduce combined with a focus on lean management. Both in the cure and care sector, the trend over the past few years is that inpatient care is substituted by outpatient care. Moreover, with regards to the long-term prospects for curative care it is worth noting that ICT, information and communication technology, is having a major impact on the way in which care is provided, further reducing the need for large physical hospital locations and accentuating the development "from bricks to clicks." Based on these trends, we assume that, despite a possible temporary recovery due to some catch-up investments, the volume of new guarantees for WFZ will be at a structurally lower level in the coming years than before.

WFZ is adjusting to these developments by strengthening review checks on participating providers and through the increase in fees to 0.25% from 0.1%, which has had a positive impact on the financial performance. Hence, we expect an average operating income of about €2.5 million (40% of revenues) over 2018-2020, compared to €1.7 million in 2017, provided that no further guarantees are called.

WFZ posted an operating income of €1.7 million (27% of revenues) at year-end 2017, following an operating income of €0.9 million (16% of revenues) in 2016. We believe that WFZ will continue to post surpluses in the next few years thanks to lower guarantee costs and increasing discount fees. As a result, we expect WFZ to report an operating income of €2.7 million by year-end 2020.

WFZ's three-tier security structure reflects the almost certain likelihood of support from the Dutch government. Firstly, if healthcare providers become unable to service their debt, and creditors call on the WFZ guarantees, then WFZ has some capacity to meet these demands from its cash and investments. WFZ maintains conservative criteria for its investments, with 'AAA' rated entities accounting for 62% of the total portfolio in 2017, while adhering to a strict policy of no exposure to equities. We consider that WFZ has strong internal liquidity; at year-end 2017, it held cash and investments of about €303 million. WFZ has a history of generating positive cash flows, and we generally expect this to continue. Another positive liquidity feature is the regular redemption profile of its investments.

Secondly, if WFZ's reserves were to fall below 0.25% of guaranteed debt, under the terms of the guarantees it provides, all the participating healthcare providers are obliged to provide WFZ with interest-free loans up to 3% of their respective guaranteed debt until reserves again exceed 1% of guaranteed debt measured at year-end.

Thirdly, if, despite this, WFZ's reserves still fall to less than 0.25% of the total guaranteed amount, Netherlands has an obligation to provide unlimited interest-free loans to increase reserves up to the 0.25% level. According to

the terms of the documents, the government must do this by the 15th day of the second month after the 0.25% level is breached. In practice, however, based on our discussions with the government and our analysis above, we consider it almost certain that the government would be willing to act as quickly as necessary to allow WFZ to honor its guarantees as agreed.

Outlook

The stable outlook on WFZ reflects our outlook on Netherlands.

We would lower the rating on WFZ if we were to downgrade Netherlands. Alternatively, we would lower the rating if we were to change our assessment of the likelihood of timely and sufficient extraordinary support from the government.

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 Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, May 18, 2018

Ratings List

Ratings Affirmed

Waarborgfonds voor de Zorgsector	
Issuer Credit Rating	AAA/Stable/--

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