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Nederlandse Waterschapsbank N.V.

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Nederlandse Waterschapsbank N.V.

SACP	a+
Anchor	bbb+	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Strong	+1
Funding	Average	0
Liquidity	Adequate	

+

Support	+4
ALAC Support	0
GRE Support	+4
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
AAA/Stable/A-1+

Major Rating Factors

Strengths:	Weaknesses:
• Almost certain likelihood of extraordinary support from the Dutch Ministry of Finance. • Extremely strong capital base. • Focus on low-risk Dutch public sector lending, supporting strong asset quality.	• Limited business diversification, with business prospects dependent on Dutch public sector funding needs. • Moderate capital generation due to low lending margins and exposure to capital markets volatility.

Outlook: Stable

The stable outlook on Nederlandse Waterschapsbank N.V. (NWB Bank) reflects that on The Netherlands (AAA/Stable/A-1+). As long as we consider support from the Dutch government to be almost certain, and provided the bank maintains an adequate financial standing, the long-term issuer credit rating on NWB Bank is unlikely to diverge from that on the sovereign. Any rating action on The Netherlands would therefore likely result in a similar rating action on NWB Bank. That said, we expect NWB Bank's financial profile to remain resilient over the next two years even during the macroeconomic downturn resulting from the COVID-19 pandemic.

We could downgrade NWB Bank if we were to take a similar action on The Netherlands. We could also lower the ratings over the next two years if we saw a reduced likelihood of support from the Dutch government toward other majority-owned sectors. This could happen if the bank's role for the Dutch government diminished, for example following a sharp increase in competition; or if we considered that the bank's link with the government had weakened.

Rationale

NWB Bank is one of two historical local government funding banks in The Netherlands. It is publicly owned, fully regulated, and provides credit to local and regional governments, water authorities, housing associations, and the healthcare sector, among others.

This public mandate, as well as the combined ownership by domestic water authorities (81%), The Netherlands (17%), and Dutch provinces (2%), underpin our view that the bank is a government-related entity (GRE) and the Dutch government will continue to provide NWB Bank with ongoing and extraordinary support, if needed. Therefore, we equalize the long-term issuer credit rating on the bank with the sovereign credit rating on The Netherlands.

Our 'a+' stand-alone credit profile (SACP) on NWB Bank captures our view of the bank's creditworthiness excluding extraordinary government support. It is one of the strongest banks among those we rate in The Netherlands, driven by its long-standing stable franchise in a niche market, very high capital base, and low credit risk. Government ownership also allows the bank to benefit from very low funding costs--an essential part of the business model given the low asset yields.

Anchor:'bbb+' for a commercial bank operating only in The Netherlands

We use our Banking Industry Country Risk Assessment (BICRA) economic and industry risk scores to determine a bank's anchor--the starting point in assigning an issuer credit rating. The anchor for a bank operating only in The Netherlands is 'bbb+'.

NWB Bank is not a commercial bank like those that dominate the domestic market--ING, ABN AMRO, and Rabobank. It has a different business focus and clientele and the economic risks it faces differ to those the commercial banks face (real estate risk, credit bubbles, or other types of imbalances). Still, the strong public finances as well as the wealthy, diversified, and open nature of the Dutch economy are features that reinforce the creditworthiness of the sovereign. Ultimately, the credit quality of most of NWB's public-sector borrowers depends on the strength of the sovereign and of the economy as whole.

Our assessment of industry risks for NWB Bank essentially incorporates the depth of the domestic capital market and the Dutch authorities' good track record in providing liquidity support. It also captures the benefits of being a regulated entity, supervised, like any other domestic bank, by the relevant banking authorities and therefore being subject to deep control of credit, market, and operational risks.

Table 1

Nederlandse Waterschapsbank N.V.--Key Figures

	--Year ended Dec. 31--				
(Mil. €)	**2019**	**2018**	**2017**	**2016**	**2015**
Adjusted assets	96,200	83,712	87,121	94,412	91,311
Customer loans (gross)	52,663	50,287	50,302	50,896	52,043
Adjusted common equity	1,790	1,702	1,622	1,502	1,396
Operating revenues	174	186	218	193	171
Noninterest expenses	49	49	48	44	39

Table 1

Nederlandse Waterschapsbank N.V.--Key Figures (cont.)					
	--Year ended Dec. 31--				
(Mil. €)	**2019**	**2018**	**2017**	**2016**	**2015**
Core earnings	87	100	123	107	95

As per our calculations, the core earnings figures exclude any extraordinary item. The respective value as of year-end 2019 excludes the extraordinary gain resulting from the release of part of the pension provision, net of taxes

Business position: Franchise stability counterbalanced by business and geographic concentration

Our assessment of NWB Bank's business position is supported by its historical and stable franchise as one of the two major lenders to the Dutch public sector. While its low-risk customer base and niche market position should support NWB's earning capacity through the credit cycle, the business and geographical concentration inherent in its business model poses some risks as well, in our view.

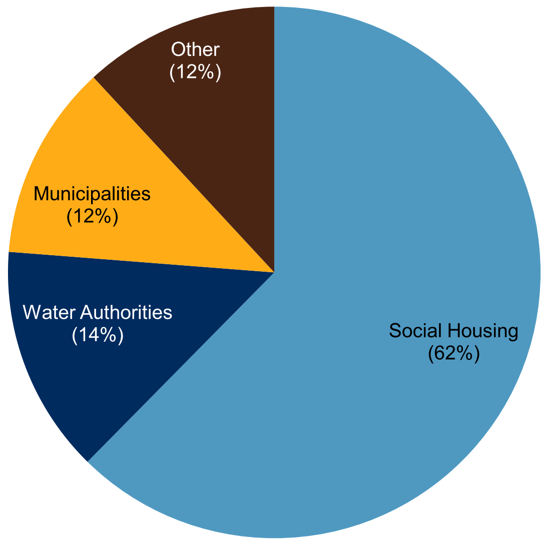
NWB's strategy remains centered on its exclusive Dutch public financing mandate. It is part of a framework that aims to minimize the cost of financing to the public sector, while complying with regulatory requirements and achieving a reasonable return for the shareholders. In this regard, we understand management's intention is to pursue a minimum return-on-equity target over time, for example set at 5.4% for 2019, despite its status as a not-profit-maximizing public bank.

NWB's business model prevents excessive risk-taking by maintaining a clear mandate in areas of low-risk and long-standing expertise and therefore revenues are very predictable. Further, as long as we consider the financing role of NWB Bank to be pivotal for the Dutch government--with a positive impact on the bank's cost-of-funding--the bank's business model is likely to remain largely shielded from competition, other than from the other major public lender, BNG Bank N.V. This is mainly because competition from commercial banks in these segments will remain modest due to the low asset margins and because most of the bank's clients have limited or no direct access to capital markets.

As of year-end 2019, the bank's customer loan portfolio stood at €52.6 billion, according to our calculation, about 4.7% higher year-on-year. The rise in lending activity mainly follows the increased financing needs of the bank's customer base. In particular, we understand the water authorities' intention to increase their annual investment targets to cope with the consequences of climate change; housing associations have also been increasing their investments to make their housing stock more sustainable, on the one hand, and to address the shortage of supply in the Dutch housing market on the other.

Chart 1

NWB's Loan Portfolio Composition (2019)



Social housing entities dominate NWB Bank's loan portfolio and represent 63% of the bank's total loans. Water authorities and municipalities follow, each accounting for 14% and 12%, respectively, of NWB Bank's €52.5 billion loan book. We do not expect this portfolio composition to change substantially in the next two years, which will benefit the bank's strong asset quality.

Over the past few years, the bank has started to invest in different asset classes, such as public-private partnerships or government-guaranteed export credit financing. It has also implemented the financing of renewable energy and green government-guaranteed projects to further diversify its loan book. However, we expect this type of investments to constitute up to a maximum 10% of the whole portfolio over time.

After years of no, or low, growth we expect the bank's business prospects to remain dynamic over 2020-2022. Specifically, we estimate that NWB's customer loan portfolio may grow by a further 7% cumulatively, with the great majority of growth concentrated in 2020. This reflects our view of a potential further increase in Dutch public sector funding needs this year, on the back of public measures to support Dutch private sector creditworthiness amid the COVID-19 macroeconomic shock.

Table 2

Nederlandse Waterschapsbank N.V.--Business Position					
	--Year ended Dec. 31--				
(%)	2019	2018	2017	2016	2015
Return on average common equity	5.4	6.0	7.8	7.4	7.0

Capital and earnings: Very high capitalization

The bank has historically displayed very high capital ratios, and this prudent capital management is unlikely to change.

At year-end 2019, our risk-adjusted capital (RAC) ratio stood at 30.8%, compared with a 38% at end-2018. We expect NWB's RAC ratio, before diversification adjustments, will remain well above 15% in the next two years.

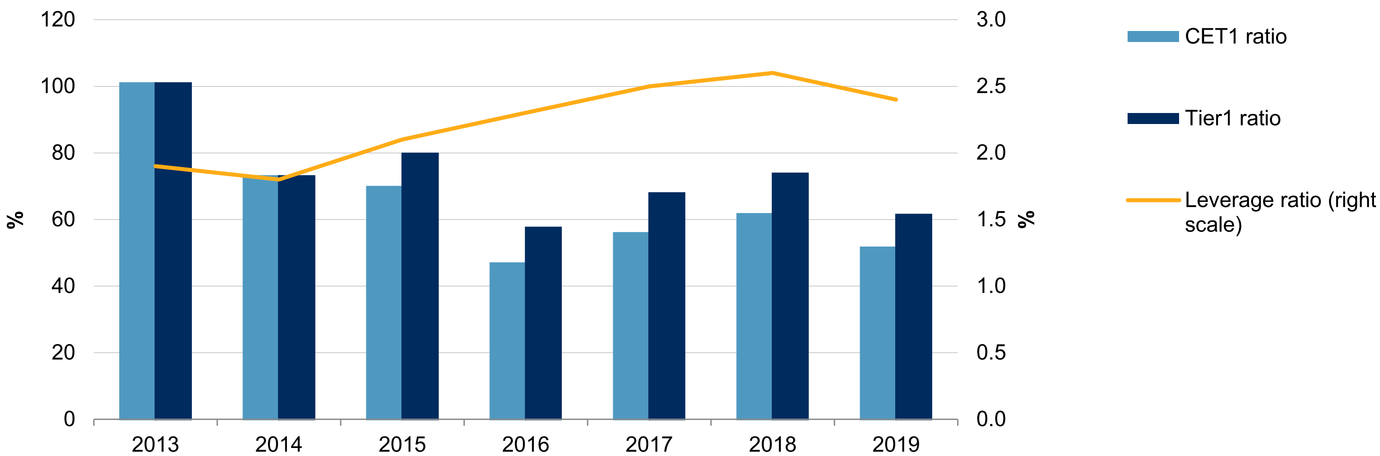
We base our RAC ratio projections on expected steady earnings of about €70 million-€80 million per year over the next two years (compared to €95 million in 2019), and on increasing risk-weighted assets (RWAs), reflecting the bank's further expansionary activity. In particular, we include in our forecasts for the next two years an outstanding loan book growing about 7% in 2020-2022, net interest margin of around 36-34 basis points (bps) through 2020-2022 according to our calculation (compared to 38 bps at end-2019), and a cost-to-income ratio averaging 30%-32% through 2020-2022.

NWB Bank fully hedges interest rate risk and foreign exchange risk through derivatives, and all counterparties are large financial institutions or pension funds. We note that the balance sheet is subject to some volatility stemming from interest rate risk and foreign exchange rate fluctuations, which directly affects our capital metric. However, this volatility will not lead the bank's capital ratio to drop below our 15% threshold, nor will it change our very strong assessment of NWB Bank's capital.

Typical for banks with a large balance sheet comprising low-risk assets, meeting Basel III leverage ratio requirements would be more challenging for NWB Bank than meeting the capital ratio requirements, which are based on RWAs. As of Dec. 31, 2019, NWB Bank registered a Basel III leverage ratio of 2.4%, which is below the 3.0% requirement for commercial banks. However, in 2019 the European Parliament agreed that a special definition of leverage ratio calculation applies to promotional banks, like NWB. According to this calculation, NWB's leverage ratio stood at 15.4% (compared to a low 2.4% resulting from the traditional calculation method).

Chart 2

Evolution Of NWB Bank's Solvency And Leverage Ratios



NWB's leverage ratio was 15.4% as of year-end 2019, according to the revised definition applied to promotional banks.

Earnings are fairly stable, but undiversified. Recurring interest income represents most of NWB Bank's total operating revenues, although results from financial transactions can affect the bottom line. The bank benefits from a highly competitive cost-to-income ratio because of its low structure and reduced staff costs and cost-of-risk. We expect this parameter to remain immaterial for the bank, although we cannot exclude that the current macroeconomic shock may negatively affect some of bank's outstanding relationships. Specifically, we refer to public-private partnerships or utility companies.

Table 3

Nederlandse Waterschapsbank N.V.--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
Tier 1 capital ratio	61.0	74.0	68.0	58.0	79.8
S&P Global Ratings' RAC ratio before diversification	N/A	N/A	37.1	33.2	43.1
S&P Global Ratings' RAC ratio after diversification	N/A	N/A	23.7	23.7	28.2
Adjusted common equity/total adjusted capital	84.8	84.2	83.5	82.4	87.5
Net interest income/operating revenues	122.4	125.8	126.6	113.0	105.3
Market-sensitive income/operating revenues	(22.4)	(25.8)	(26.6)	(13.0)	(5.3)
Noninterest expenses/operating revenues	28.2	26.3	22.0	22.8	22.8
Preprovision operating income/average assets	0.1	0.2	0.2	0.2	0.1
Core earnings/average managed assets	0.1	0.1	0.1	0.1	0.1

N/A--Not applicable.

Table 4

Nederlandse Waterschapsbank N.V.--Risk-Adjusted Capital Framework Data

(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government & central banks	82,656.0	27.0	0.0	2,355.0	2.8
Of which regional governments and local authorities	74,304.0	27.0	0.0	2,353.1	3.2
Institutions and CCPs	12,825.2	460.0	3.6	672.0	5.2
Corporate	3,282.0	1,675.0	51.0	2,461.5	75.0
Retail	0.0	0.0	0.0	0.0	0.0
Of which mortgage	0.0	0.0	0.0	0.0	0.0
Securitization§	424.0	85.0	20.0	84.8	20.0
Other assets†	19.0	19.0	100.0	21.4	112.5
Total credit risk	99,206.2	2,266.0	2.3	5,594.6	5.6
Credit valuation adjustment					
Total credit valuation adjustment	--	637.5	--	842.5	--
Market Risk					
Equity in the banking book	0.0	0.0	0.0	0.0	0.0
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	0.0	--	0.0	--
Operational risk					
Total operational risk	--	373.1	--	406.9	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	3,276.6	--	6,844.0	100.0
Total Diversification/ Concentration Adjustments	--	--	--	3,439.9	50.3
RWA after diversification	--	3,276.6	--	10,283.9	150.3
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		2,010.0	61.3	2,110.0	30.8
Capital ratio after adjustments‡		2,010.0	61.3	2,110.0	20.5

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2019', S&P Global Ratings.

Risk position: The bank is likely to maintain its conservative risk profile

Our assessment of NWB Bank's risk position reflects its continued focus on low-risk lending issued to, or guaranteed by, public authorities. Government risk dominates the portfolio, which as of Dec. 31, 2019 comprised: 65% social housing, 14% water authorities, 12% municipalities, and 4% health care. Another government-related entity (WSW) guarantees longer term lending to social housing associations, and Waarborgfonds voor de Zorgsector (WfZ) guarantees longer term lending to health care institutions. The central bank considers these exposures to be equivalent to sovereign risk, resulting in a 0% risk weight. We anticipate that new non-solvency free production--such as renewable energy, public-private partnerships, or lending to utility companies--will remain limited and will not materially change the underlying risk of the global portfolio. We also note that the bank has not suffered loss of principal or made loan loss provisions, and that its liquidity portfolio comprises highly rated securities. We expect these aspects to remain broadly supportive of NWB Bank's strong risk position.

Cross-currency swaps fully offset foreign-exchange risk stemming from the bank's foreign currency issuance. NWB Bank has a sizable €145 million notional derivatives portfolio as of Dec. 31, 2019. The bank resorts to interest-rate swaps and cross-currency swap instruments for hedging purposes only, which is inherent to its business model and risk management. NWB Bank mitigates its counterparty credit risk by dealing exclusively with highly rated counterparties and by having a credit support annex with all counterparties. The bank has centrally cleared all new clearable swaps since May 2016.

We note that the bank's business model depends on continued access to low-cost liabilities given the structurally low yields on most of its assets. This creates a structural sensitivity to any negative market sentiment, particularly regarding Dutch sovereign risk.

Table 5

Nederlandse Waterschapsbank N.V.--Risk Position

	--Year-ended Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	4.7	(0.0)	(1.2)	(19.9)	(1.7)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	N/A	56.6	40.3	52.8
Total managed assets/adjusted common equity (x)	53.7	49.2	53.7	62.9	65.4

N/A--Not applicable.

We see social and environmental factors as relevant for our credit analysis of NWB Bank, especially if compared to commercial banks operating in the Dutch market. Our view stems from the bank's material involvement in financing the Dutch social housing sector and projects related to flood protection and water resources management. NWB Bank remains the main financing partner of Dutch water authorities, public bodies which carry huge responsibility for keeping the country dry and managing water resources. Historically, the bank's market share in this sector has been around 90%. We believe that its role as lender to these counterparties will become more and more publicly relevant, helping water authorities to adapt to the adverse effects of climate change.

Funding and liquidity: The bank is wholesale funded with limited reliance on short-term funding

We view funding as average and liquidity as adequate, despite NWB Bank's main funding and liquidity metrics, as per our calculations, being weaker than Dutch banking peers'. Its regulatory liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) stood comfortably above the minimum level as of year-end 2019, at 204% and 118%, respectively.

In line with public sector-focused peers, NWB Bank is entirely wholesale funded because it does not take deposits, which deprives it of a stable funding source. We calculate NWB Bank's stable funding ratio at 83.72% and broad liquid assets to short-term wholesale funding at 0.46x as of Dec. 31, 2019. However, unlike with other 100% wholesale-funded entities, we do not incorporate any negative rating adjustment in our assessment of NWB Bank's funding because we also factor qualitative factors into our assessment. NWB Bank enjoys a large and diversified investor base across markets, products, currency, and tenors. The bank is perceived in the market as a quasi-sovereign risk making it attractive to investors. The credit standing of the Dutch sovereign inevitably facilitates access to funding at relatively affordable cost. NWB Bank has also reinforced its investor base by raising €9.9 billion in 2019 of which a significant portion was from sustainable funding with an average maturity of 7.6 years. The amount of sustainable bonds as a percentage of the total amount of bonds on the bank's balance sheet was 20% at the end of 2019.The funding in 2019 was mainly raised in euros (67%) and U.S. dollars (27%).

We also consider that the bank's liquidity position is more resilient than our metrics imply, owing to its untapped European Central Bank facility and its large liquidity portfolio that comprises cash at the Dutch central bank and highly liquid securities. Lastly, unlike most commercial banks we rate, almost all of NWB Bank's loan book is solvency free and could be pledged as collateral at De Nederlandsche Bank in times of liquidity stress.

Table 6

Nederlandse Waterschapsbank N.V.--Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
Long-term funding ratio	63.9	62.9	65.3	66.1	45.2
Stable funding ratio	83.7	83.9	80.3	78.6	45.1
Short-term wholesale funding/funding base	28.7	29.3	27.2	26.5	48.6
Broad liquid assets/short-term wholesale funding (x)	0.5	0.6	0.6	0.5	0.2
Short-term wholesale funding/total wholesale funding	28.6	29.1	27.1	26.4	48.5

Support: Almost certain likelihood of support from the Dutch government

We equalize our long-term issuer credit rating on NWB Bank with the sovereign credit rating on The Netherlands. This reflects the support that we understand the bank receives from the Dutch Ministry of Finance, due to its public sector mandate and combined ownership by domestic water authorities (81%), the central government (17%), and Dutch provinces (2%). Water authorities in The Netherlands are decentralized public authorities with a similar legal status to municipalities. On average, they receive 5% of their revenues from the government and the rest from taxes that they can levy. We view NWB Bank as a GRE with an almost certain likelihood of timely and sufficient extraordinary government support.

We base our view on NWB Bank's:

- Critical role as one of the state's two public sector banks with a public policy mandate. In our view:
- --NWB Bank plays a vital role in providing low cost financing to the Dutch public sector, which is a top public policy goal;
- --Private sector commercial banks are typically willing to finance only a small part of the public sector's financing needs due to lower margins and increased illiquidity, and are not able to compete with the low-cost financing that NWB Bank provides;

- --In the absence of public sector banks, the government would likely have to finance the public sector directly; and
- --NWB Bank's interlinkages with other entities (for example, WSW) that benefit from government guarantees increase the government's incentive to provide extraordinary support; and
- Integral link with the government, since we consider the bank as an extension of the government. The bank's articles of association limit NWB Bank's ownership and lending activities to the public sector, which supports our view of the link between NWB Bank and the government. We note that although the government is not involved in the day-to-day running of the bank, it maintains close oversight over the bank's strategy and capital policy.

Nevertheless, we will monitor ongoing development in the Dutch social housing sector in case the state does not provide additional support to other Dutch GREs.

Our assessment also factors in the EU's Bank Recovery and Resolution Directive (BRRD). Our longstanding view is that the BRRD does not appear to prevent the Dutch government, in its capacity as existing shareholder of a bank, from granting support to Dutch-domiciled GREs in going-concern situations--even if the GREs are subject to BRRD. That said, in a gone-concern scenario, the BRRD could prevent the government from injecting capital into some GREs to correct an acute solvency problem without first bailing in senior liabilities.

Additional rating factors:None

No additional factors affect the ratings.

Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- The Netherlands Ratings Affirmed At 'AAA/A-1+'; Outlook Stable, Nov.16, 2018
- Dutch Social Housing Guarantee Fund WSW Outlook Revised To Negative; 'AAA' Rating Affirmed, July 20, 2018
- Banking Industry Country Risk Assessment: The Netherlands, June 11, 2018

- Various Dutch Bank Outlooks To Positive On Receding Economic Imbalances In The Netherlands, Sept. 15, 2017

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	**3**	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	**bbb+**	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of June 30, 2020)*

Nederlandse Waterschapsbank N.V.	
Issuer Credit Rating	AAA/Stable/A-1+
Certificate Of Deposit	
Local Currency	A-1+
Commercial Paper	
Foreign Currency	A-1+
Senior Unsecured	AAA
Short-Term Debt	A-1+
Issuer Credit Ratings History	
24-Nov-2015	AAA/Stable/A-1+
27-May-2015	AA+/Positive/A-1+
02-Dec-2013	AA+/Stable/A-1+
Sovereign Rating	
Netherlands	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.