Qivalio

Comments related to the social housing providers credit rating methodology

Qivalio's credit rating methodology was available for comments on Qivalio's website from the 16th of March-2020. The agency promoted this new methodology mostly via email and phone. The team in charge of the methodology received and discussed its methodology with different actors comprising two persons from the industry with financing managing position, a financial advisor to the French social housing providers which include advise on the CRA selection process, an asset manager dedicated to the public sector as well as a senior banker working in the bond department of a French leading bank. Qivalio believes to have collected sufficient feedbacks and deep discussions to validate its credit rating methodology.

The material points of discussions are stressed below and their integration in the final version of the rating methodology is highlighted when it led to changes into the final version. The comments related to wording or explanation of our methodology in greater details are not reported into this document as they are deemed as not meaningful. Furthermore, it should be noted that the methodology was draft after having already discussed with people working in this sector and different from the ones whose feedback was collected. The early discussion involved people with senior position in small and intermediate social housing providers as well as people with managing position in the leading bank of the French social housing providers. The methodology was also made feasible thanks to Qivalio's longstanding experience in corporate credit rating as well as on longstanding experience on credit opinions for real estate investment and development company.

Financial metrics

Q: Are the factors computed on historical performance or on forecast

A: The ratios used in the financial risk are intended to be based on our projections for the next 6 or 18 months depending on the date of the calendar. The ratios of vacancy and cost of bad debt are by nature difficult to forecast and as such Qivalio will give priority to the most recent ratios communicated by the operators. The selection of the ratios remains the decision of the rating committee. As such, in the event of significant changes in the scope of activity, the rating committee could consider to use proforma ratio in order to better reflect the underlying performance. This for instance will be the case in the event of significant cash-outflow related to acquisitions or extraordinary capex while the acquired asset will not have fully contributed to the annual profitability.

Q: Why the methodology does not consider any LTV ratio? Is it a criterion you will be assessing?

A: The inclusion of an LTV ratio in the methodology was long debated within Qivalio. It is an important criterion in real estate investment and an important indication of the financial strategy, risk appetite of an issuer. However, Qivalio decided not to include this criterion directly in its methodology for diverse reasons. First, the external appraisal of the asset is often not available. Secondly, the recourse to an LTV computed on accounting or historical valuation of the real estate asset is also subject to distortions given that (i) the annual accounting depreciation of the assets may not reflect accordingly the economic depreciation or appreciation of the value of the assets and (ii) we would reasonably expect that a significant portion of assets built in the 1970-1990's will contribute to profitability but would be fully amortized, and as such would be excluded from the assets value computation used in the historical LTV. Thirdly, Qivalio estimates that the monetization of existing assets is more complex than the monetization of traditional residential assets especially the monetization of the more social assets. In our discussions, we realized that the monetization of intermediary housings is likely to be more feasible and their drivers are not as much dependent on the regulation. Consequently, we amended our methodology stating that in the event that a provider would own a significant proportion of unregulated intermediary assets, we may consider the inclusion of a LTV ratio for these assets or even decide not to apply the social housing methodology in the event the regulated activity would not be considered as material.

Q: What level of financial leverage ratio do you consider in your methodology?

A: The details of the grid is considered as confidential and was not disclosed. Nevertheless, our leverage ratio is not commensurate with the level that are seen in the traditional corporate sector for which Qivalio has a longstanding experience. The reason why leverage differs from the corporate grid is that the sector is by nature very capital and debt intensive. In this sense, it is common to see private people to borrow in between 75% to 100% for the purchase of residential assets. The significant visibility provided by the regulation made also possible the recourse to higher leverage. The financial leverage was a recurrent point of discussions and we consider that our vision and methodology was not subject to potential amendments.

Portfolio attractiveness

Q: How do you assess the attractiveness of the portfolio

A: Qivalio defines the attractiveness through 3 sub-factors: the regional attractiveness, the energy efficiency and the size of the portfolio. The regional attractiveness was long debated with one of our commentators. We agreed that this was a key factor in assessing social housing providers as providers with significant assets located in an area with a lack of supply (stressed area) are perceived as less risky than actors with significant reliance in an area with oversupply (unstressed area). Stressed area usually characterized an attractive area with a low unemployment, positive demography and low vacancy. The demographical factor was not assessed a criterion in our methodology while it was perceived by a commentator as a key factor in assessing the portfolio attractiveness. Qivalio believes the regional social vacancy rate is good proxy to assess the regional attractiveness of a portfolio but also agrees that dynamic of the demography is a good proxy. As such, Qivalio amended its final version stated it believes the regional demography evolution is a good proxy to estimate the regional attractiveness and may used this factor, if it believes it is appropriate.

State support

Q: How do you factor the eventual support from the State and is there any linked with the ownership structure?

A: The sector is characterized by different legal incorporation of the social housing providers which lead to a more or less direct governmental ownership. As such, some kind of incorporations are more favourable for public intervention, even though which public organ will intervene when and how is we believe subject to debate. As such, Qivalio believes a qualitative analysis of the situation is more appropriate. Furthermore, the default in the sector is rather low; the institutional environment in place allows to take appropriate actions with a limited number of actors involved making the restructuring easier. We have been asked if the direct or indirect ownership will affect the estimated support. As stated in its methodology, Qivalio believes that the potential support would not be driven by the ownership structure but rather by the systemic risk implied.