EthiFinance Ratings

Social Housing Providers Rating Methodology

1 FRAMEWORK AND DEFINITION

This document provides an overview of EthiFinance Ratings' credit rating process (including rating initiation and rating monitoring) and credit rating methodology applied to Social Housing Providers. This document aims to explain how EthiFinance Ratings assesses the credit risk related to Social Housing Providers with a specific focus on the French sector.

1.1 Social Housing Providers rating

EthiFinance Ratings' credit ratings indicate an issuer's credit quality. In order to determine this, EthiFinance Ratings analyzes various factors, including the activity framework profile, the portfolio attractiveness, the rental risk profile, the financial profile, and the expected support from the public sector in which the provider operates. This rating methodology applies for operators with significant reliance on regulated housings. Should the degree of reliance on regulated houses be less preponderant, the rating committee may consider in its analysis additional factors, such as LTV, or even decide to apply the corporate methodology in the event the proportion of regulated rents would not be considered as material.

When determining an issuer's rating, EthiFinance Ratings performs both an historical analysis of the financial data as well as a forward-looking analysis using qualitative and quantitative information. The forward-looking analysis factors in the potential impact of risk factors which have been identified during the analysis and which may have an impact on the credit metrics of the provider.

EthiFinance Ratings' credit ratings are assigned assuming a single corporate entity and a single class of debt, regardless of structural or contractual considerations. Consequently, our ratings apply to consolidated groups for which audited consolidated accounts are available. Debt located at a level above the consolidated group may be factored in on a case-by-case basis. In the event that EthiFinance Ratings considers that the consolidated figures would result in material distortion, EthiFinance Ratings may adjust the historic data and its financial forecasts to reflect an economical approach closer to reality. In the event of material adjustments resulting from EthiFinance Ratings' approach, the report underlines the rationale behind the adjustments. The rating may also apply at an individual level in the event that the provider does not own any subsidiaries, or these have an insignificant impact on the Company's financials should the subsidiaries be consolidated.

1.2 Social, Environmental and Governance aspects

EthiFinance Ratings believes that extra-financial risks linked to environment, social and governance (ESG) are an integral part in assessing the creditworthiness of an issuer. The rating grid for Social Housing Providers takes into consideration some specific ESG factors:

- Concerning the environment, one of the sub-factors assesses the energy consumption of the housing. Energy consumption is a key environmental indicator with direct impacts on carbon emission. Currently, there is a strong governmental incentive to improve the energy efficiency of housing. In addition, it is also a key credit factor having impacts for instance on future capex requirements and running charges for tenants. Furthermore, production costs in France are

currently rising on the back of land price inflation and the raising of construction standards.

- The social aspect is at the heart of the Social Housing sector. The importance of social housing in the sustainability and stability of a given country is reflected, among other qualitative factors, into the score of our activity framework profile. For France, there is a significant proportion of social housing in the overall housing and rental housing markets. Social housing has been established in France for a long time and is at the forefront of the French welfare state, which in turn is a key aspect of the French economy, providing strong interior demand and stability. As such, we consider in France the social aspect, along with its well-structured regulation, as a strong credit enhancement.
- Concerning governance, one of our sub-factors includes an assessment of the strategy and financial policy. This sub-factor pays attention to the independence of the board, and the regularity of board & executive meetings and review of budgets. EthiFinance Ratings has a longstanding experience in the analysis of corporate transparency & governance, the principles of which can be applied to Social Housing Providers.

In all cases, should the assessment of the ESG criteria raise strong risk concerns, the rating committee may decide to downgrade the standalone and/or the final rating. In this case, the report will detail the rationale behind the rating committee's decisions.

2 RATING METHODOLOGY

2.1 Methodological approach

The approach to rating the credit quality of Social Housing Providers relies on a standalone credit rating and a consideration of the estimated strength of the support from the public sector, in particular from the government and local authorities. The standalone credit rating reflects the intrinsic credit quality of a Social Housing Provider. The estimated support is the assessed likelihood that the State or local authorities would intervene to support the financial position of a provider. Depending on the estimated strength of the support, the final rating is more or less close to the sovereign rating. EthiFinance Ratings' reports disclose the standalone rating, the strength of the estimated support, and the final credit rating.

The standalone rating assigned by EthiFinance Ratings is based on an analysis of a mix of qualitative factors (activity framework profile, portfolio attractiveness, and the strategy & financial policy) and quantitative factors (historical and projected credit metrics, current rental risk). Each factor analyzed by EthiFinance Ratings is divided into sub-factors. The standalone rating is the weighted average rating of each sub-factor.

Certain specific credit considerations may subsequently cap the standalone rating at a lower level than originally envisaged. These include among others: specific regional risk, liquidity profile, transparency, and governance. These considerations are exceptional and subject to the rating committee's decision. In the event that the standalone rating is capped, the rationale behind the decision is stated in the rating report.

EthiFinance Ratings' final credit ratings are computed from the standalone rating and the estimated strength of the external support. The approach differs depending on the estimated strength of this

support.

EthiFinance Ratings' Credit Rating Assessment		
20%	Activity framework profile	Institutional environment Regulatory framework
30%	Portfolio attractiveness	Regional social real-estate attractiveness Portfolio energy efficiency Social real estate portfolio size
15%	Rental risk	Vacancy Cost of bad debt
35%	Financial factors	Operating margin Cash-flow capacity Leverage Strategy & financial policy

100%

Strength of the Public Support	
Strong	Financial rating up to three notches below the sovereign rating
Weak	Final rating in between the standalone rating and the sovereign rating
Absent	Standalone rating

2.2 EthiFinance Ratings' standalone rating assessment

2.2.1 Rating factors: Activity framework profile

EthiFinance Ratings assesses the activity framework profile of an issuer based on a number of qualitative factors. The assessment is comprised of two layers of analysis: (1) the institutional environment, and (2) the regulatory framework. Note that the institutional environment and regulatory framework scores are equal for all the providers of a given country. A change in either layer could result in an adjustment of the assessment. However, EthiFinance Ratings does not anticipate material changes to the short or medium-term assessments in the activity framework profile that would result in any upgrade or downgrade for these sub-factors. For each layer, EthiFinance Ratings has developed a qualitative, detailed range of analysis from AAA to CCC-. The scope of analysis provides the rating committee with a wide range of possible gradings derived from a methodological and structured approach.

2.2.1.1 Institutional environment

The institutional environment reflects the institutions in place to regulate and monitor the sector as well

as their independence. The clear distinction and separation of activities (legislator, regulator, funding…) with the presence of independent actors result in better monitoring of the sector and risk identification. As such, an environment with actors under strict banking rule regulation will typically provide greater comfort and stability to the sector. An environment with no clear distinction, typically an environment in which the entity in charge of monitoring has strong dependency links with the entities/sector it controls, may be subject to conflict of interest and will rank lower in our rating. Likewise, an environment in which there is no clear distinction between the legislator and the regulator will bring greater risk of conflicts of interest impacting the monitoring of the sector, which could lead to greater credit risk.

In the case of French providers, the assessment of the institutional framework results in an AA grade. EthiFinance Ratings' assessment of this criteria reflects the independence of the Agence Nationale de Contrôle et du Logement Social (ANCOLS), or national agency in charge of social housing monitoring, the regulator. The regulator reports to the economy ministry as well as to the ministry of the city and housing. The regulator is independent from the legislator. The ANCOLS produces an annual report of activity as well as a specific Social Housing Provider report, which are available online. The ANCOLS aims at controlling 90% of the Social Housing Providers over the medium-term and an audit of all the most significant providers. The ANCOLS is under the supervision of the Court of Auditors (Cour des Comptes), the supreme body for auditing the use of public funds in France. The Court is independent from the Government and Parliament. It has financial jurisdiction and is in charge of auditing, issuing rulings, and certifying the State and social security accounts, as well as contributing to the evaluation of public policies. The financing of the sector mostly relies on subsidized long-term loans from Caisse des Dépôts et Consignations (CDC), a state-owned financial institution operating under banking regulation. The Social Housing Providers make a mandatory annual financial contribution to the Caisse de Garantie du Logement Locatif Social (CGLLS), the guarantee fund for social housing, which acts as a mutual fund which may intervene in the event of financial difficulties, and which provides - in some cases – counter-guarantees to the CDC for its loans to the Social Housing Providers. The CGLLS is a public institution under banking regulation. The CGLLS contributes to the stability of the sector. The graph in the appendix to this report outlines the main players in the French institutional environment and the interactions between them.

2.2.1.2 Regulatory framework

In the case of French providers, the assessment of the regulatory framework results in an AA grade. The regulatory framework assessment outlines the stability of the activity, the visibility of revenues & cash-flow, the competitive environment, and the regulation in place.

The French Social Housing Providers sign an agreement with the French state which – among other conditions - requires them to rent their housings on certain terms (including price) to a specific population. In exchange, the Social Housing Providers have access to subsidized loans and benefit from tax reduction and state subsidies. The regulated housing rents are directly paid from the state to the Social Housing Provider, a strong credit enhancement for the operator allowing it to better control debtor risk. Social housing represents 17% of the total French housing market and is a significant contributor to the housing being constructed. There is a strong interest for the State to continue to support French social housing. French social housing is characterized by lower (around 20%) rental prices than in the private market. As such we consider that competition from the private market is low, and this is reflected in a low national vacancy rate of 2.9% for social housing.

2.2.2 Rating factors: Portfolio attractiveness

2.2.2.1 Regional social real estate attractiveness

The regional social real estate attractiveness is an important risk factor and is captured by the weighted regional social housing vacancy rate. The aim of this sub-factor is to capture the degree of exposure of the asset portfolio to stressed/unstressed market. This degree is a good proxy for regional economic attractiveness. Typically, a provider with a significant reliance on a rural area with low social real estate attractiveness will rank lower than a provider with a social real estate portfolio based in a large and dynamic urban area. A provider could have a low vacancy rate in a depressed area which over the long term may be difficult to maintain as another local provider could offer more competitive rents. The portfolio could also be exposed to greater competition from the private housing market, which could offer competitive rents with more attractive assets. Overall, Social Housing Providers are subject to regional policy decisions and related urban policy, all the more so in the event these providers have a close or similar ownership. If appropriate, the regional social vacancy rate may be replaced by the regional demographic evolution which we believe is a good proxy of the regional attractiveness.

2.2.2.2 Portfolio relative energy efficiency

EthiFinance Ratings uses the Diagnostic of the Energy Performance (DPE) to analyze the portfolio energy efficiency. This diagnostic is an estimate of the energy consumption of each housing unit. The housings are attributed a letter from A to G according to their efficiency. The DPE is realized by independent experts. EthiFinance Ratings estimates the average score from A to G of the portfolio. This score is then compared to the national average score for Social Housing Providers. Depending on the spread from the national score, the sub-factor results in an upgrade or a downgrade within the scale. We believe it is a critical factor as a portfolio of assets with a low score characterizes a portfolio which requires higher capex and high running charges for tenants. For clarity, EthiFinance Ratings only uses the report related to energy consumption and not the report related to carbon emissions. EthiFinance Ratings believes that energy consumption is more credit risk-relevant than the carbon efficiency report given that carbon emission could be subject to the national energy mix. Furthermore, any State decision to change its energy mix via for instance the subsidies of certain energy assets (such as renewables) or amendment to its nuclear policy could have significant impacts on the carbon performance over time while one operator asset may have not changed materially. The rating committee may deem it more appropriate to compare the score for the regional performance or apply a discount. For clarity, in the event the rating relates to a non-French provider and in the event the national average is not available, the rating committee will consider whether it is relevant to compare it to France's average.

2.2.2.3 Social real estate portfolio size

The size of the portfolio is an important criterion as a greater size leads to a better diversification of assets and a better spread of the geographical risk with less reliance on specific assets. The greater size provides (or at least gives some headroom) for greater efficiencies & synergies, permitting the better absorption of fixed costs. A greater size provides also more visibility, an important feature in negotiations with local authorities.

2.2.3 Rating factors: Rental risk

2.2.3.1 Vacancy

Vacancy captures the attractiveness of the portfolio of a Social Housing Provider. The vacancy considered is the commercial vacancy over three months. As such, the vacancy does not consider the technical vacancy typically linked to maintenance, refurbishment, scrapping etc. A significant vacancy may indicate that the portfolio is not competitive (especially if the portfolio is based in attractive areas) and may result in lower profitability (reduction in revenues and unfavorable computation of charges) and result in a worse credit risk profile. In the analysis of the vacancy, EthiFinance Ratings pays attention to the spread of the vacancy. A vacancy rate characterized by a significant concentration in one or a few assets should be read differently than a vacancy rate which is spread across the whole portfolio. In the former case, the portfolio could be of high quality but impacted by one or a few poor assets, which we believe could be restructured/resolved more easily than a similar vacancy well spread across the portfolio. The potential adjustments are subject to rating committee decisions.

2.2.3.2 Cost of bad debt

Even though the State pays directly the rentals of regulated housing to the Social Housing Providers, there is still a credit risk derived from the fact that the State's contribution may not be sufficient to cover the full amount of the rental and rental charges. The cost of risk is the result of the addition of the bad debt and the provision for doubtful debt net of the reversal of doubtful provision. The result is divided by the income generated by the rental activity. A high cost of risk may indicate poor management with a lack of procedure for bad debt collection, a concentration of assets in complicated areas, or a relatively uncompetitive portfolio. In any case, it results in a worse credit risk profile.

2.2.4 Rating factors: Financial risk

EthiFinance Ratings assesses the financial risk based on ratios and qualitative factors. In order to capture the best picture of the credit risk, EthiFinance Ratings tends to include a number of adjustments which aim to capture the underlying recurring performance.

The ratios are based on an operating margin, cash-flow capacity, and leverage computed as follows:

Operating margin = (operating income – operating cost)/operating income

Cash-flow capacity = (net income – exceptional income + depreciation + net provision)/operating income

Leverage = net adjusted debt/EBITDA

The operating margin and cash-flow capacity are fundamental factors in determining a borrower's debt repayment capacity. Strong ratios highlight the capacity of the borrower to generate cash-flow which can be used to repay debt, invest in maintaining, and/or extend the portfolio, or to maintain a strong treasury position.

Leverage is based on a net debt-to-EBITDA ratio. The sector may benefit from very long-term subsidized

loans (from the CDC in France for instance) as well as the specific regulatory framework. As a consequence, the sector can support greater leverage than a typical private corporate or real estate private company. However, a provider with higher debt will still be considered as a higher risk. EthiFinance Ratings may adjust the debt of the provider with off-balance sheet items which are considered debt-like such as debt guarantees, securitization etc. Furthermore, EthiFinance Ratings may adjust net debt for hedging assets/liabilities which could be based on their mark-to-market value or their potential realistic value.

The financial factors also rely on the assessment of the strategy and financial policy. EthiFinance Ratings assesses the provider's cash-flow capacity and sustainability of its debt and how aggressive the development and funding are. As such, a provider with significant debt stemming from a recent social housing portfolio in a dynamic area could have a better score than a provider with moderate leverage but an old portfolio in a run-down area, which may require significant capex. EthiFinance Ratings also takes into consideration the provider's strategy, especially the intended development of the portfolio and the extent to which the provider has secured its resources (financial & human) to realize its intended development. For the assessment, EthiFinance Ratings takes into consideration the track record, governance, and experience of management, an analysis of budget and business plans, and risk appetite. The analysis also relies on past performance, EthiFinance Ratings' forecast, and discussions with management. EthiFinance Ratings has developed a detailed, qualitative range of analysis from AAA to CCC-. The scope of analysis provides the rating committee with a wide range of possible gradings derived from a methodological and structured approach.

2.3 Consideration of the State's support

EthiFinance Ratings' final rating considers the degree of expected support from the public sector. It is an important aspect as the sector benefits from large public funding and is considered to be at the center of the French social system, which is also a crucial feature of the French economy, an economy considered as resilient with relatively strong internal demand sustained by a specific social system. However, it should be noted that, currently, the government does not usually provide direct guarantees to the lenders of the social housing provider, although it is customary for local authorities to lend their guarantees to loans provided by the CDC for social housings located in their localities. However, the CGLLS is a fund in place to support the restructuring of providers within a specific framework of intervention, which is not systematic. EthiFinance Ratings also considers in its final rating indirect support from the public sector, which could be strong, weak or absent. The assessment of the support is the decision of the rating committee.

The considered sovereign rating is the second-best sovereign rating assigned to the government of France by rating agencies disclosed by Agence France Tresor (the entity in charge of managing the State's debt and cash) or any other available sovereign rating considered relevant by the rating committee. Depending on the estimated strength of the support, the approach to determine the final rating differs, leading to a final rating more or less close to the sovereign rating.

- Strong support can be characterized by expected direct financial intervention or specific subsidies from the State, or at the level of the region, or by specific measures to rescue a provider such as, but not limited to, real estate portfolio rotation or tie-up with a provider with a better risk profile. Strong support reflects the estimated systemic risk of a provider defaulting or strong

reputational damage for the State in the event it does not intervene. In this event, it is likely to be more beneficial for the government to provide support than not. In the event of strong support, the final rating could be upgraded in between the sovereign rating and up to three notches below.

- Weak support reflects an expectation of only weak intervention from the public sector. If EthiFinance Ratings believes that there is no systemic risk and that the impact of the limited support will result in a broadly neutral situation for the State or the region then it may assess the expected support as weak. The estimated weak support can result, but is not limited to, the size of the provider, controversial management & governance practices at the provider level with no systemic risk etc. Weak support is, however, not a total lack of support as the provider could still benefit from the support of municipalities, loan restructuring from CDC, or intervention by the CGLLS. In the event of weak support, the final rating is in between the standalone rating and the sovereign rating, depending on the rating committee's assessment of the strength of the expected support. In any case, the final rating could not be superior to the rating of a provider had government support been assessed as strong.
- In the event of absence of support, the final rating corresponds to the standalone rating.

In all cases, the final rating could be subject to exceptional adjustments from the rating committee. These adjustments may reflect certain key rating factors which are considered material for the Social Housing Providers to survive on a going-concern basis, may they be key factors to monitor the future performance of the Social Housing Providers, or factors which expose them to material event risks which are difficult to quantify through a grid and thus cannot be factored in otherwise. Furthermore, in the event there is a material difference between the sovereign rating and the standalone rating, the rating committee could consider it more appropriate to adjust the final rating, especially when strong support for the Provider is assumed. In the event of exceptional adjustments, the rating report will detail the rationale behind the rating committee's decisions. In all cases, the final rating is capped by the sovereign rating.