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# New Issue: Eiendomskreditt AS

## Norwegian Legislation-Enabled Mortgage Covered Bonds

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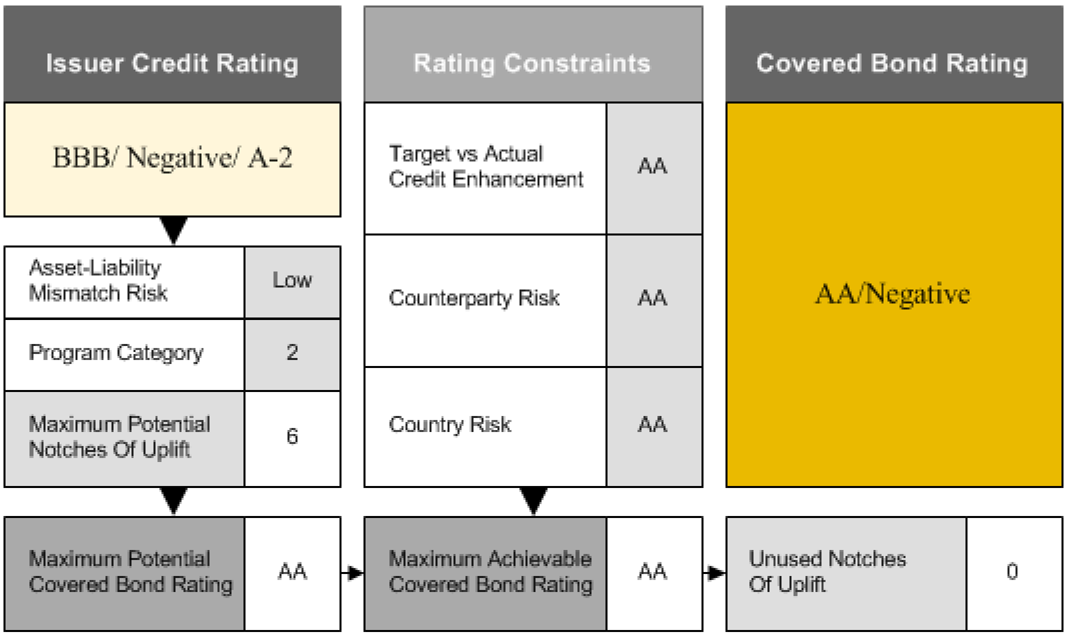
## Ratings Detail




## Program Overview

**Table 1**

| Eiendomskreditt AS Covered Bonds | |
|---|---|
| Jurisdiction | Norway |
| Covered bond type | Legislation |
| Underlying assets | Commercial mortgages |
| Outstanding covered bonds (bil. NOK) | 2.377 |
| Initial rating/year | AA/2014 |
| Extendible maturities | Yes |
| Target credit enhancement (%) | 24.78 |
| Available credit enhancement (%) | 27.71 |

*Based on data as of May 15, 2014. NOK--Norwegian krone.

## Major Factors

### Strengths

- A low weighted-average loan-to-value (LTV) ratio compared with the maximum permissible LTV ratio under Norwegian covered bond legislation, allowing the mortgage company to operate without losses since operations commenced in 1998.
- Low risk of asset-liability mismatch (ALMM).
- Available credit enhancement exceeds the target credit enhancement associated with the current rating level.

### Weaknesses

- According to our asset-liability mismatch criteria, there are no unused notches of uplift, meaning a downgrade of Eiendomskreditt AS would trigger a rating action on the covered bonds.

## Outlook: Negative

Our negative outlook on Eiendomskreditt AS' covered bonds reflects our negative outlook on the issuer Eiendomskreditt AS (BBB/Negative/A-2). Given that the 'AA' rating on the covered bonds is derived from a six notch uplift from the issuer credit rating (ICR), a downgrade of Eiendomskreditt's ICR would trigger a corresponding rating action on the covered bonds, all other factors remaining unchanged.

## Rationale

Eiendomskreditt's mortgage covered bonds are backed by a pool of Norwegian commercial loans.

From our initial analysis of the legal and regulatory framework for Norwegian covered bonds, we concluded that the cover pool's assets are isolated from the issuer's risk of bankruptcy or insolvency. This asset isolation allows us to assign a higher rating to the covered bonds than the issuer. We determined the covered bonds' maximum achievable rating by analyzing the cover pool's asset credit quality as of May 15, 2014, along with the payment structure, and cash flow mechanics.

We classify the program's ALMM risk as "low" and we have assigned the program to Category 2. Under our ALMM criteria, this allows a maximum uplift of six notches from the rating on the issuer.

Our analysis shows that the program's current available credit enhancement is 27.71%--greater than the 24.78% needed under our analysis to achieve an 'AA' rating.

In our opinion, the program's documentation fully addresses its counterparty risk exposure. Our current counterparty criteria therefore do not constrain our ratings on the covered bonds (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013). In addition, sovereign risk does not constrain the ratings because the mortgage assets are all in Norway, which we rate 'AAA'.

As a result of the above, we rate the covered bonds issued under the program 'AA'. Our methodology and assumptions for rating covered bonds are outlined in the criteria article "Covered Bond Ratings Framework: Methodology And

Assumptions," published on June 26, 2012.

## Program Description

Eiendomskreditt AS is a Norwegian covered bond company owned by 85 Norwegian savings banks. Eiendomskreditt provides residential mortgages and commercial real estate loans, mainly to customers in the five largest counties of Southern Norway and Trondheim. In addition to its geographic concentration, Eiendomskreditt is concentrated in the commercial real estate sector and has the highest share of loans to this sector compared with domestic Norwegian banks. Loans to commercial real estate and residential mortgages accounted for 66% and 30% of total lending at end-2013. We do not expect the geographic or sector concentrations to change significantly, although we expect an increase in the relative share of commercial real estate loans transferred from Eiendomskreditt's owner banks as Eiendomskreditt becomes a main funding entity for the group. The cover pool entirely comprises commercial loans.

**Chart 1**
**Eiendomskreditt AS Transaction Structure**

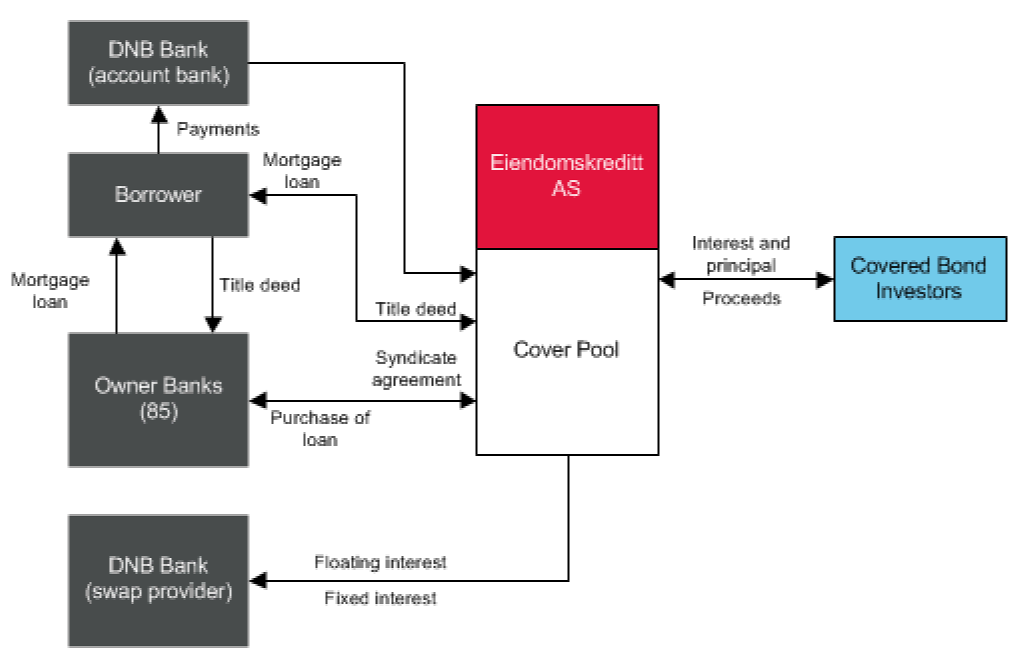


**Table 2**

| Eiendomskreditt AS Covered Bonds Participants | | | |
|---|---|---|---|
| **Role** | **Name** | **Rating*** | **Rating dependency** |
| Issuer | Eiendomskreditt AS | NR | |
| Bank account provider | DNB Bank ASA | A+/Stable/A-1 | Yes |
| Swap provider | DNB Bank ASA | A+/Stable/A-1 | Yes |

*We apply the potential notches of uplift to the long-term rating on DNB Bank ASA to derive the rating on the covered bonds. NR--Not rated.

## Issuer-Specific Factors

### Legal and regulatory risks

The Norwegian covered bond legislation was enacted in 2007, with accompanying amendments to the Financial Services Act and supplementary regulation from the Ministry of Finance. The legislation complies with the European Banking Authority's Capital Requirement Directive (CRD) and the Undertakings for Collective Investment in Transferable Securities (UCITS). This makes Norwegian covered bonds eligible for reduced risk weighting when calculating capital adequacy.

Eiendomskreditt's covered bonds are governed by Norwegian law. Specifically, the Financial Institutions Act encapsulates the main covered bonds regulation, and the Norwegian Ministry of Finance supports the regulations on mortgage credit institutions.

The legal framework's bankruptcy legislation requires the appointment of a cover pool administrator and gives investors a senior claim over the cover pool's assets. The legal framework restricts the type of business that mortgage credit instructions can engage in. It includes requirements on the cover pool's composition and the appointment of an independent inspector responsible for oversight and compliance of the cover pool.

In our legal analysis, we applied our European legal criteria and our criteria for rating covered bonds (see "Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance," published on Sept. 13, 2013).

From our initial analysis of the legal and regulatory framework for Norwegian covered bonds, we concluded that the cover pool's assets are isolated from the issuer's risk of insolvency, or from the insolvency of one of the owner banks.

Although the mortgage company engages in direct lending, there are a number of loans included in the cover pool originated under a syndicate agreement with an owner (agent) bank. For these loans, a syndicate agreement is entered into with Eiendomskreditt and a mortgage document and promissory note is issued in connection with the syndicate agreement. The relationship between Eiendomskreditt and the agent bank is primarily regulated by the syndicate and the Promissory Note Act, in addition to the Financial Institutions Act, the Financial Contracts Act, and the Satisfaction of Claims Act. This relationship has been reviewed in detail, as has the syndicate agreement setup. We have concluded that there is no additional risk associated with these loans, neither in the event of default of Eiendomskreditt or the agent bank.

Eiendomskreditt is not a deposit taking institution, and therefore set-off risk is not present for loans that are issued directly. However, as the agent bank involved in loans issued under a syndicate agreement do have deposits, we have reviewed the potential set-off risk associated with these loans. Our legal analysis has concluded that loans issued under a syndicate agreement are unlikely to present any additional set-off risk to the cover pool.

### Operational and administrative risks

Eiendomskreditt AS is located in Bergen and has 14 full-time employees, allowing the mortgage company to operate with low costs. Although the small pool of employees results in key man risk among the management team, this is mitigated to some extent by the broad experience of the team--the management of the company is experienced, all with 20 plus years of experience in the finance/banking sector. Further oversight of Eiendomskreditt's operations is provided by the board of directors, which includes executives from the owner banks that have the largest ownership share.

Eiendomskreditt focuses on origination in Southern Norway and focuses primarily on commercial lending. Despite the geographic and sector concentration, we consider Eiendomskreditt's underwriting process to be conservative, with LTV limits of 55% for commercial loans (less than the 60% specified in the legislation). This has allowed the mortgage company to operate without any losses since becoming operational in 1998. Furthermore, Eiendomskreditt performs its own credit analysis on all loans included in the cover pool, also for loans funded through a syndicate agreement.

We have not identified any operational or administrative risks that could affect our assessment of the program. Our analysis of operational and administrative risks follows the criteria in "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 26, 2012.

## Cover-Pool Specific Factors

### Asset credit quality

We have reviewed the updated asset information as of May 15, 2014. The cover pool contains commercial loans (94%) with low LTVs compared to their underwriting standards, as well as substitute assets (4.5%) and cash (1.5%).

**Table 3**

**Eiendomskreditt AS Covered Bonds Composition**

| | --May 15, 2014-- | |
|---|---|---|
| Asset type | **Value (mil. NOK)** | **Percentage of cover pool (%)** |
| Commercial mortgages | 2,849.38 | 94.01 |
| Substitute assets | 136.50 | 4.50 |
| Cash | 45.00 | 1.48 |
| Total | 3,030.88 | |

**Table 4**

**Eiendomskreditt AS Covered Bonds Commercial loans by Property Type**

| | --May 15, 2014-- | |
|---|---|---|
| Property type | **Value (mil. NOK)** | **Percentage of cover pool (%)** |
| Mixed commercial | 1,783.98 | 62.58 |
| Housing association | 415.42 | 14.57 |
| Private rental/multifamily | 407.45 | 14.29 |

**Table 4**

| Eiendomskreditt AS Covered Bonds Commercial loans by Property Type (cont.) | | |
|---|---|---|
| Office | 189.88 | 6.71 |
| Industrial/warehouse | 52.66 | 1.85 |

**Table 5**

| Eiendomskreditt AS Covered Bonds Key Credit Metrics | |
|---|---|
| | **May 15, 2014** |
| Average loan size (NOK) | 7,561,739.81 |
| Weighted average loan-to-value (LTV) ratio (%) | 40.67 |
| Weighted average loan seasoning (months)* | 38.77 |
| Balance of loans in default (%) | 0.21 |
| **Credit analysis results** | |
| Weighted average foreclosure frequency (WAFF; %) | 22.73 |
| Weighted average loss severity (WALS; %) | 12.37 |
| Asset default risk (%) | 6.64 |

*Seasoning refers to the elapsed loan term.

**Table 6**

| Eiendomskreditt AS Covered Bonds Geographic Distribution Of Loan Assets | |
|---|---|
| | **--May 15, 2014--** |
| **Top five concentrations** | **Percentage of cover pool (%)** |
| Oslo | 58.94 |
| Three cities | 41.06 |
| Rest of Norway | 0.00 |
| Total | 100 |

We account for these features in our measure of asset default risk, which is a function of our measure of the level of defaults (weighted-average foreclosure frequency; WAFF) and our measure of possible losses (weighted-average loss severity; WALS).

The pool has strong credit characteristics, with low LTV ratios, high seasoning, and low arrears levels. These factors contribute to low WAFF and WALS when compared to the base values (please see Appendix for more information).

**Table 7**

| Eiendomskreditt AS Covered Bonds Loan Seasoning Distribution* | |
|---|---|
| | **--May 15, 2014--** |
| | **Percentage of portfolio (%)** |
| Less than 18 months | 31.63 |
| 18 to 24 | 14.56 |
| 24 to 36 | 16.25 |
| 36 to 48 | 12.72 |
| 48 to 60 | 2.20 |
| More than 60 | 22.42 |

**Table 7**

| Eiendomskreditt AS Covered Bonds Loan Seasoning Distribution* (cont.) |
|---|
| **Weighted-average loan seasoning (months)** |
| 38.67 |

*Seasoning refers to the elapsed loan term.

**Table 8**

| Eiendomskreditt AS Covered Bonds Loan-To-Value (LTV) Ratios | |
|---|---|
| | **--May 15, 2014--** |
| (%) | **Percentage of cover pool (%)** |
| 0 to 60 | 98.42 |
| 60 to 80 | 0.16 |
| 80 to 90 | 0.00 |
| 90 to 95 | 0.85 |
| 95 to 100 | 0.00 |
| Above 100 | 0.58 |
| Weighted-average LTV ratio | 40.67 |

With the exception of possible declining property prices in Norway, which we will continue to monitor and could result in higher losses in the event that a loan defaults, we expect the cover pool's performance to remain stable.

Our analysis of the assets' credit quality follows the principles laid out in "Principles Of Credit Ratings," published on Feb. 16, 2011. For additional information on the specific adjustments, please see the appendix.

### Payment structure and cash flow mechanics

Our analysis of the covered bonds' payment structure shows that the cover pool's cash flows would be sufficient to make timely payment to the covered bond holders at an 'AA' rating level. We believe that the program is exposed to ALMM risk because the program's structural features do not address mismatches in cash-flows of the assets and liabilities.

Under our ALMM criteria, a program's ALMM exposure and ability to cover the mismatch translates into the potential notches of uplift that we use to derive the covered bond rating. We consider this program to have the ability to raise funds through asset sales. Although covered bonds play an important role in the Norwegian market, the market has a relatively short history. The first covered bond issuer came to market less than 10 years ago and the legislation came into force in 2007. As a result, Norwegian covered bonds stand in Category '2' under our ALMM criteria. To assess ALMM risk, we calculate the percentage of the cover pool that shows a mismatch between the maturities of the assets and the liabilities.

According to our ALMM criteria, the maximum potential rating on covered bonds in Category 2, with "low" ALMM risk, is six notches above the ICR. This means that Eiendomskreditt's covered bonds can reach a maximum rating of 'AA' if the available credit enhancement is at least equal to the target credit enhancement, and if other factors (such as counterparty or country risk) do not constrain the rating.

The available credit enhancement as of June 15, 2014 is 27.71%. After applying our credit and cash flow stresses, we calculate a target credit enhancement of 24.78%. This is lower than the available credit enhancement, allowing for a covered bond rating that is six notches higher than our long-term ICR on Eiendomskreditt AS.

We apply an uplift to the ratings on the covered bonds from the rating on Eiendomskreditt AS. The highest rating of 'AA' is six notches above our long-term ICR on Eiendomskreditt.

We analyzed the program's cash flows under 'AAA' credit stresses, as well as under liquidity and interest rate stresses. We also ran different default timing and prepayment patterns.

We modeled the market value risk by discounting the cover pool assets' stressed cash flows with a modeled interest rate curve and a "spread shock" (an additional discount margin). We calculate the net present value of the assets' projected cash flows using a discount rate, which we base on the pool-specific asset spreads over the relevant funding rates. The current stressed target asset spread that we use for Eiendomskreditt's cover pool is 1,000 basis points (bps). We combined this with our assumptions of prepayment rates at 0.5% and 24.0% for low and high prepayment scenarios, respectively.

We analyzed the cash flows according to our criteria in "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009, "Assessing Asset-Liability Mismatch Risk In Covered Bonds: Revised Methodology And Assumptions For Target Asset Spreads", published on April 24, 2012, "Update To The Cash Flow Criteria For European RMBS Transactions," published on Jan. 6 2009, and "Cash Flow Criteria for European RMBS Transactions," published on Nov. 20, 2003.

**Table 9**

**Eiendomskreditt AS Covered Bonds ALMM Metrics**

| | **May 15, 2014** |
|---|---|
| Asset WAM (years) | 11.87 |
| Liability WAM (years) | 4.85 |
| Maturity gap (years) | 7.02 |
| ALMM (%) | 2.26 |
| ALMM classification | Low |
| Maximum uplift above issuer rating (notches) | 6 |
| Target credit enhancement for maximum uplift (%) | 24.78 |
| Target credit enhancement for first notch of uplift (%) | 6.64 |
| Available credit enhancement (%) | 27.71 |

ALMM--Asset-liability maturity mismatch. WAM--Weighted-average maturity.

## Additional Factors

### Counterparty risk

We have identified several counterparty risks to which the covered bonds are exposed. However, these are either mitigated through structural mechanisms, or we have taken them into account in our modeling. Therefore, we consider that they do not constrain our ratings on the covered bonds.

### Account provider

DNB Bank is the program's bank account provider. An account agreement covers the issuer's accounts with DNB Bank. We consider the agreement to be in line with our current counterparty criteria, and therefore it does not constrain our ratings on the covered bonds.

### Swaps

Swaps in place fully cover interest rate mismatches between the mortgage loans in the cover pool and the payments due to covered bondholders. A swap agreement governs the program's liability swaps, which provide various replacement options if the swap provider, DNB Bank, is downgraded below 'A', which is consistent with our current counterparty criteria.

All of the swaps included in the cover pool are fixed-to-floating swaps to cover interest due on the floating rate liabilities.

### Liquidity

All of the liabilities are issued in soft-bullet form (where the maturity can be extended, usually by one year).

We analyze counterparty risk by applying our relevant counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013, and "Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions, published on May 31, 2012).

### Country risk

Sovereign risk does not constrain our ratings on the covered bonds because the mortgage assets are all located in Norway, which we rate 'AAA'. In addition, we consider that these assets have a "low" sensitivity to country risk. Therefore, our nonsovereign ratings criteria permit a six-notch ratings uplift above our sovereign rating on Norway.

### Appendix: Summary of adjustments in our credit analysis

We applied the methodology and assumptions in our principles of credit ratings in our credit risk analysis.

We derived the base foreclosure frequencies and market value declines that we used in our credit analysis by comparing our base assumptions to levels in markets that have similar credit characteristics and mortgage performance, and for which we have published criteria. Specifically, we used our criteria for analyzing mortgage collateral in Danish covered bonds as a starting point for all of our base assumptions for the program. The application and rationale of each adjustment can be found below the relevant subsection.

The Norwegian residential mortgage loan market bears a number of similarities to the Danish mortgage market. Both the Danish and Norwegian covered bond regulation has, to a large extent, been inspired by German practice. In particular, both markets have the following features:

- Lenders have a full recourse to borrowers of residential mortgage loans. Lenders will pursue this right if necessary.
- The legal framework is creditor-friendly and has strong enforcement regimes.
- They have similar underwriting practices, assessing the borrower's creditworthiness and the underlying property's quality. For example, standardized valuation methods serve as a basis for loan origination.
- They have similar loan repayment maturities, normally of 30 years. Unlike Germany, the Norwegian market has a large variable-rate market. However, we believe that Norwegian lenders' loan underwriting processes typically take

this feature into account. Furthermore, we consider that this feature has not increased defaults in and of itself, based on the data available to us.

- Both countries have a long tradition of on-balance sheet refinancing of residential mortgage loans through deposits and covered bonds. The originate-to-distribute model has not been a strong feature in either country.

## Base Assumptions For The Credit Analysis Of Norwegian Commercial Mortgage Loans

Bearing aforementioned factors in mind, this section provides additional detail on the adjustments taken in the credit analysis.

### Adjustments to the weighted-average foreclosure frequency (WAFF)

Our base foreclosure frequency at an 'AAA' rating level is 25% for all property types that are currently included in the cover pool.

**Table 10**

**Adjustments To Base Foreclosure Frequency: LTV Ratio**

| LTV ratio | |
|---|---|
| 60% to 80% | 1 x Base FF |
| 81% to 90% | 1.5 x Base FF |
| 91% to 100% | 3 x Base FF |
| 100% and above | 4 x Base FF |

LTV--Loan-to-value. FF--Foreclosure frequency.

LTV ratios have historically been a key foreclosure predictor, with low LTV ratios associated with lower probabilities of loan default. For loans with LTV ratios above 80%, we apply an analytical adjustment to the base foreclosure frequency as outlined in table 10. We derived the ratio brackets and base foreclosure frequency multipliers by comparing other jurisdictions with similar economic performance.

**Table 11**

**Adjustments To Base Foreclosure Frequency: Seasoning**

| Months | |
|---|---|
| 18 to 60 | 0.9 x Base FF |
| 60 and above | 0.75 x Base FF |

FF--Foreclosure frequency.

We applied a seasoning benefit to loans with a seasoning above 18 months, as loans with a performance history often perform better than a newly originated loan. We based the applied limits on generally applied benefits from comparable jurisdictions. We do not make any adjustments based on seasoning to loans that are in arrears.

### Arrears

All loans in arrears are automatically assigned a foreclosure frequency of 75%. We consider loans that are in arrears to have a much greater probability of default.

### Adjustments to the weighted-average loss severity (WALS)

Our base market value decline at a 'AAA' rating level is 55% for all property types that are currently included in the cover pool, as is the case in Denmark.

When calculating the total loss associated with a loan, we add a foreclosure cost of 7% of the remaining loan balance.

## Advance Notice Of Proposed Criteria Change For Covered Bonds

Our ratings are based on our applicable criteria, including those set out in the criteria articles "Covered Bonds: Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009, and "Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions," published June 14, 2011. However, please note that these criteria are under review (see "S&P Publishes Advance Notice of Proposed Criteria Change For Covered Bonds," published on April 29, 2014, and "Request For Comment: Methodology And Assumptions For Ratings Above The Sovereign—Single Jurisdiction Structured Finance," published Oct. 14, 2013).

As a result of this review, our future criteria applicable to rating covered bonds may differ from our current criteria. These criteria changes may affect the ratings on the outstanding covered bonds issued by Eiendomskreditt. Until such time that we adopt new criteria, we will continue to rate and surveil these covered bonds using our existing criteria (see the list of related criteria and research below).

## Related Criteria And Research

### Related Criteria

- Europe Asset Isolation And Special-Purpose Entity Criteria--Structured Finance, Sept. 13, 2013
- Counterparty Risk Framework Methodology And Assumptions, June 25, 2013
- Covered bond Ratings Framework: Methodology And Assumptions, June 26, 2012
- Covered Bonds Counterparty And Supporting Obligations Methodology And Assumptions, May 31, 2012
- Methodology And Assumptions For Analyzing Mortgage Collateral In Danish Covered Bonds, May 2, 2012
- Assessing Asset-Liability Mismatch Risk In Covered Bonds: Revised Methodology And Assumptions For Target Asset Spreads, April 24, 2012
- Global CDOs of Pooled Structured Finance Assets: Methodology And Assumptions, Feb. 21, 2012
- Nonsovereign Ratings That Exceed EMU Sovereign Ratings: Methodology And Assumptions, June 14, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds, Dec. 16, 2009
- Update to The Cash-Flow Criteria For European RMBS Transactions, Jan. 6, 2009

### Related Research

- Advance Notice Of Proposed Criteria Change For Covered Bonds, April 29, 2014
- Methodology and Assumptions For Ratings Above The Sovereign—Single Jurisdiction Structured Finance, Oct. 14, 2013

- Research Update: Ratings On Norway Affirmed At 'AAA/A-1+'; Outlook Stable, May 2, 2014
- European Structured Finance Scenario And Sensitivity Analysis: The Effects Of The Top Five Macroeconomic Factors, March 14, 2012
- Understanding Standard & Poor's Rating Definitions, June 3, 2009
- A Listing Of S&P's New Actions Aimed At Strengthening The Ratings Process, Feb. 7, 2008
- Covered Bond Monitor: Technical Note, Feb. 14, 2006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