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Transaction Update: Eiendomskreditt AS (Commercial Mortgage Covered Bonds Program)

Norwegian Legislation-Enabled Obligasjoner Med Fortrinnsrett

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Ratings Detail

Reference Rating Level	**bbb**
Resolution Regime Uplift	N/A*
Systemic Importance	Very Strong
Adjusted Issuer Credit Rating	bbb
GRE And Sovereign Support	0
Issuer Credit Rating	**BBB**

+

Jurisdictional-Supported Rating Level	**a**
Assigned Jurisdictional Support Uplift	+3
Jurisdictional Support Assessment	Very Strong
Legal Framework	Very Strong
Systemic Importance	Very Strong
Sovereign Credit Capacity	Very Strong

+

Maximum Achievable Covered Bond Rating	**aa+**
Collateral Support Uplift	+4
Overcollateralization Adjustment	0
Liquidity Adjustment	0
Potential Collateral-Based Uplift	+4

=

Covered Bond Rating	**AA+/Negative**
Rating Constraints	aa+
Counterparty Risk	aaa
Country Risk	aaa

*N/A –Not applicable. Note: Eiendomskreditt is domiciled in Norway, which is part of the European Economic Area (EEA). Although Norway is in the process of implementing legislation similar to the Bank Recovery and Resolution Directive (BRRD), in our analysis We will not consider this support until adopted.

Major Rating Factors

Strengths

- The program benefits from a public commitment to maintain a level of overcollateralization consistent with the rating. Furthermore, liquidity risk is covered through the soft-bullet repayment profile of the bonds.
- The cover pool comprises mortgages with low loan-to-value (LTV) ratios compared with the average of other Norwegian issuers we rate.
- The cover pool's weighted-average maturity has materially decreased since our previous review, reducing the program's asset-liability mismatch.

Weaknesses

- The pool primarily comprises commercial mortgages, which we view as having higher credit risk than residential mortgages.
- The result of the largest obligor test now floors the cash-flow results of our analysis at 22.86%, reflecting that the

cover pool is concentrated.

- Volatile sectors, such as oil-related industries could affect the performance of the cover pool, which is highly concentrated in southern and western Norway.

Outlook: Negative

S&P Global Ratings' negative outlook on Eiendomskreditt AS' commercial mortgage covered bonds reflects that on the issuer, Eiendomskreditt AS (BBB/Negative/A-2). This means that, all else being equal, any rating change on Eiendomskreditt's issuer credit rating (ICR) would automatically lead to a similar rating action on the covered bonds.

Rationale

We are publishing this transaction update following our periodic review of Eiendomskreditt's mortgage covered bond program and related issuances.

Our covered bond rating process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014, and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

From our analysis of the legal and regulatory framework for Norwegian covered bonds, we have concluded that the assets in the cover pool are isolated from the issuer's risk of a bankruptcy or insolvency. This asset isolation allows us to assign a higher rating to the covered bonds than our long-term ICR on Eiendomskreditt.

We conducted a review of Eiendomskreditt's mortgage operations, which we view as prudent. We believe satisfactory procedures are in place to support our ratings on the covered bonds.

Eiendomskreditt is domiciled in Norway, which is part of the European Economic Area (EEA). Although Norway is in the process of implementing legislation similar to the Bank Recovery and Resolution Directive (BRRD), we will not consider this support as part of our analysis until the new legislation is adopted. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'bbb', the same as the long-term ICR on the issuer.

We considered the likelihood for the provision of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage programs in Norway, we assigned three notches of uplift from the RRL. Therefore we assess the jurisdiction-supported rating level (JRL) at 'a' (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Nov. 3, 2017).

We have reviewed the asset information provided as of Dec. 31, 2017. The cover pool comprises Norwegian commercial real estate mortgage loans, as well as substitute assets and cash. Based on our cash flow analysis, the available credit enhancement in the program exceeds the target credit enhancement, which means that covered bonds are eligible for up to four notches of collateral-based uplift. The total collateral-based uplift is not reduced by any notches given that Eiendomskreditt has provided a public statement committing to hold the level of overcollateralization to maintain the rating, and we consider that the soft-bullet structure of the liabilities covers liquidity risk for 180 days. As a result, the covered bonds are able to reach 'aa+' under our covered bonds criteria.

There are currently no rating constraints to the 'AA+' ratings relating to counterparty or country risks.

The negative outlook on the ratings reflects that on the issuer, given that the program benefits from no unused notches of uplift. This means that, all else being equal, a rating change on Eiendomskreditt would automatically lead to a similar rating action on the covered bond program.

We have based our analysis on the criteria articles referenced in the Related Criteria section.

Program Description

Table 1

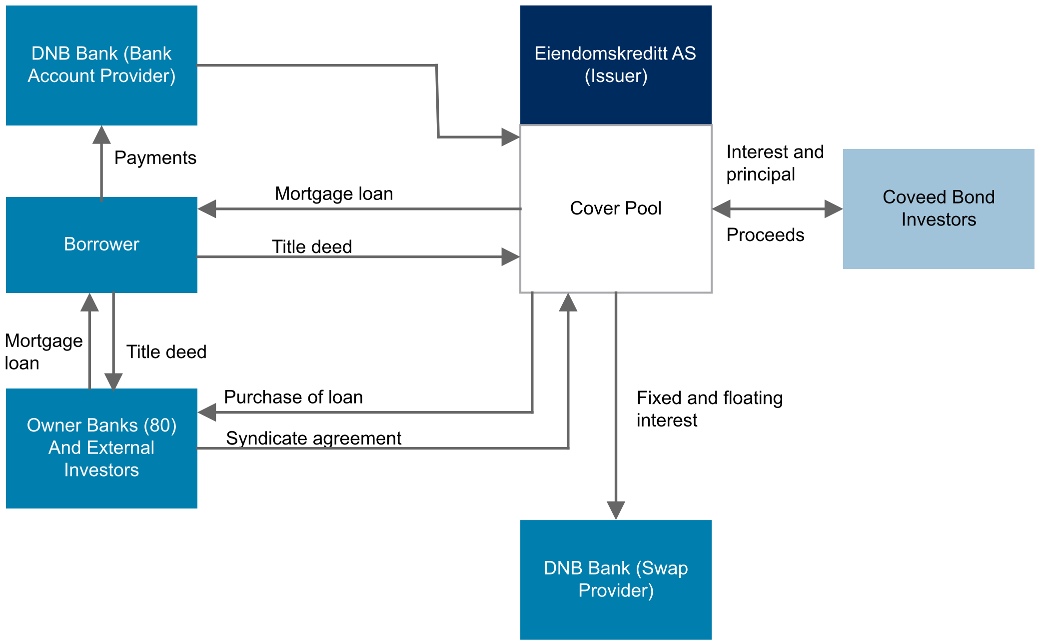
Program Overview*	
Jurisdiction	Norway
Year of initial rating	2014
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. Nok)	2.92
Redemption profile	Soft bullet
Underlying assets	Commercial mortgages
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	22.86
Available credit enhancement (%)	32.62
Collateral support uplift	4
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of December 31, 2017.

Eiendomskreditt is a Norwegian covered bond company that has historically been owned by Norwegian savings banks. Since 2017, ownership is not restricted to savings banks only, given that two external investors, R Transit AS and AS Meteva, each acquired ownership of the company. As of December 2017, each had an ownership of 24.99%. Eiendomskreditt provides residential mortgages and commercial real estate loans, mainly to customers in Southwestern Norway (focused in Hordaland, Oslo, Akershus, Bergen, and Rogaland). In addition, Eiendomskreditt is concentrated in the commercial real estate sector and has the highest share of loans to this sector among domestic Norwegian banks. The cover pool mainly comprises commercial mortgage loans.

Chart 2

Eiendomskreditt AS Commercial Mortgage Covered Bonds
Transaction Structure



We have not observed any material changes to the program's structure that would affect our ratings on the covered bonds since we last affirmed our ratings.

Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	Eiendomskreditt AS	BBB/Negative/A-2	Yes
Bank account provider	DNB Bank ASA	A+/Positive/A-1	Yes
Swap provider	DNB Bank ASA	A+/Positive/A-1	Yes

Rating Analysis

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 and the Undertakings for Collective Investment in Transferable Securities. 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 legal criteria and our criteria for rating covered bonds (see "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017). From our 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. This asset isolation allows us to assign a higher rating to the covered bond program than the long-term ICR of the issuer.

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 does 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 is located in Bergen and has 11 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 team's broad experience, with each member of management having at least 20 years' 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 with the largest ownership share.

Eiendomskreditt primarily focuses on originating commercial real estate mortgage loans, having its major exposure in Southwestern Norway, an area particularly exposed to the reduction in oil prices observed over the last few years. The relative volatility of oil-related industries could affect the cover pool's performance, which we closely monitor.

Despite the geographic and sector concentration, we consider Eiendomskreditt's underwriting process to be conservative, with LTV limits of 55% for commercial mortgage loans (less than the 60% specified in the legislation), although this limit is increased to 60% for private rental properties and to 65% for residential properties. This has allowed the mortgage company to operate with virtually no losses since becoming operational in 1998. Furthermore, Eiendomskreditt performs its own credit analysis on all loans included in the cover pool, as well as for loans funded through a syndicate agreement.

In our opinion, there are no operational or administrative risks from the cover pool's management and loan origination that would constrain the covered bond ratings to the same level as the long-term ICR.

We view the bank's underwriting criteria as prudent.

Our analysis of operational and administrative risk follows the principles laid out in our covered bond ratings framework.

Resolution regime analysis

Eiendomskreditt is domiciled in Norway, which is part of the European Economic Area. Although Norway is in the process of implementing legislation similar to the BRRD, in our analysis we do not consider this support until adopted. Therefore, under our covered bonds criteria, we assess the RRL as 'bbb', the same as the long-term ICR on the issuer.

Jurisdictional support analysis

Under our analysis of jurisdictional support in our covered bonds criteria, we determine a JRL, which is our assessment of the creditworthiness of a covered bond program once we have considered the level of jurisdictional support, but before giving credit to the amount of collateral.

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market. Our assessment of the expected jurisdictional support for Norwegian mortgage covered bond programs is very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Nov. 3, 2017). Under our covered bonds criteria, this means that the program can receive up to three notches of jurisdictional uplift from the RRL. This leads to a JRL for Eiendomskreditt's mortgage covered bonds of 'a'.

Collateral support analysis

We base our analysis on the loan-level data provided by the issuer as of Dec. 31, 2017. The cover pool primarily comprises Norwegian commercial mortgages. Additionally, the pool has substitute assets and cash (see table 3).

We base our credit analysis of mortgage assets on our commercial real estate criteria and our public sector criteria (see "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015 and "Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," published on Dec. 9, 2014).

We assess the credit quality of a typical mortgage cover pool by estimating the credit risk associated with each loan in the pool. We then calculate the aggregate risk to assess the cover pool's overall credit quality. In order to quantify the potential losses associated with the entire pool, we weight each loan's foreclosure frequency and loss severity by its percentage of the total pool balance. Weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) estimate the required loss protection, assuming all other factors remain unchanged.

We have observed a slight improvement in the credit risk in the mortgage assets compared with our previous analysis. The WAFF has remained very stable at 25.36% compared to 25.52% in December 2016. The WALS has decreased to

36.93% from 38.59% in the previous review. The decrease is mainly driven by the cover pool now being concentrated into slightly lower LTV buckets (cover pool weighted-average LTV has decreased to 39.01% from 41.65%).

Table 3

Cover Pool Composition

	--Dec. 31, 2017--		--Dec. 31, 2016--	
Asset type	**Value (mil. NOK)**	**Percentage of cover pool (%)**	**Value (mil. NOK)**	**Percentage of cover pool (%)**
Commercial mortgages	3,666.23	94.81	2,799.11	87.76
Substitute assets	160.00	4.14	140.00	4.39
Cash	40.89	1.06	250.50	7.85
Total	3,867.12		3,189.61	

Table 4

Commercial Loans by Property Type

	--Dec. 31, 2017--		--Dec. 31, 2016--	
Property Type	**Value (mil. NOK)**	**Percentage of cover pool (%)**	**Value (mil. NOK)**	**Percentage of cover pool (%)**
Mixed commercial	2,413.33	65.83	1,718.84	61.41
Housing association	231.00	6.30	235.03	8.40
Private rental/multifamily	386.86	10.55	352.17	12.58
Office	581.96	15.87	396.17	14.15
Industrial/warehouse	35.39	0.97	72.75	2.60
Other	17.69	0.48	24.14	0.86
Total Mortgages	3,666.23		2,799.11	

Table 5

Key Credit Metrics

	--Dec. 31, 2017--	--Dec. 31, 2016--
Average loan size (€)	11,385,812.76	7,907,087.23
Total number of loans	322	354
Weighted-average LTV ratio (%)	41.40	41.69
Weighted-average loan seasoning (months)*	38.36	47.63
Arrears above 90 days (%)	0.25	0.25
Credit analysis results:		
Weighted-average foreclosure frequency (WAFF; %)	25.36	25.52
Weighted-average loss severity (WALS; %)	36.93	38.59
AAA credit risk (%)	22.86	20.60

*Seasoning refers to the elapsed loan term.

Table 6

LTV Ratios

	--Dec. 31, 2017--	--Dec. 31, 2016--
(%)	**Percentage of cover pool (%)**	
0-20	6.82	8.27
20-40	35.43	32.11

Table 6

LTV Ratios (cont.)

	--Dec. 31, 2017--	--Dec. 31, 2016--
40-60	56.99	57.85
60-80	0.76	0.80
Above 80	0.00	0.97
Weighted-average LTV ratios	41.40	41.69

LTV--Loan to value.

Table 7

Loan Seasoning Distribution*

	--Dec. 31, 2017--	--Dec. 31, 2016--
	Percentage of portfolio (%)	
Less than 18 months	46.04	27.64
18-24	6.85	6.38
24-36	5.63	9.56
36-48	6.35	8.18
48-60	5.02	21.40
More than 60	30.10	26.59
Weighted-average loan seasoning (months)	38.36	47.63

*Seasoning refers to the elapsed loan term.

Table 8

Geographic Distribution Of Loan Assets

	--Dec. 31, 2017--	--Dec. 31, 2016--
Top five concentrations	Percentage of cover pool (%)	
East	48.37	44.72
West	39.10	45.46
North	3.15	1.37
South	4.77	1.74
Trondelag	4.61	6.72
Total	100.00	100.00

Table 9

Collateral Uplift Metrics

	--Dec. 31, 2017--	--Dec. 31, 2016--
Asset WAM (years)	8.64	10.82
Liability WAM (years)	4.37	4.54
Available credit enhancement	32.62	34.92
Required credit enhancement for first notch of collateral uplift (%)	22.86	20.60
Required credit enhancement for second notch of collateral uplift (%)	22.86	20.60
Required credit enhancement for third notch collateral uplift (%)	22.86	22.65
Target credit enhancement for maximum uplift (%)	22.86	27.31
Potential collateral-based uplift (notches)	4	4

Table 9

Collateral Uplift Metrics (cont.)

	--Dec. 31, 2017--	--Dec. 31, 2016--
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	N	N
Collateral support uplift (notches)	4	4

WAM--Weighted-average maturity.

According to our covered bonds criteria, the maximum potential collateral-based uplift on a covered bond program above the JRL is four notches. We then make adjustments to the maximum collateral-based uplift by reviewing the coverage of six months of liquidity and the level of commitment for the overcollateralization. The covered bonds issued by Eiendomskreditt benefit from a public statement regarding the level of overcollateralization. Additionally, we consider six months' liquidity to be met by the one-year extendable maturities provided on the covered bonds. As a result, we do not make any adjustments to the four notches of uplift based on collateral support.

By applying our credit and cash flow stresses, we calculate a target credit enhancement of 22.86%. This represents a decrease compared with the 27.31% target credit enhancement in December 2016. The decrease is primarily due to an improvement in the program's asset-liability mismatch, where the cover pool's weighted-average maturity has decreased to 8.64 years from 10.82 years. The target credit enhancement is currently driven by the largest obligor test. We define the largest obligor test as the assessment of the covered bonds' ability to withstand the default of a minimum number of the largest obligor exposures in the cover pool with a fixed recovery rate, factoring in the underlying assets' credit quality.

The available credit enhancement of 32.62% is greater than the target credit enhancement of 22.86%. With a JRL of 'a' and four notches of collateral-based uplift, the achievable rating on the covered bonds is 'AA+'.

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.

We analyze counterparty risk by applying our relevant counterparty criteria (see "Counterparty Risk Analysis In Covered Bonds," published on Dec. 21, 2015 and "Counterparty Risk Framework Methodology And Assumptions," published on June 25, 2013).

Account provider

DNB Bank is the program's bank account provider. An account agreement covers the issuer's accounts with DNB Bank, which contains replacement language with a minimum counterparty rating of 'A/A-1'. 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

The swaps in place cover interest rate mismatches between the mortgage loans in the cover pool and the payments due to covered bondholders. A swap agreement governs most of 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.

We consider the agreements to be in line with our current counterparty criteria, and therefore counterparty risk from the swaps does not constrain our ratings on the covered bonds.

Country risk

We base our analysis of country risk on the application of our "Ratings Above The Sovereign—Structured Finance: Methodology And Assumptions," published on Aug. 8, 2016. As Norway is currently rated 'AAA', country risk does not constrain the ratings in any way.

Potential Effects Of Proposed Criteria Changes

Our ratings are based on our applicable criteria, including our "Covered Bonds Criteria," published on Dec. 9, 2014. However, the resolution regime analysis section of these criteria is under review (see "Methodology For Assigning Financial Institution Resolution Counterparty Ratings," published on April 19, 2018, and "Request For Comment: Methodology For Incorporating The Effect Of Resolution Regimes Into Covered Bond Ratings," published on Jan. 31, 2017). As a result of this review, we may amend certain paragraphs of our covered bonds criteria. This change may affect the ratings on the outstanding covered bonds issued under this covered bond program. Until this time, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria").

Related Criteria

- Criteria - Structured Finance - General: Methodology And Assumptions: Assessing Pools Of European Residential Loans, Aug. 4, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria - Structured Finance - General: Ratings Above The Sovereign - Structured Finance: Methodology And Assumptions, Aug. 8, 2016
- Criteria - Structured Finance - Covered Bonds: Counterparty Risk Analysis In Covered Bonds, Dec. 21, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Criteria - Structured Finance - General: Counterparty Risk Framework Methodology And Assumptions, June 25, 2013

- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Criteria Guidance: Covered Bonds Criteria, May 2, 2018
- Glossary Of Covered Bond Terms, April 27, 2018
- Global Covered Bond Characteristics And Rating Summary Q4 2017, Jan. 24, 2018
- Request For Comment: Methodology For Incorporating The Effect Of Resolution Regimes Into Covered Bond Ratings, Jan. 31, 2017
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Nov. 3, 2017
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Nov. 3, 2017