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

Norwegian Legislation-Enabled Obligasjoner Med Fortrinnsrett

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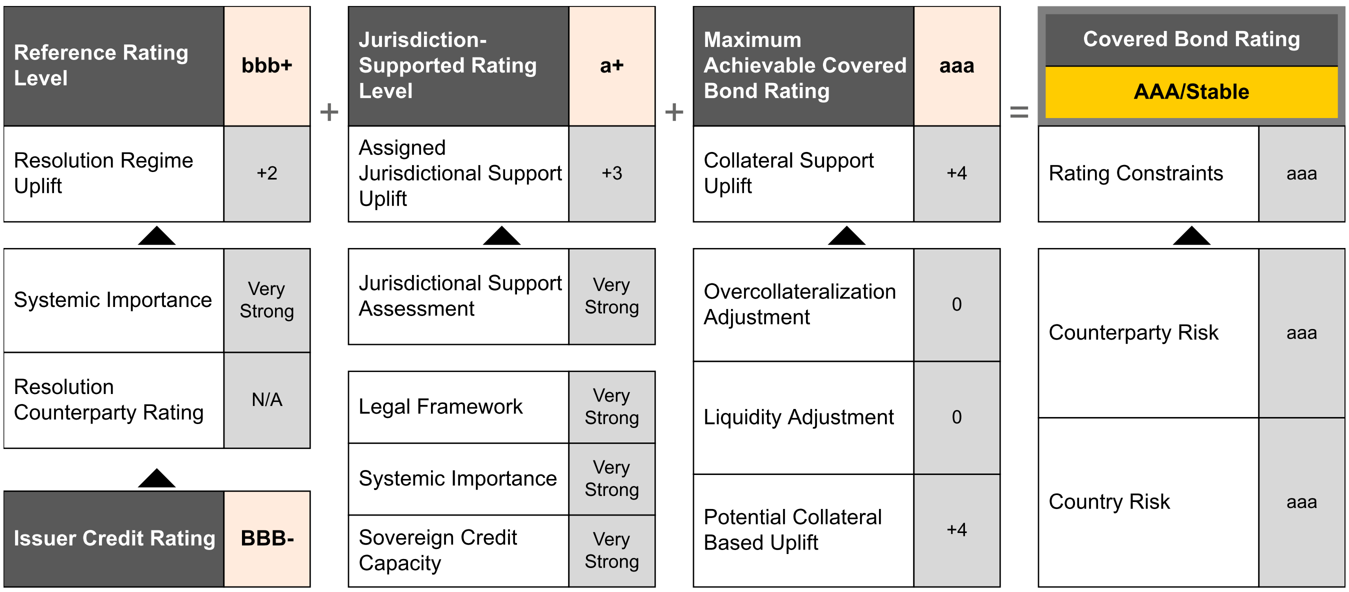
Ratings Detail



Major Rating Factors

Strengths

- The issuer commits through a public statement to maintain a level of overcollateralization consistent with the current rating.
- All the covered bonds present a soft bullet profile, meaning that liquidity risk is covered.

Weaknesses

- The 10 largest obligors in the cover pool currently account for more than one quarter of its total balance.
- At present, the program does not benefit from any unused notches of uplift.

Outlook: Stable

S&P Global Ratings' stable outlook on Eiendomskreditt AS' commercial mortgage covered bonds reflects that on the issuer, Eiendomskreditt AS (BBB-/Stable/A-3). All else being equal, any downgrade 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). In January 2019 Norway has implemented legislation similar to the European Union's Bank Recovery and Resolution Directive (BRRD) and we considered this support as part of our analysis until the new legislation is adopted. Therefore, under our covered bonds criteria, we assessed the reference rating level (RRL) as 'bbb+', two notches higher than 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 March 3, 2020).

We based our credit analysis on the loan-level data provided by the issuer as of Dec. 31, 2019 and our cash flow analysis, including the largest obligor test, on the loan-level data and the asset-liability profile as of March 31, 2020. 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 'aaa' under our covered bonds criteria.

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

The stable 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 downgrade 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

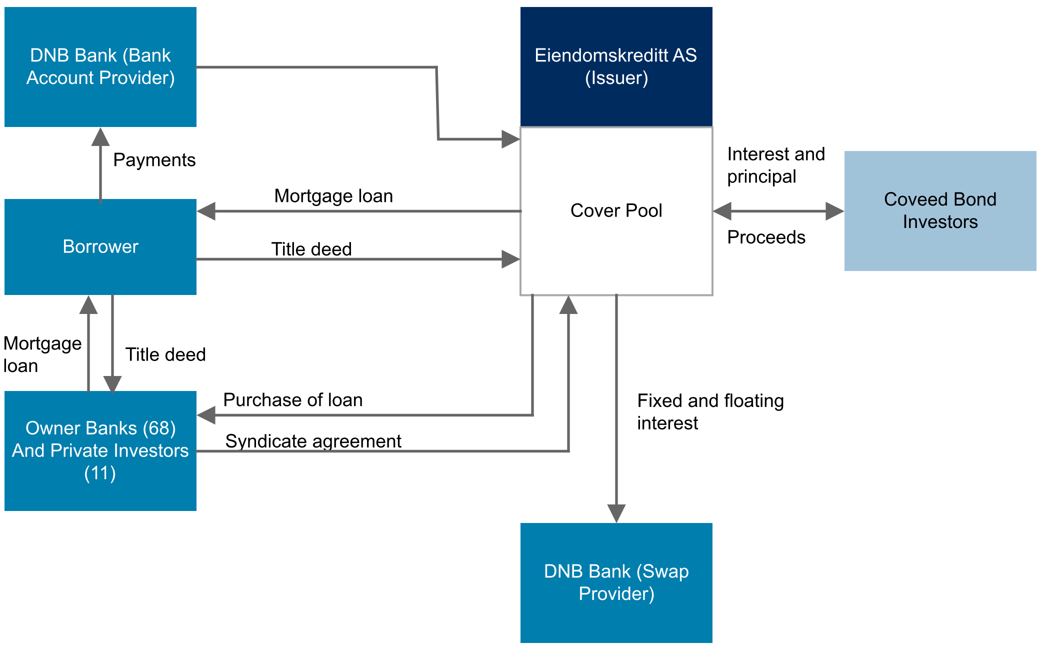
Table 1

Program Overview*	
Jurisdiction	Norway
Year of initial rating	2014
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. Nok)	3.99
Redemption profile	Soft bullet
Underlying assets	Commercial mortgages
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	16.87
Available credit enhancement (%)	28.60
Collateral support uplift	4
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of March 31, 2020.

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 shares of the company. As of December 2017, each had an ownership of 24.99%, which increased to 30% in October 2018. The lender provides primarily mortgage loans backed by commercial real estate collateral located in Norway.

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-/Stable/A-3	Yes
Bank account provider	DNB Bank ASA	AA-/Stable/A-1+	Yes
Swap provider	DNB Bank ASA	AA-/Stable/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 regulation on mortgage credit institutions.

The Norwegian covered bond law defines the eligibility criteria for the type of assets that may and may not be included in the cover pool. The "Finanstilsynet" (the Norwegian FSA) appoints an independent inspector to regularly review compliance, oversee the register for the cover pool, and ensure that the value of the cover pool always exceeds the issued covered bonds. The law also stipulates that the issuer must be a specialized credit institution and obtain a license from the Norwegian FSA.

A mortgage credit institution can include mortgage credit assets secured on residential and commercial properties within the European Economic Area (EEA) or the Organisation for Economic Co-operation and Development (OECD), and public sector credit assets granted to or guaranteed by a public body within the EEA and the OECD. It may also include supplementary assets, i.e., securities issued by eligible financial institutions within the EEA or the OECD.

According to the Norwegian covered bond law, in the event of issuer insolvency, bondholders have an exclusive preferential claim on the cover pool. Should an event occur, an administrator will be appointed to administer the cover pool and to ensure timely payments.

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 risk of 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 Eiendomskreditt engages in direct lending, there are a number of loans included in the cover pool that are 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.

On Jan. 1, 2019, the Bank Recovery and Resolution Directive became effective in Norway. The law exempts covered bonds from bail-in, which under our criteria means that we may assign up to two notches of resolution support uplift to the transaction.

Operational and administrative risks

Eiendomskreditt is located in Bergen and has a small number of full-time employees, allowing the mortgage company to operate with low costs. 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, with a large exposure in Western Norway, an area particularly vulnerable to the reduction in oil prices. However, the lender's presence in the region has seen a reduction, with loans backed by properties thereby located dropping from roughly one-third of the pool in December 2018 to about one-quarter of the pool one year later.

We consider Eiendomskreditt's underwriting process to be conservative, with loan-to-value (LTV) limits of 55% for commercial mortgage loans (less than the 60% specified in the legislation), although this limit is increased to 60% for loans backed by residential-use properties. This has allowed the mortgage company to operate with virtually no losses since becoming operational in 1998. Furthermore, the lender performs its own credit analysis on all loans included in the cover pool, as well as for loans funded through a syndicate agreement.

Eiendomskreditt has recently revised its internal policy in order to tackle concentration risk. Under the new rules, the 10 and the 20 largest borrowers cannot add up to more than 30% and 50% of the cover pool, respectively.

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

Eiendomksreditt is based in Norway, which in January 2019 implemented a resolution regime similar to the EU's BRRD. We deem Norwegian covered bonds to have a very strong systemic importance, meaning that the program's RRL is equal to the greater of (i) the long-term ICR on the issuer, plus two notches; and (ii) the resolution counterparty rating (RCR) on the issuer. Given that the long-term ICR on the issuer is 'BBB-' and that it hasn't been assigned an RCR, the RRL is 'bbb+'.

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 March 3, 2020). 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 credit analysis on the loan-level data provided by the issuer as of Dec. 31, 2019 and our cash flow analysis, including the largest obligor test, on the loan-level data and the asset-liability profile as of March 31, 2020. The cover pool primarily comprises Norwegian commercial mortgages, along with a small portion of 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. The 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 an increase in credit risk in the mortgage assets compared with our previous analysis, as of December 2018.

The WAFF has remained very stable, at 25.34% compared to 25.19%, whereas the WALS has increased to 52.98% from 39.55%.

The WAFF has slightly increased due to our assessment of industry concentration risk. We used our analytical judgement to reconcile the collateral types provided by the issuer with the industry codes featured in our CDO Evaluator model and applied an industry concentration adjustment to a portion of the cover pool (33.56%) to which we've increased the base foreclosure frequency. In the previous analysis, we applied a geographic concentration adjustment to a slightly lower portion of the pool (32.34%), to reflect that the transaction's exposure toward Western Norway significantly exceeded the area's GDP.

The WALS has increased to 52.98% from 39.55%. Based on additional information provided by the issuer we have reclassified certain properties reported as "combined-use" to industry categories that we view as "operating" as opposed to "investment". In our credit analysis, we apply a higher market value decline to the former (85% against 75%), hence the rise in the pool's estimated loss severity.

Table 3

Cover Pool Composition

	--Dec. 31, 2019--		--Dec. 31, 2018--	
Asset type	**Value (mil. NOK)**	**Percentage of cover pool**	**Value (mil. NOK)**	**Percentage of cover pool**
Commercial mortgages	4,838.21	96.58	4,392.37	95.08
Substitute assets	160.00	3.19	205.00	4.44
Cash	11.28	0.23	22.27	0.48
Total	5,009.50		4,619.65	

Table 4

Commercial Loans by Property Type

	--Dec. 31, 2019--	--Dec. 31, 2018--
Property Type	**Percentage of cover pool**	**Percentage of cover pool**
Mixed commercial*	71.27	67.01
Housing association	4.55	5.34
Private rental/multifamily	11.04	12.70
Office	12.09	13.74
Industrial/warehouse	0.90	1.08
Other	0.14	0.13
Total mortgages	100.00	100.00

*In December 2019 we have reclassified the properties reported as mixed-commercial based on additional information received by the issuer.

Table 5

Key Credit Metrics

	--Dec. 31, 2019--	--Dec. 31, 2018--
Weighted-average LTV ratio (%)	45.15	42.82
Arrears above 30 days (%)	0.00	0.63
Credit analysis results:		
Weighted-average foreclosure frequency (WAFF; %)	25.34	25.19
Weighted-average loss severity (WALS; %)	52.98	39.55

Table 6

LTV Ratios

	--Dec. 31, 2019--	--Dec. 31, 2018--
(%)	**Percentage of cover pool**	
0-20	5.71	7.13
20-40	22.73	26.88
40-60	69.82	65.45
60-70	1.73	0.54
Above 70	0.00	0.00
Weighted-average LTV ratios	45.15	42.82

LTV--Loan to value.

Table 7

Geographic Distribution Of Loan Assets

	--Dec. 31, 2019--	--Dec. 31, 2018--
Top five concentrations	Percentage of cover pool	
East	61.17	58.63
West	24.67	32.29
North	2.36	2.42
South	3.35	3.86
Trondelag	8.44	2.81
Total	100.00	100.00

Table 8

Collateral Uplift Metrics

	--Mar. 31, 2020--	--Dec. 31, 2018--
Asset WAM (years)	5.58	7.67
Liability WAM (years)	4.38	4.26
Available credit enhancement	28.60	36.84
AAA credit risk (%)	10.51	7.55
Required credit enhancement for first notch of collateral uplift (%)	12.04	9.53
Required credit enhancement for second notch of collateral uplift (%)	13.57	11.51
Required credit enhancement for third notch of collateral uplift (%)	15.10	13.49
Target credit enhancement for maximum uplift (%)	16.63	15.47
Largest obligor test (%)	16.87	22.21
Potential collateral-based uplift (notches)	4	4
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 covered by the one-year extendable maturities documented 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 as of March 2020 of 16.63%, higher than the target credit enhancement of 15.47% calculated as of December 2018. The negative impact of the credit results is partially offset by a decrease in the weighted-average liability cost (c. 30 bps) and a decrease in the timing mismatch between assets and liabilities of more than two years.

Under our commercial real estate criteria, for cover pools backed by commercial real estate collateral we perform a 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. In March

2020, the largest obligor test result is 22.29%. In line with our commercial real estate criteria, we perform an additional cash flow run where we default only the obligors that drive the largest obligor test and give benefit to the excess spread generated by the transaction. This run results in a credit enhancement of 16.87%. This figure constitutes the floor to the credit enhancement commensurate with a 'AAA' rating.

The available credit enhancement of 28.60% exceeds the target credit enhancement of 16.87%. With a JRL of 'a+' and four notches of collateral-based uplift, the achievable rating on the covered bonds is 'AAA'.

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 Framework Methodology And Assumptions," published on March 8, 2019).

Account provider

DNB Bank is the program's bank account provider. According to the account agreement, if DNB Bank is downgraded below 'A/A-1', it commits to replace itself with a bank rated at least 'A/A-1' or to obtain an appropriately rated guarantor. The remedy period is 60 calendar days. These mitigants support a 'AAA' rating.

Swaps

The program features a number of cover pool interest-rate swaps with a single counterparty, DNB Bank. The swaps in place cover interest rate mismatches between the mortgage loans in the cover pool and the payments due to covered bondholders.

Governing the swaps is an agreement that we reviewed under our counterparty risk criteria. There are rating triggers in place: if DNB Bank is downgraded below 'A/A-1' it will start posting collateral in 10 calendar days, and if it is downgraded below 'A-/A-2' it will replace itself in 60 calendar days. We deem the collateral posting framework outlined in the documentation to be strong.

We determine the maximum supported rating under this swap agreement by interpolating the replacement trigger and the issuer's RRL.

In the analysis of the swaps, we applied analytical judgment to determine that the liquidity risk posed by termination costs is mitigated. The potential termination cost of the swaps currently registered in the cover pool is lower than the buffer between the transaction's available credit enhancement and the credit enhancement commensurate with the rating. Based on the nature of the swaps and historical evidence, we expect termination costs to remain below the transaction's unused credit enhancement.

In light of this assessment, the risk posed by the swaps does not constrain the rating. Should potential termination costs exceed the transaction's unused credit enhancement, the maximum supported rating under our counterparty criteria would be lower.

Sovereign risk

We base our analysis of sovereign risk on the application of "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published on Jan. 30, 2019. Under our criteria, this transaction displays moderate sensitivity to country risk and can be ratedup to 4 notches above the sovereign. As Norway is currently rated 'AAA', country risk does not constrain the ratings on the program and its related issuances.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The consensus among health experts is that the pandemic may now be at, or near, its peak in some regions, but will remain a threat until a vaccine or effective treatment is widely available, which may not occur until the second half of 2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Related Criteria

- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions, Jan. 30, 2019
- Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Covered Bonds Criteria, Dec. 9, 2014
- Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Characteristics And Rating Summary Q2 2020, June 30, 2020
- Global Covered Bond Insights Q2 2020, June 30, 2020
- Global Covered Bonds: Assessing The Credit Effects Of COVID-19, March 25, 2020
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, March 3, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, March 3, 2020
- Glossary Of Covered Bond Terms, April 27, 2018