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

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Table Of Contents

Major Rating Factors

Outlook: Stable

Rationale

Program Description

Rating Analysis

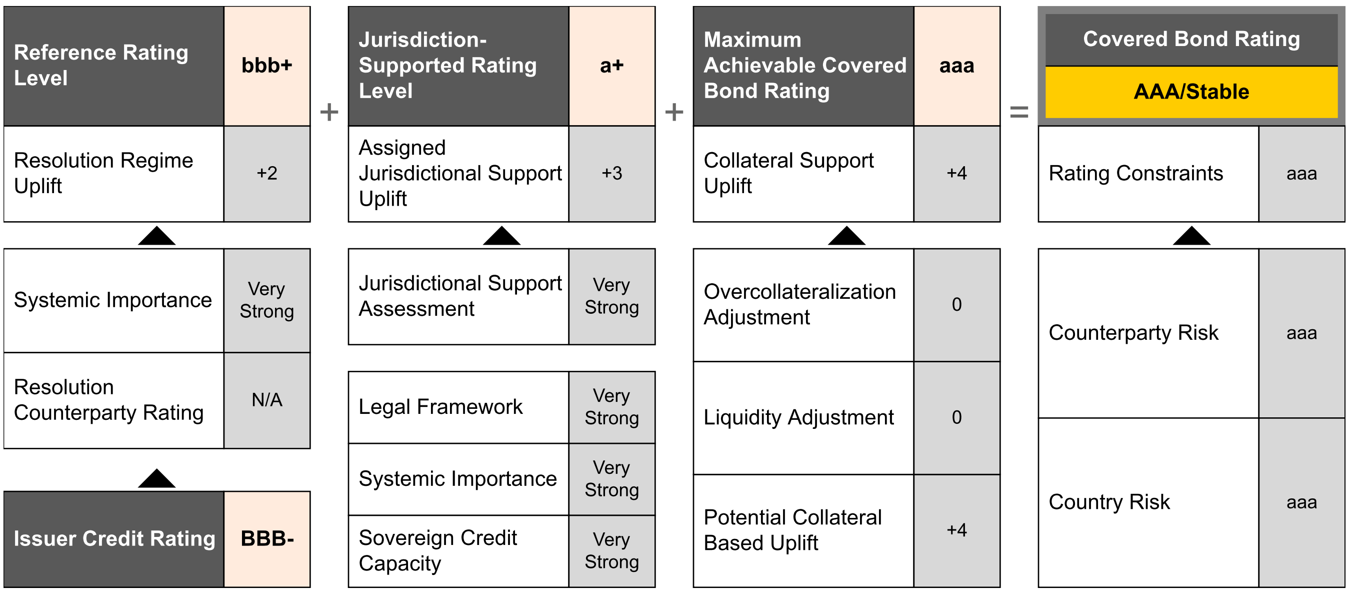
Environmental, Social, And Governance (ESG) Factors

Related Criteria

Related Research

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

Ratings Detail



Major Rating Factors

Strengths

- The issuer commits through a public statement to maintain a level of credit enhancement commensurate 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 almost one quarter of the 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.

The issuer is domiciled in Norway, which implemented in 2019 a resolution regime similar to the EU's Bank Recovery and Resolution Directive (BRRD; see "Norway's Adoption Of BRRD Resolution Regime Results In Additional Ratings Uplift For Norwegian Covered Bonds," published on Jan. 2, 2019). We assess the systemic importance of covered bonds in Norway as very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Nov. 27, 2020). These factors increase the likelihood that Eiendomskreditt would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations. 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+'.

We based our credit analysis on the loan-level data provided by the issuer as of March 31, 2021, and our cash flow analysis, including the largest obligor test, on the loan-level data and the asset-liability profile as of June 30, 2021. 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 subject to any deductions given that Eiendomskreditt has provided a public statement committing to hold the level of overcollateralization to maintain the rating, and that we consider the soft-bullet structure of the liabilities to cover 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 due to counterparty or country risks.

The stable outlook on the ratings reflects the outlook 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.

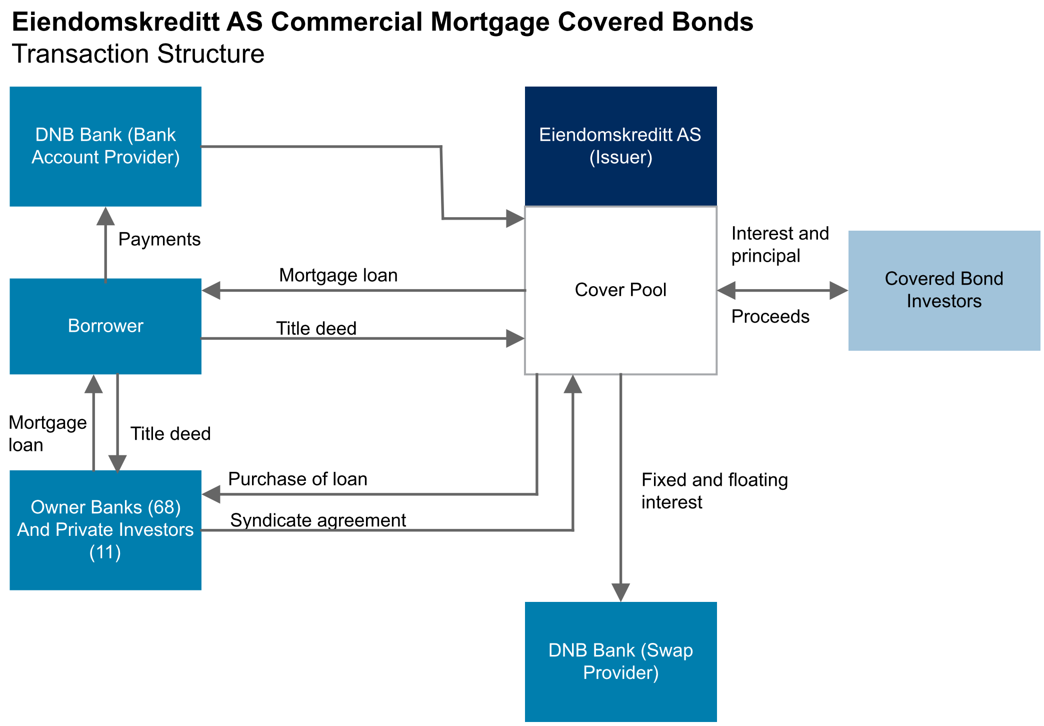
Program Description

Table 1

Program Overview*	
Jurisdiction	Norway
Year of initial rating	2014
Covered bond type	Legislation-enabled
Outstanding covered bonds (bil. Nok)	4.40
Redemption profile	Soft bullet
Underlying assets	Commercial mortgages
Jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Target credit enhancement (%)	16.79
Available credit enhancement (%)	29.53
Collateral support uplift	4
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of June 30, 2021.

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 September 2020, they each had an ownership of 30%. The lender provides primarily mortgage loans backed by commercial real estate collateral located in Norway.



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 in May 2020.

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, some of the loans included in the cover pool have been originated under a syndicate agreement with an owner (agent) bank. A mortgage document and a promissory note are issued in connection with the 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 nor of the agent bank.

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

On Jan. 1, 2019, the BRRD 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.

The bank primarily focuses on originating commercial real estate mortgage loans, with the bulk of the exposure concentrated in Eastern Norway.

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 it became operational in 1998. Furthermore, the lender performs its own credit analysis on all loans included in the cover pool, as well as the loans funded through the syndicate agreement.

In 2019, Eiendomskreditt revised its internal policy 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 that would constrain the covered bond ratings to the same level as the long-term ICR.

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 we have not 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 the having to liquidate collateral assets in the open market. Our assessment of the expected jurisdictional support for Norwegian mortgage covered bond programs is very strong. 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 March 31, 2021, and our cash flow analysis, including the largest obligor test, on the loan-level data and the asset-liability profile as of June 30, 2021. 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.

Compared to our previous credit analysis, as of Dec. 31, 2019, we have observed a mild decrease in the portfolio's expected loss, which is given by the product of WAFF and WALS. Both indicators have improved, dropping to 25.13% from 25.34% and to 48.34% from 52.98%, respectively.

The slight decrease in the WAFF is due to the fact that we are applying the industry concentration adjustment to a lower portion of the pool. 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 30.48% of the cover pool, against 33.56% in our previous analysis. We have increased the base foreclosure frequency for this portion of the pool.

The WALS has decreased as a consequence of a decline in the weighted-average market value decline (MVD), which in turn depends on the collateral types backing the loans in the cover pool.

Table 3

Cover Pool Composition

	--March 31, 2021--		**--Dec. 31, 2019--**	
Asset type	Value (mil. NOK)	Percentage of cover pool	Value (mil. NOK)	Percentage of cover pool
Commercial mortgages	5,356.37	95.15	4,838.21	96.58
Substitute assets	215.00	3.82	160.00	3.19
Cash	58.08	1.03	11.28	0.23
Total	5,629.45		5,009.50	

Table 4

Commercial Loans by Property Type

	--March 31, 2021--	**--Dec. 31, 2019--**
Property Type	**Percentage of cover pool**	
Mixed commercial*	68.58	71.27
Housing association	3.83	4.55
Private rental/multifamily	9.34	11.04
Office	16.30	12.09
Industrial/warehouse	1.79	0.90
Other	0.16	0.14

Table 4

Commercial Loans by Property Type (cont.)

	--March 31, 2021--	--Dec. 31, 2019--
Total mortgages	100.00	100.00

*We have reclassified the properties reported as mixed-commercial based on additional information received by the issuer.

Table 5

Key Credit Metrics

	--March 31, 2021--	--Dec. 31, 2019--
Weighted-average loan-to-value ratio (%)	45.65	45.15
Arrears above 30 days (%)	0.00	0.00
Credit analysis results:		
Weighted-average foreclosure frequency (%)	25.13	25.34
Weighted-average loss severity (%)	48.34	52.98

Table 6

LTV Ratios

	--March 31, 2021--	--Dec. 31, 2019--
(%)	**Percentage of cover pool**	
0-20	5.46	5.71
20-40	16.43	22.73
40-60	77.57	69.82
60-70	0.54	1.73
Above 70	0.00	0.00
Weighted-average LTV ratios	45.65	45.15

LTV--Loan to value.

Table 7

Geographic Distribution Of Loan Assets

	--March 31, 2021--	--Dec. 31, 2019--
Top five concentrations	**Percentage of cover pool**	
East	64.75	61.17
West	29.52	24.67
North	0.47	2.36
South	1.07	3.35
Trondelag	4.18	8.44
Total	100.00	100.00

Table 8

Collateral Uplift Metrics

	--June 30, 2021--	--March 31, 2020--
Asset WAM (years)	5.94	5.58
Liability WAM (years)	4.44	4.38
Available credit enhancement	29.53	28.60

Table 8

Collateral Uplift Metrics (cont.)

	--June 30, 2021--	--March 31, 2020--
AAA credit risk (%)	10.73	10.51
Credit enhancement commensurate with first notch of collateral uplift (%)	12.20	12.04
Credit enhancement commensurate with second notch of collateral uplift (%)	13.67	13.57
Credit enhancement commensurate with third notch of collateral uplift (%)	15.13	15.10
Target credit enhancement for maximum uplift (%)	16.60	16.63
Largest obligor test (%)	16.79	16.87
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.

By applying our credit and cash flow stresses, we calculate a target credit enhancement as of June 2021 of 16.60%, in line with the target credit enhancement of 16.63% calculated as of March 2020. The results are stable, with the positive factors, such as the lower expected loss and spread compression, being entirely offset by the introduction of a 30% haircut to all loans linked to a discretionary rate set by the lender.

Under our 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. As of June 2021, the largest obligor test result is 16.79%. This figure is higher than the target credit enhancement--hence, it constitutes the floor to the credit enhancement level commensurate with a 'AAA' rating.

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 adjust the maximum collateral-based uplift based on whether we consider liquidity risk to be covered for at least six months and on the issuer's commitment to maintain the credit enhancement at a certain level. We consider liquidity risk to be mitigated by the fact that all the bonds present one-year extendable maturities. Moreover, the issuer published a statement committing to a maintain a level of credit enhancement commensurate with the current rating. As a result, we do not make any adjustments to the four notches of uplift based on collateral support.

The available credit enhancement of 29.53% exceeds the target credit enhancement of 16.79%. With a JRL of 'a+' and four notches of collateral-based uplift with no deductions, the covered bonds can achieve a 'AAA' rating.

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 considered them in our modeling. Therefore, 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 ASA is the program's bank account provider. Under 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.

To determine the maximum supported rating under the swap agreement, we interpolate the replacement trigger and the issuer's RRL. When doing so, we consider whether termination costs are senior or subordinated (or otherwise mitigated).

We used our analytical judgment to determine that in this program the liquidity risk posed by termination costs is mitigated. The potential termination costs 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 be lower than the transaction's unused credit enhancement over time.

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 rated up to four notches above the sovereign. As the covered bonds are issued in a country that is not a member of a monetary union, and the program includes structural coverage of refinancing needs over a 12-month period (soft-bullet covered bonds), the program can be rated up to four notches above the long-term sovereign rating. As Norway is currently rated 'AAA', country risk does not constrain the ratings on the program and its related issuances.

Environmental, Social, And Governance (ESG) Factors

ESG credit factors influence the credit quality of Eiendomskreditt's cover pool in a broadly similar way to other Norwegian issuers. The issuer does not offer specific ESG themed mortgages and currently our credit analysis is not affected by specific environment-related factors. We do not consider the mortgages in the cover pool to be particularly exposed to the Norwegian oil sector. Despite the issuer's part focus on loans backed by multi-family housing and cooperative housing associations, to which we assign lower default assumptions compared to loans backed by commercial property, their volume is not large enough to affect our overall assessment. To manage concentration risk, the issuer has implemented rules aimed at keeping the concentration of the largest borrowers below a certain threshold. All outstanding covered bonds present soft-bullet maturities, hence we do not adjust the potential collateral-based uplift due to liquidity risk. Additionally, the program features a public commitment to maintain a level of assets in the cover pool commensurate with the current rating. Therefore, it can achieve all four notches of collateral-based uplift.

Related Criteria

- Global Framework For Payment Structure And Cash Flow Analysis Of Structured Finance Securities, Dec. 22, 2020
- 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
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- Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Global Derivative Agreement Criteria, June 24, 2013
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q3 2021, Sept. 9, 2021
- Norway 'AAA/A-1+' Ratings Affirmed; Outlook Stable, March 12, 2021
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Nov. 27, 2020
- Assessments For Target Asset Spreads According To Our Covered Bonds Criteria, Nov. 27, 2020
- ESG Industry Report Card: Covered Bonds, Nov. 9, 2020
- Eiendomskreditt AS, Oct. 12, 2020
- Norway's Adoption Of BRRD Resolution Regime Results In Additional Ratings Uplift For Norwegian Covered Bonds, Jan. 2, 2019
- Glossary Of Covered Bond Terms, April 27, 2018