DNB Boligkreditt AS NOK 50bn Covered Bond ISIN NO0013056184

The AAA rating with a Stable Outlook assigned to the NOK 50bn Norwegian mortgage-covered bond issued out of DNB Boligkreditt AS (DNBB) covered bond programme reflects the issuer's credit quality enhanced by two notches of governance support.

Cut-off date	Cover pool	Cover asset type	Covered bonds
30 September 2023	NOK 674.4bn	Residential mortgage loans	NOK 376.0bn

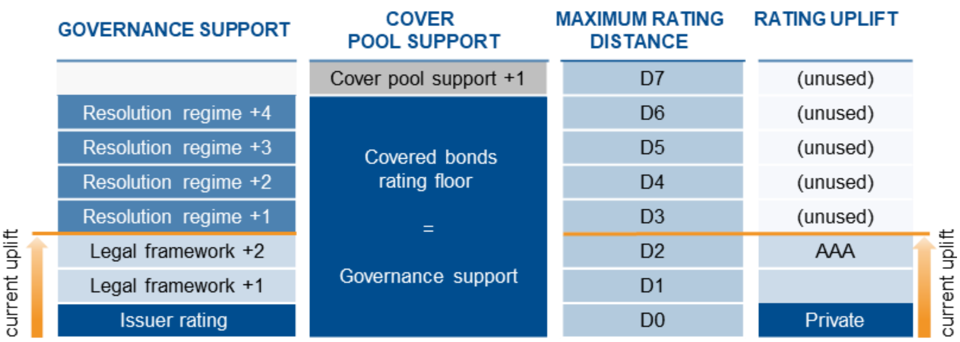
DNBB is a specialised credit institution issuing covered bonds to refinance the mortgage lending of its parent, DNB Bank ASA, one of the leading banks in Norway. Our view on DNBB's credit quality reflects its strong integration into DNB and providing the group with the ability to refinance residential mortgage loans using covered bonds.

As of 4 September 2023, Sbanken Boligkreditt AS (Sbanken), also a wholly owned subsidiary of DNB Bank, was merged into DNBB. Prior to the merger, Sbanken's covered bonds accounted for less than 7% of the accumulated bonds, its cover assets for less than 4%. Accordingly, this merger is credit neutral and reflected into our analysis as of 30 Sept. 2023.

Governance support is the primary rating driver for the rated bond. It is providing six notches of uplift above the issuer rating. Our view is based on the strength of Norway's legal covered bond framework and resolution regime as well as the systemic importance of DNB and its covered bonds. Only two notches are needed to raise the covered bond rating to the highest achievable level.

We have assigned the interplay between complexity and transparency a cover pool complexity (CPC) category of 'high', allowing the maximum uplift from cover pool support of one notch on top of the governance uplift. This means, together with unused governance support of four notches, the covered bond has a five-notch buffer against an issuer downgrade.

Figure 1: Covered bond rating building blocks



Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectation that: i) the credit performance of DNB will continue to be stable; ii) the risk profile of the covered bond programme will remain prudent; and iii) both DNB and DNBB will remain willing and able to provide enough overcollateralisation (OC) to support the covered bond's very high credit quality.

Ratings & Outlook

Issuer rating	Not disclosed
Outlook	Not disclosed
NOK 50bn covered bond NO0013056184	AAA
Outlook	Stable
Rating action	New
Last rating action date	8 Nov 2023

Lead Analyst (Covered Bonds)

Mathias Pleißner
+49 69 6677389-39
m.pleissner@scoperatings.com

Lead Analyst (Banks)

Pauline Lambert
p.lambert@scoperatings.com

Related Research

Scope assigns AAA rating to DNB Boligkreditt's NOK 50bn issue (NO0013056184), Outlook Stable, Nov 2023

Inflation fuels real house-price declines across Europe, July 2023

Norwegian banks: material CRE exposure manageable despite pressures, August 2023

Scope Ratings GmbH

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Rating drivers and mitigants

Positive rating drivers

High issuer credit quality. DNBB's strong credit quality, which reflects that of its parent, forms the starting point for our covered bond rating.

Norwegian covered bond legal framework (two notches). Domestic legislation ensures the integrity of Norway's covered bond framework, enabling full support and enforcement of recourse to the cover pool.

Resolution regime assessment (four notches). Norwegian covered bonds are exempt from bail-in; regulators are likely to restructure the bank using available resolution tools; DNBB's covered bonds are systemically relevant; and a cohesive stakeholder group supports the market's ongoing development.

Cover pool support (one notch). A strong cover pool provides additional stability to covered bond rating, which is already at the highest achievable level thanks to the governance-related uplift.

Negative rating drivers and mitigants

CPC category. The interplay between complexity and transparency allows the maximum additional cover pool uplift of only one notch. Improved transparency could enhance the programme's protection against an issuer downgrade.

Upside rating-change drivers

Issuer. An upgrade of DNBB may increase the buffer of the covered bond rating against an issuer downgrade.

CPC category. Higher transparency could increase the rating buffer against an issuer downgrade.

Downside rating-change drivers

Issuer. DNBB's rating may be negatively impacted by impaired profitability of its parent, by decreasing the buffer of the covered bond rating against an issuer downgrade and/or making cover pool support the primary rating driver.

Resolution-regime assessment. A significant fall in the market share or relevance of covered bonds as a funding vehicle could remove the regulator's incentive and ability to maintain the issuer as going concern, negatively impacting the rating.

The issuer

We maintain and monitor a private issuer rating on DNBB, the wholly owned subsidiary of DNB Bank ASA. We also have a subscription rating on DNB Bank ASA, which can be found, along with the rating report, on ScopeOne, *Scope's digital marketplace*. You can register for access to ScopeOne here.

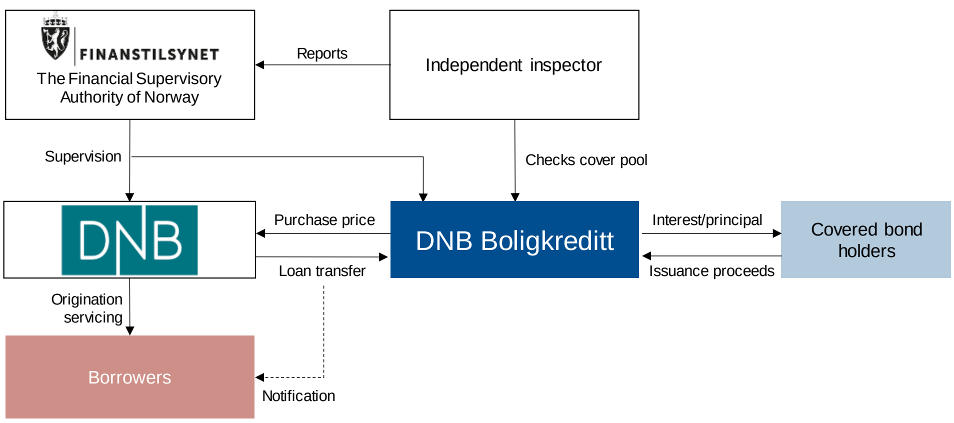
DNB holds a dominant market position and a diversified business franchise in its home market of Norway, which underpin its resilient ability to generate earnings. The group's leading retail and commercial banking franchise is complemented by leading positions in asset management, insurance and investment banking. The group also offers leasing, real estate brokerage, accounting and enterprise resource planning. DNB has a comprehensive approach to sustainability, which it defines as long-term value creation in line with the expectations of key stakeholders including owners, customers and employees. Management has also been successfully addressing the challenges from digitalisation. The group's robust operating performance is providing a buffer against potential credit impairments and supporting growth. Management is targeting a return on equity of at least 13%, while a key performance indicator is a cost-to-income ratio of below 40%. Asset quality metrics remain sound, underpinned by a diversified and balanced loan book. Meanwhile, the exposure to more cyclical industries has reduced.

DNB has a strong record of accumulating capital to meet the increasingly demanding regulatory requirements. The group's solvency metrics on an absolute basis continues to be reassuring. Customer deposits are the primary source of funding, but the group also depends on international funding markets as Norway's market is small.

Programme structure

The Norwegian legal covered bond framework is mainly based on the covered bonds section of the Financial Institutions Act and a related regulation on mortgage credit institutions, both introduced in 2007. The act was amended to transpose the European Covered Bond Directive and came into force on 8 July 2022, the same day as the directive in the EU. Under this framework, issuance is permitted only through specialist covered bond issuers. Like most Norwegian covered bonds issuers (generally called *Boligkreditt*, or specialised residential mortgage institutions), DNBB relies on loans directly originated by its parent bank or on loans underwritten by the bank and originated by DNBB itself. In either case, the parent bank generally provides most of the servicing, allowing DNBB to keep staff numbers low.

Figure 2: Issuance structure



Source: Scope Ratings

Governance support analysis

Governance support factors enhance the covered bond rating by six notches above DNBB's private issuer rating. This is based on our view of: i) Norway's covered bond legal framework; and ii) the resolution regime and systemic importance of DNB and its covered bonds.

Legal framework analysis

Two notches of uplift based on legal framework analysis

We consider the Norwegian covered bond framework to be one of Europe's strongest, meeting our criteria for protecting investors. Therefore, we assign the highest credit differentiation of two notches.

The framework, together with common market practices, ensures i) the cover pool is segregated from the parent's insolvency estate; ii) bond payments can continue after insolvency; and iii) identified risks can be mitigated by OC, which generally remains available after insolvency. Norwegian covered bonds also benefit from specific regulatory oversight as well as liquidity and other risk management guidelines.

Resolution regime analysis

Four notches of additional uplift reflecting resolution regime

Four additional notches of uplift reflect our assessment of the Norwegian resolution regime and systemic importance considerations. This includes: i) the implementation of the Bank Recovery and Resolution Directive and the exemption of covered bonds from bail-in; ii) incentives that prevent regulatory intervention in the issuer affecting the covered bonds' credit quality and performance; iii) product-, issuer- and country-specific aspects relevant to the systemic importance of covered bonds in Norway; and iv) the existence of a pro-active stakeholder community.

The first of the four notches reflects Norwegian covered bonds' exemption from bail-in. This reflects that, in a resolution scenario, regulators are likely to restructure DNBB, together with DNB, as a going concern using available tools. Our view is based on DNB's close integration with the group and status as a domestically systemic important bank. In addition, we consider DNB to have a substantial cushion of eligible liabilities for bail-in to protect the covered bonds of its subsidiary.

The second rating notch reflects our view of the covered bonds' systemic importance in Norway for mortgage lending. We classify Norwegian residential-mortgage covered bonds as a systemic refinancing product. In 2022, covered bond issuances accounted for around 6% of GDP. In Norway, 23 specialised covered bond issuers are active, issuing residential, commercial and public sector-backed covered bonds. Globally, Norway was the eighth largest issuer in 2022 and the tenth largest by total outstanding size.

DNBB's covered bond-issuing activities and market share come with a high systemic importance, resulting in the third notch of rating uplift. A failure of a covered bond issuer with the size and setup of DNBB could result in contagion that creates systemic problems for other issuers reliant on this refinancing channel for their core product of residential mortgage lending.

The fourth rating notch reflects the very active Norwegian stakeholders and a proactive regulator supporting the domestic covered bond market. The country's covered bond issuers actively co-operate under the umbrella of the Norwegian Covered Bond Council to promote the product and initiate any changes to the framework.

For more information on our view of the Norwegian legal framework and resolution regime, please refer to Legal framework analysis: Norway.

Cover pool characteristics

Reporting date	Sep 2023	Sep 2022
Balance (NOK bn)	674.4	687.1
Residential (%)	100%	100%
Substitute (%)	0.0%	0.0%

Property type (%)

Reporting date	Sep 2023	Sep 2022
Houses	65.5%	65.6%
Apartments	31.4%	31.1%
Multi-family houses	2.9%	2.9%
Others	0.7%	0.4%

General information

Reporting date	Sep 2023	Sep 2022
No. of loans	347,279	362,425
No. of obligors	302,688	312,559
Avg. size (NOK m)	1.9	1.9
Top 10 (%)	0.2%	0.2%
Remaining life (y)	22.8	22.7
Indexed LTV (%)	51.7%	49.8%

Interest rate type (%)

Reporting date	Sep 2023	Sep 2022
Floating	94.9%	94.9%
Fixed	5.1%	5.1%

Repayment type (%)

Reporting date	Sep 2023	Sep 2022
Annuity	77.4%	79.5%
Interest-only	22.6%	20.5%

Cover pool analysis

The covered bond's governance support of up to six notches already provides for the highest possible rating. It is the key rating driver and, as such, the additional cover pool support is currently not needed. We determine whether cover pool support could further stabilise the ratings by first examining the interplay between complexity and transparency. This analysis translates into a CPC category of 'high', which constrains the cover pool-related uplift to one out of a maximum three notches on top of the governance-related uplift.

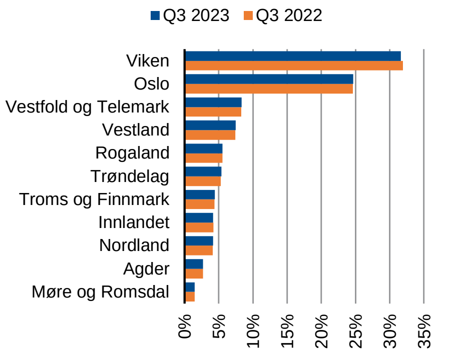
Constraining factors were the limited public visibility with regards to the issuer's origination standards, issuance strategy, hedging strategy and counterparty risk mitigation.

Cover pool composition

The residential mortgage pool is highly granular with around 350,000 loans, mostly to borrowers in Oslo and Viken areas. The granularity is also evidenced by the low share of multi-family houses at only 2.9%. Around two-thirds of the pool are secured by owner-occupied properties. As is usual for Norwegian mortgages, loans are mostly floating rate. The share of bullet loans is rather elevated at around 23%. These typically include revolving credit lines with rather low loan/value (LTV) ratios. The average indexed LTV of 51.7% indicates high recoveries, even under our most severe stresses.

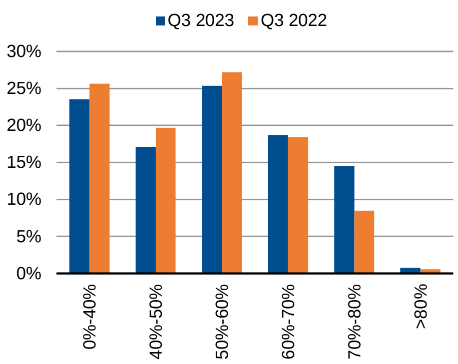
While most of the cover pool characteristics remain relatively stable, the indexed LTV has slightly increased by 1.9 pp from 49.8% one year ago. This is due to the slight deterioration in house prices, which is moderate compared to some other Nordic and central European housing markets.

Figure 3: Regional distribution



Source: Scope Ratings, DNB

Figure 4: LTV distribution (indexed)



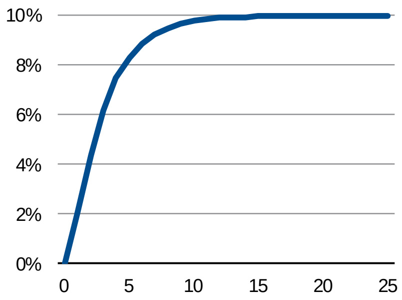
Source: Scope Ratings, DNB

Asset risk analysis

Strong credit quality translates into low credit risk

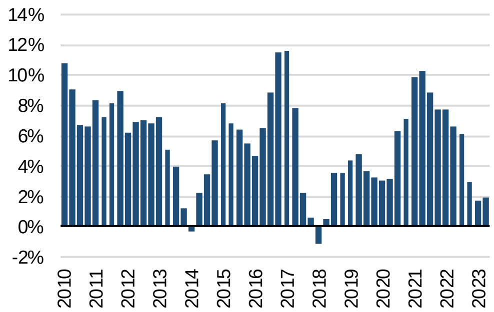
The cover pool's credit quality is strong and in line with that of Norwegian peers. Our projection of default on mortgage loans uses an inverse Gaussian distribution given the high granularity of the cover pool. We have established an unchanged term default probability of 10% and assumed a coefficient of variation of 55% for the mortgage assets.

Figure 5: Expected term defaults, cumulative



Source: Scope Ratings, DNB

Figure 6: House price growth Norway, annualised



Source: Scope Ratings, statOECD

We calculate a stressed recovery rate of 72.5%. Despite recently moderate increases, Norway's medium-term housing growth has exceeded our long-term sustainable growth assumption of 3.0%. This results into stressed market value haircuts of up to 47.5% for property foreclosures. We further assume base market value haircuts of 5% to account for an imminent correction to more sustainable house price levels.

In addition, we assume a fire-sale discount of 20% for properties sold under non-standard market or distressed conditions. The level reflects that the cover pool is tilted towards the metropolitan, more liquid areas of Oslo. Our recovery analysis also includes a flat 10% haircut for repossession-related costs.

We assumed a recovery lag of 24 months reflecting Norway's lean and digital sale procedures as well as the more regional asset exposure.

Figure 7: Norwegian total security value haircuts (TSVH)

Region	Base MVD	Stressed MVD	Fire-sale discount	Stressed TSVH
Oslo	5.0%	47.5%	20%	57.5%
South-Western	5.0%	40.0%	20%	52.5%
Rest of Norway	5.0%	40.0%	20%	52.5%

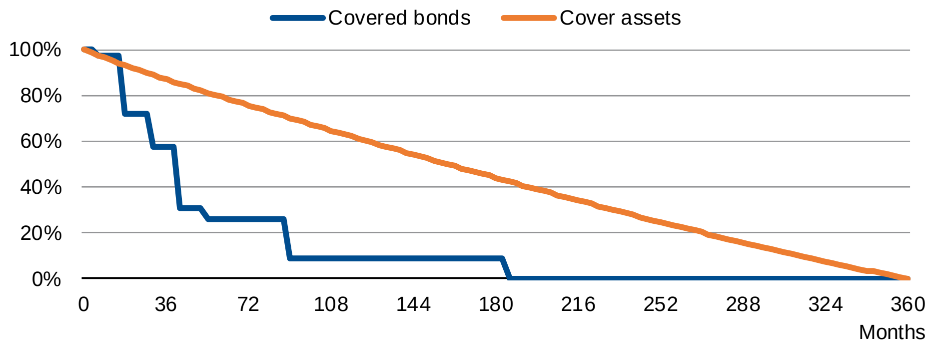
Cash flow risk analysis

We set the level of OC that supports the AAA rating at the legal minimum of 5% because the rating is based on governance support. Cover pool support is not a rating driver.

To test rating stability, we determined the OC needed to support the current rating uplift if the programme had to rely on cover pool support. We found that cover pool support can maintain the AAA rating up to a five-notch issuer downgrade. Our analysis used public data provided by DNBB.

We projected asset cash flows based on the cover pool's weighted average life complemented by the reported average remaining term to maturity. We relied on the covered bond's stratified maturity schedule as reported. In our base scenario we further assume an annual excess margin of 25 bp generated by the cover pool over the interest on the covered bonds, based on market information and benchmarking.

Figure 8: Amortisation profile



Source: Scope Ratings, DNB

In the event of recourse to the cover pool, we assume assets will be sold at a discount of up to 150 bp if cash accumulated from cover pool amortisation is insufficient to pay timely interest and principal on the covered bonds. The cover pool does not include short-term substitute assets. We derived this liquidity premium by analysing the long-term development of trading spreads for Norwegian and other 'core country' covered bond spreads.

We tested for low (1%) and high (up to 15%) prepayments to stress the programme's sensitivity to unscheduled repayments. The programme is most sensitive to low prepayments. Forced asset sales at a discount are therefore likely given the maturity mismatch between the long-dated assets and the short-dated liabilities.

Asset-liability mismatches

	Assets	Liabilities
NOK	100%	100%**
Fixed	5.1%	0.0%**
Floating	94.9%	100.0%**
WAL (years)	14.5	4.3*

*extended
**after hedge

Other market risks are limited thanks to the issuer's prudent hedging strategy. Around 5% of the cover assets pay a fixed rate while all covered bonds have floating rates when including the use of swaps. Also, there is no foreign exchange risk as all liabilities denominated in foreign currency are swapped to Norwegian krone.

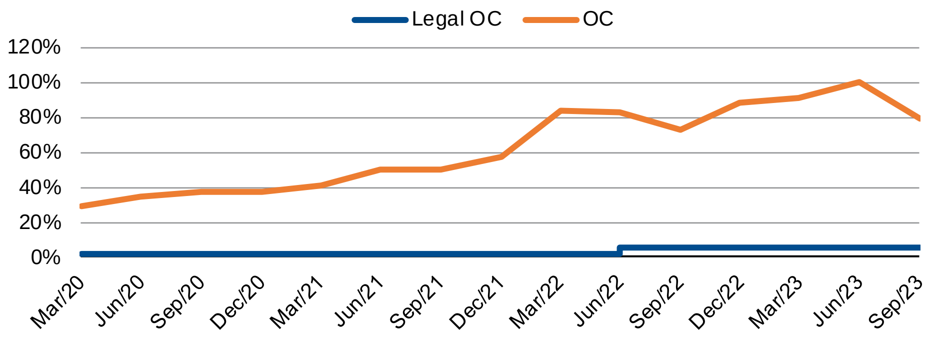
We applied country- and asset-type-specific servicing fees which the cover pool needs to pay. For the residential mortgage loans, we assumed a servicing fee of 25 bp.

Availability of overcollateralisation

Overcollateralisation fully taken into account

The current rating of DNBB allows us to fully account for the provided OC of 79.4% (at end-September 2023), which is well above the OC supporting the programme's AAA rating. We are not aware of plans that would significantly change the risk profile or reduce available OC to levels that would no longer support the current rating uplift.

Figure 9: OC development



Source: Scope Ratings, DNB

Other risk considerations

Counterparty risk mitigated by alignment of interests

The rated covered bond has a significant counterparty exposure to the issuer as well as to the issuer's parent in its roles as loan originator, servicer, bank account provider, paying agent and swap counterparty. However, if a regulator were to intervene, we believe the strong alignment of interests between the bank and the covered bond holders would prevent any negative impact. We also view positively the fact that collections are generally made via direct debit, allowing for a relatively swift redirection of payments if necessary.

Sovereign risk does not affect the ratings

Sovereign risk does not limit the covered bond rating. We believe the risks of an institutional framework meltdown, legal insecurity or currency-convertibility problems are remote.

Established green bond framework

DNB established its green bond framework in 2021 based on ICMA Green Bond Principles. Under this framework DNB issues green covered bonds (through DNBB) and uses the proceeds to finance green residential buildings. DNB currently follows a best-in-class approach, whereby the 15% of Norwegian buildings with the lowest CO_2 emission are labelled as 'green'. As of October 2023, DNB and DNBB together have an equivalent of NOK 41,007m of green covered bonds outstanding. They have issued three green bonds, denominated in euro and Swedish krona. As such, the rated NOK 50bn is not a dedicated green-labelled covered bond.

Sensitivity analysis

Four-notch buffer from governance support …

The issuer's credit quality in combination with the governance-related uplift of up to six notches allows the AAA rating on the NOK 50bn covered bond to be maintained without the need for credit support from the cover pool, even upon an issuer downgrade of up to four notches.

… plus one notch from cover pool support

The covered bond rating can even withstand an issuer downgrade of five notches thanks to the one notch of additional uplift provided by the cover pool. However, such an issuer rating downgrade would require a major adverse shock to the Norwegian economic and banking environment and would likely lead to changes in the cover pool's asset quality and risk structure, thereby requiring constant monitoring of the programme's credit quality.

Summary of covered bond characteristics

Reporting date	30 September 2023	30 September 2022
Issuer name	DNB Boligkreditt AS	
Country	Norway	
Covered bond name	Obligasjoner med fortrinnsrett (Norwegian mortgage-covered bonds)	
Covered bond legal framework	Norwegian legal covered bond framework	
Cover pool type	Residential mortgage loans	
Composition	Residential: 100%	Residential: 100%
	Substitute: 0%	Substitute: 0%
Issuer rating	Private	Private
Current covered bond rating (ISIN NO0013056184)	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullet	Soft bullet
Cover pool currencies	NOK (100%)	NOK (100%)
Covered bond currencies (post-hedge)	NOK (100%)	NOK (100%)
Governance support	6	6
Maximum additional uplift from CPC category	1	1
Maximum achievable covered bond uplift	7	7
Potential covered bond rating buffer	5	5
Cover pool (NOK bn)	674.4	687.1
thereof, substitute assets (NOK bn)	0	0
Covered bonds (NOK bn)	376.0	397.4
Overcollateralisation: current / legal minimum	79.4% / 5.0%	72.9% / 5.0%
Overcollateralisation to support current rating	5.0%	5.0%
Overcollateralisation upon a one-notch issuer downgrade	5.0%	5.0%
Weighted average life of assets	14.5	13.7
Weighted average life of liabilities (extended)	4.3	4.5
Number of loans	347,279	362,425
Average loan size (NOK m)	1.9	1.9
Top 10 residential	0.2%	0.2%
Interest rate type – assets	Floating: 94.9%	Floating: 94.9%
	Fixed: 5.1%	Fixed: 5.1%
Interest rate type – liabilities (post-hedge)	Floating: 100%	Floating: 100%
	Fixed: 0%	Fixed: 0%
Weighted average LTV (indexed)	51.7%	49.8%
Geographic split (top three)	Viken: 31.6%	Viken: 31.9%
	Oslo: 24.7%	Oslo: 24.6%
	Vestfold og Telemark: 8.3%	Vestfold og Telemark: 8.3%
Default measure	Inverse Gaussian	Inverse Gaussian
Mean default rate (cumulative/annualized)	10.0% / 70bp	10.0% / 70bp
Coefficient of variation	55.0%	55.0%
Recovery rate assumption (base/stressed)	95.0% / 72.5%	97.0% / 72.5%
Maximum liquidity premium	150 bp	150 bp
Servicing fee	25 bp	25 bp

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris
10 avenue de Messine
FR-75008 Paris

Phone +33 6 6289 3512

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 09 38 35

Madrid
Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London
52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

Disclaimer