Realkredit Danmark A/S
Issuer Rating Report

SCOPE A+ STABLE

Scope's credit view (summary)

The **A+ issuer rating** of Realkredit Danmark A/S (Realkredit or RKD) is aligned with that of its parent company, Danske Bank A/S (Danske), as we consider Realkredit to benefit from Danske's full support and therefore apply our top-down approach to the analysis.

In determining the reliability and stability of the parent company's support for the subsidiaries, we take into consideration, in particular, the extent to which the subsidiary is aligned with the strategic goals of the group, its fully integration into the group's operations and the fact that the absence of support would be highly detrimental to Danske. We also take into account the parent's track record in supporting its subsidiaries.

As a specialised mortgage finance subsidiary in Danske Group's home market of Denmark, Realkredit originates the majority of its domestic mortgage loans within Danske, for which Danske provides a first loss guarantee. While Realkredit has its own governance structure, it is closely integrated into the group through a common strategy and risk management principles. The loans are funded by covered bonds, which makes the bank an important funding vehicle for Danske Group.

Realkredit's standalone financial profile continues to be supported by its high asset quality, strong capitalisation and position as a major covered bond issuer in Denmark. We consider Realkredit's proven pass-through funding model as a key credit strength.

Credit quality remains sound. This continues to be supported by low loan-to-value (LTV) ratios across the portfolio. A solid risk position as Denmark's second largest mortgage lender puts Realkredit in a good position to weather the current recession, even though asset quality in commercial real estate may weaken.

Realkredit's monoline business model is focused on mortgage lending with less diversified revenue streams. Profitability is also challenged by lower new lending activity, somewhat offset by remortgaging into variable-rate loans, which generate higher administration fee income. Return on equity is still sound, supported by cost efficiency measures and low cost of risk, but also likely to remain under pressure due to rising regulatory requirements.

Realkredit is dependent on wholesale funding. However, the Danish covered bond market is well established and liquid with a wide range of domestic and foreign investors.

Outlook

The **Outlook is Stable,** reflecting alignment with the Outlook of the parent company.

Rating-change drivers

- Any change in the parent's issuer rating is likely to lead to a concurrent change for Realkredit as Realkredit's rating is aligned with that of its parent.

- A weakening of the strategic importance of RKD as a core subsidiary for Danske, resulting in a lower likelihood of support, could lead to a rating downgrade.

Ratings & Outlook

Issuer rating	A+
Outlook	Stable
Short-term debt rating	S-1+
Short-term debt rating Outlook	Stable
Covered bonds ratings	AAA
Covered bonds Outlook	Stable

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Issuer profile

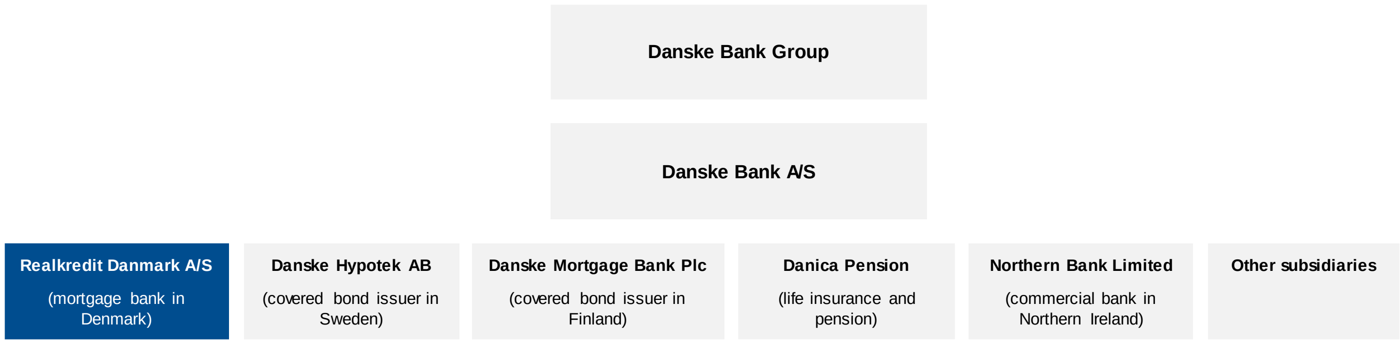
Realkredit is a fully owned mortgage subsidiary of Danske and is part of Denmark's largest banking group in terms of total assets. Realkredit accounts for approximately 20% of the group's assets and 40% of its loan book.

As a stand-alone entity, Realkredit has a market share of 24% in Danish mortgage lending and is Denmark's second largest mortgage bank with assets of DKK 781bn as of end-June 2023. It is one of the major issuers of covered bonds in the Danish covered bond market, as mortgages are required by law to be financed by covered bonds.

Realkredit is a fully integrated subsidiary of Danske Group

As a part of its monoline business model, Realkredit funds most mortgage loans originated by Danske Group in Denmark, though Danske also originates mortgage loans funded through its own mortgage pools and mortgage subsidiaries in Sweden and Finland (Figure 1).

Figure 1: Danske Group’s structure

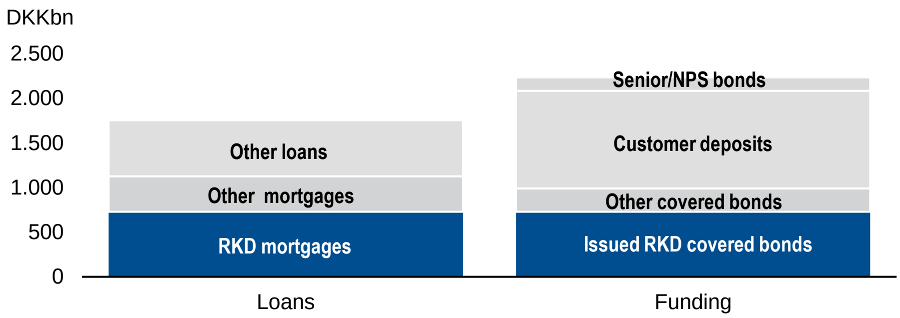


Source: Danske Group’s data, Scope Ratings

Realkredit has no branches or subsidiaries outside Denmark. While the majority of customers are served in Denmark, the bank also has customers in Norway and Sweden. Mortgage loans to private customers and SMEs are distributed through Danske's branch network and finance centres, as well as through Realkredit's own chain of home real estate agencies, a call centre and online services.

Realkredit’s loans are funded by covered bonds, which makes the bank a key funding vehicle for Danske Group (Figure 2). In addition, Danske provides Realkredit with a first loss guarantee on the unsecured part of certain originated mortgages.

Figure 2: Danske Group’s loan portfolio and funding structure



Data as of end-June 2023. Source: Danske Group’s data, Scope Ratings

High integration into the group through a uniform strategy, risk management and ESG initiatives

We believe Realkredit, as a core operating and fully integrated subsidiary, would receive full support from Danske if required. Key back-office support, control functions and overall strategy are provided by Danske. While Realkredit has its own governance structure, it is fully integrated into Danske Group, following the same strategy and risk management principles. Realkredit also performs certain tasks on behalf of the group, such as property valuation.

The group's new Forward '28 strategy, announced in June 2023, sets ambitious targets including strengthening of digitalisation, advisory services and sustainability. Realkredit, with its deep expertise in the mortgage, housing and real estate markets, intends to play an important role in the implementation of the group's new strategy. Realkredit strives to continuously improve its digital service of customers and aims to further improve advisory services for homeowners and to simplify services.

Sustainability has been an integrated part of the group's strategy and corporate goals since 2019, thus Realkredit has a strong focus on sustainability business initiatives. At the beginning of 2023, the group has launched a new Climate Action Plan, in line with the Paris Agreement, which sets ambitious targets for the reduction of financed CO_2 emissions, as well as other actions and initiatives related to the group's climate efforts. To support the group's ambition, Realkredit has set a 75% reduction target for mortgages in Denmark, to be achieved by 2030.

Green bond issuance in line with the group's targets

In support of the group's sustainable financing objectives, Realkredit remains committed to offering green bond mortgage financing, enabling customers to achieve their climate targets. Green bond issuance continues to grow, targeting the mid-cap segment in Denmark, Sweden and Norway. At end-June 2023 total green lending amounted to DKK 24.1bn with potential to grow further. Assets eligible for green bond issuance, i.e. properties with an energy performance certificate of A or B which have not been financed by green bond issuance, amounted to approximately DKK 84.2bn at end-2022. Green bonds are backed by loans for energy-efficient commercial property, energy transmission and renewable energy projects.

Sound profitability supported by cost efficiency and low cost of risk

Covered bonds are backed by Danish mortgages, the principal and interest of which are passed directly on to covered bond investors, whereas Realkredit charges an administration margin (net interest income excluding interest income from own investments). As customers have been switching to fixed-rate loans to take advantage of the low interest-rate environment, Realkredit's administration margin has been falling in recent years.

In 2022, interest rate hikes have triggered remortgaging activity as borrowers convert to variable-rate loans to reduce their outstanding debt. In 2022 Realkredit remortgaged loans for DKK 92bn, against DKK 56bn in 2021. Remortgaging to variable-rate loans generally results in higher administration fee income, but given the lower LTVs on remortgaged loans, this had a neutral effect on Realkredit's administration margin. Remortgaging activity slowed slightly in the first half of 2023, as many homeowners had already refinanced their loans and rising interest rates on variable-rate loans reduced the incentive to remortgage from fixed-rate loans. At end-June 2023 fixed-rate mortgages accounted for approximately 38% of all disbursed loans (YE 2022: 41%).

Given the uncertainty in the housing market, mortgage demand is expected to fall further, although at a slowing pace, thereby putting pressure on the bank's administration margin.

Realkredit's monoline business model is focused on mortgage lending with less diversified revenue streams. In addition, the bank generates trading income on the part of its securities portfolio that is not related to mortgage lending. Profitability is also challenged by lower new lending activity, somewhat offset by remortgaging into variable-rate loans, as these generate higher administration fee income. Return on equity is still sound, supported by cost efficiency measures and low cost of risk, but also likely to remain under pressure due to rising regulatory requirements.

In H1 2023 the bank’s operating income at DKK 3.4bn was visibly higher compared with DKK 2.9bn in the same period in 2022 (full year 2022: DKK 5.9bn). The increase was driven mainly by net interest income and income from own investment portfolios due to rising interest rates, while the administration margin declined given lower sales activity in the mortgage market. At 15.4%, Realkredit’s cost-income ratio is low (2022: 18.5%) and reflects the group's overall focus on cost efficiency, which we view as credit positive.

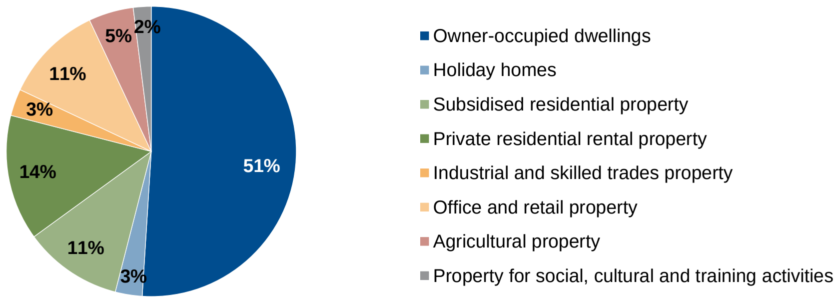
Despite the continued rise in interest rates, higher consumer prices and uncertainty in the property market, the level of impairment charges remains low. In H1 2023, loan loss reversals amounted to DKK 14m (H1 2022: DKK 17m), against impairment charges of DKK 212m (3 bp) in 2022. The post-model adjustments are maintained to cover the impact of macroeconomic uncertainty.

For 2023, Realkredit expects its net profit to be higher than in 2022 on the back of rising interest rates, lower operating costs and contained loan loss provisions. We deem that realistic.

High asset quality supported by healthy mortgage loans

Realkredit’s core loan segment is residential mortgage loans (54%), including owner-occupied housing and holiday homes (Figure 3). Realkredit also provides mortgages to the corporate sector, including commercial real estate, residential rental property and agricultural property.

Figure 3: Loan portfolio split by segment

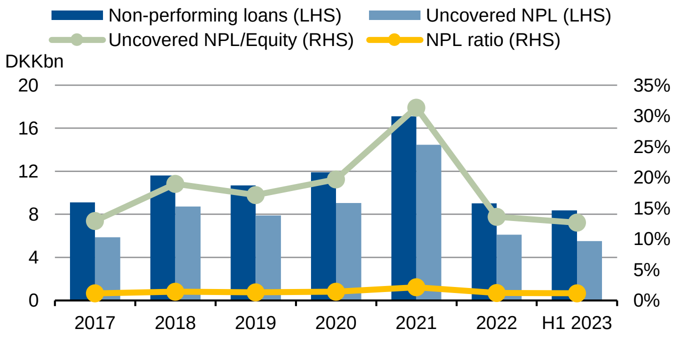


Data as of YE 2022. Source: RKD’s data, Scope Ratings

High asset quality supported by low LTVs

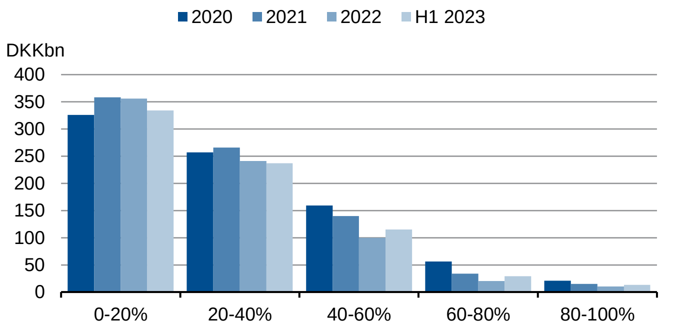
The overall quality of the loan portfolio remains high. At end-June 2023, Realkredit’s mortgage NPLs, called stage 3 loans according to IFRS 9, accounted for a low 1.2% of total loans (2022: 1.2%). See Figure 4.

Figure 4: Non-performing loans (NPLs) vs uncovered NPLs



Source: SNL, Scope Ratings

Figure 5: LTV breakdown



Source: RKD's data, Scope Ratings

Realkredit's asset quality benefits from the strong legislative standards for mortgage loans under Denmark's Mortgage Act and Denmark's covered bond legislation. Realkredit sets LTV caps at 80% for residential mortgages and 60% for commercial real estate. Higher LTV limits may apply for public housing and are also covered by the government guarantee.

Based on stable borrower credit quality, Realkredit kept LTVs at a low average level of 51.5% as of end-June 2023 (50% for residential, 53% for commercial property). The increase from the average level of 48% at end-2022 was driven by falling house prices. Only a small portion of loans, less than 2%, mainly related to public housing with municipal and state guarantees, had LTVs above 80% (with DKK 5bn covered by a public guarantee). At end-June 2023, Danske's total first loan loss guarantees to cover the risk of rising LTVs amounted to DKK 34bn (2022: DKK 38bn).

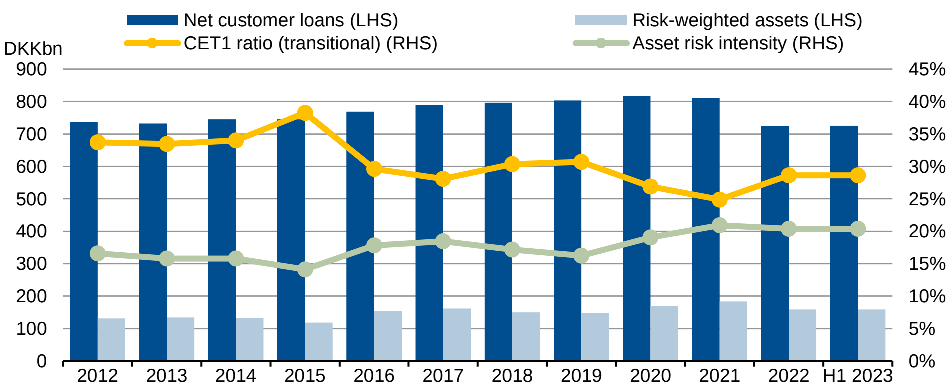
Danish mortgage bank regulatory diamond: well within parameters

Realkredit and other Danish mortgage lenders are subject to the supervisory diamond that sets several thresholds on: annual lending growth, certain product types such as interest-only loans, short-term refinancing as well as large exposures concentration. Realkredit has been operating well within these limits in recent years.

Strong capitalisation challenged by tightening regulatory regime

Realkredit's prudential capital metrics are strong, underpinned by increasing interest rates reducing risk-weighted assets given the lower market value of its loan book. At end-June 2023, the CET1 ratio was high at 28.6%, more than 14 pp above Realkredit's minimum capital requirement. However, we expect capital ratios to decline materially over the coming years due to regulatory changes of risk-weighting floors as a result of EBA guidelines and Basel IV.

Figure 6: Solvency ratios



Source: SNL, Scope Ratings

With total capital of DKK 46.2bn and a total capital ratio of 29.1%, calculated in accordance with the Capital Requirements Regulation and Directive (CRR/CRD), Realkredit had DKK 17.1bn above its solvency need of 10.3% and the combined buffer requirement of 8%. The latter includes a systemic risk buffer of 3%, a Pillar II requirement of 2.5% and the Danish countercyclical capital buffer, which was increased to 2.5% starting from end-March 2023.

The transitional leverage ratio stood at 5.7% at YE 2022 (YE 2021: 5.1%), well above the requirement of 3%.

Strict matching of assets and liabilities to mitigate risks

Realkredit's main risks are the credit risk from mortgage loans and the liquidity risk, which is mainly related to refinancing auctions. The refinancing auctions are supported by the well operating and historically resilient Danish mortgage bond market. In addition, the refinancing risk is governed by the Danish FSA by two indicators in the supervisory diamond for mortgage banks.

Covered bonds as a core and strictly regulated funding source

The Danish mortgage bond market has always been based on the matching of terms and conditions for loans and corresponding covered bonds, restrictive eligibility criteria, including LTV limits and property valuation requirements. The issuer posts additional collateral if LTVs rise above statutory limits. The effect of its balancing principle is that interest rate, exchange rate and liquidity risks are largely eliminated for mortgage banks and passed on to borrowers or borne by covered bond investors. Refinancing risk is mitigated by the issuance of bonds with longer maturities than the fixing periods. The maturity of covered bonds can also be extended in the event of a failure to refinance.

In accordance with Danish mortgage banking regulation, Realkredit's assets and liabilities are divided into two main active pools of residential and commercial mortgages: Capital Centre (CC) S and CC T. Mortgage loans in CC S have a fixed interest rate for life; loans in CC T are variable-rate mortgages. Together, the two CCs account for more than 90% of the bank's balance sheet, with the remainder being a small pool of CC A for government-guaranteed social housing loans. In the event of insolvency, the assets and liabilities of each pool would be separated.

Realkredit’s liquidity is solid, but funding could become more expensive as Danish mortgage banks need more liquidity to provide additional collateral in the face of falling house prices. In principle, however, we consider the effect very limited.

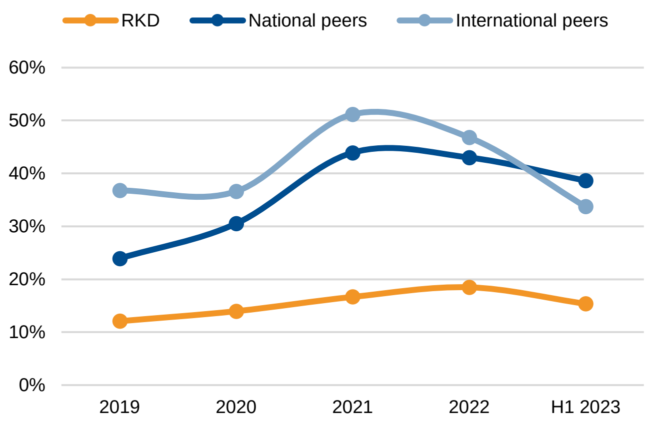
Minimum requirements for own funds and eligible liabilities: potential funding needs ahead

Realkredit can issue additional junior covered bonds out of its pools to fund collateral that no longer meets LTV requirements. Post MREL regulation, issuers of covered bonds can also issue non-preferred senior debt to achieve the same result. Given the anticipated increase in risk-weighted assets and the expected decline in the capital buffer, Realkredit may need additional bail-in-able loans from Danske, which we consider as manageable for the parent.

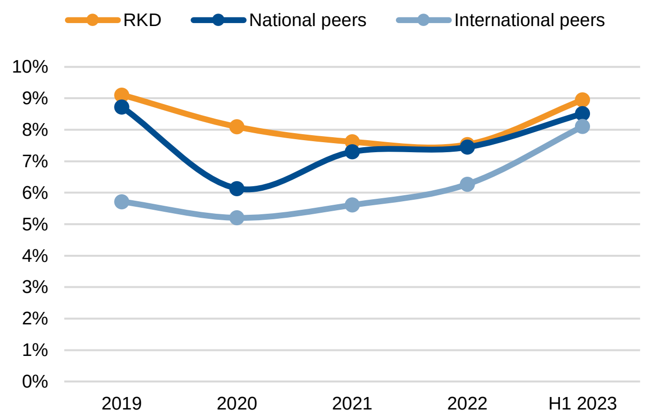
As a credit institution, Realkredit is subject to the liquidity coverage ratio, which consists of a Pillar I and a Pillar II requirement, with the Pillar II requirement covering stressed arrears, remortgaging and refinancing risks. At end-June 2023, Realkredit had unencumbered liquid assets of DKK 19bn after caps and haircuts with an adequate buffer of DKK 11.1bn.

I. Appendix: Peer comparison

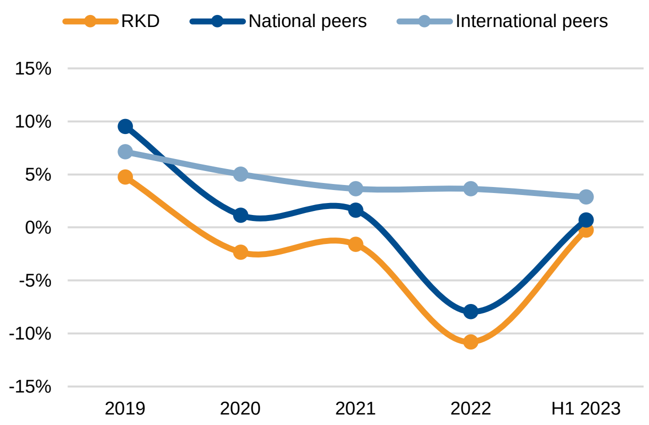
Cost/income ratio (%)



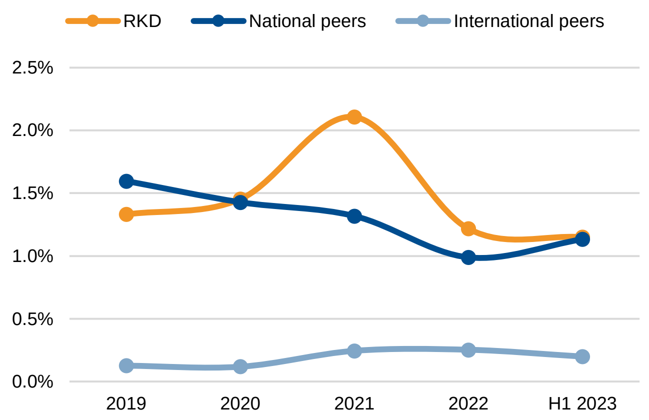
Return on average equity (%)



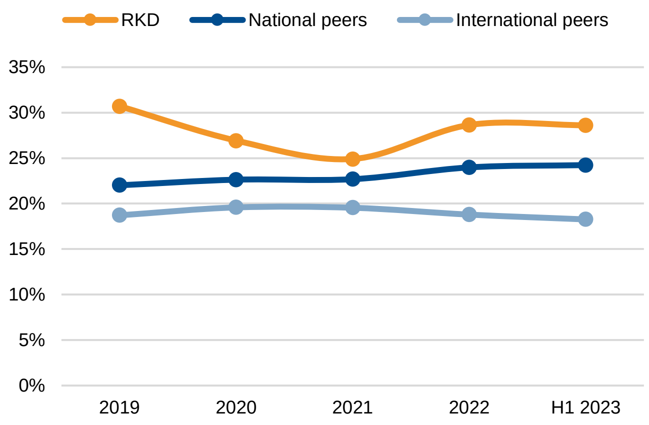
Asset growth



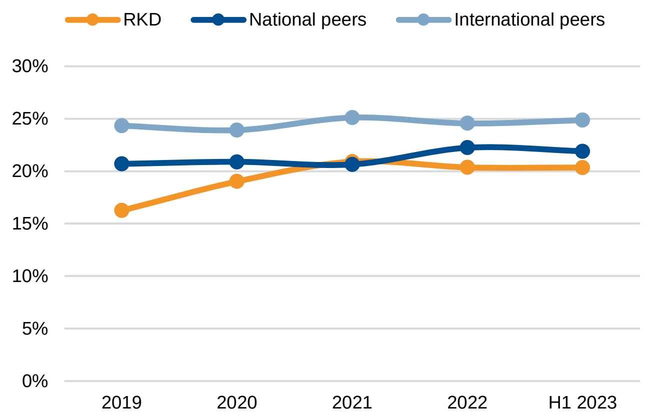
Problem loans/gross customer loans (%)



Common equity tier 1 ratio (%, transitional)



Asset risk intensity (RWA/ total assets, %)



National peers: Nykredit Realkredit, Nordea Kredit Realkredit

International peers: Nordea Hypotek, DNB Boligkreditt, Swedbank Hypotek, Stadshypotek, Länsförsäkringar Hypotek, SpareBank 1 Boligkreditt, PKO Bank Hipoteczny, Bausparkasse Schwäbisch Hall, Achmea Bank, Münchener Hypothekenbank, Nationwide Building Society

Source: SNL, Scope Ratings

II. Appendix: Selected financial information – Realkredit Danmark A/S

	2019	2020	2021	2022	H1 2023
Balance sheet summary (DKK m)					
Assets					
Cash and interbank assets	53,826	25,045	18,643	8,761	6,877
Total securities	52,491	47,226	46,475	46,836	47,610
of which, derivatives	128	39	40	114	51
Net loans to customers	803,122	817,026	810,547	724,642	725,590
Other assets	3,109	1,971	1,334	1,989	1,189
Total assets	**912,548**	**891,268**	**876,999**	**782,228**	**781,266**
Liabilities					
Interbank liabilities	4,003	2,000	2,000	2,000	2,000
Senior debt	853,579	835,284	820,983	724,246	NA
Derivatives	5	17	16	14	62
Deposits from customers	0	0	0	0	0
Subordinated debt	0	0	0	0	0
Other liabilities	4,968	4,377	4,528	6,491	NA
Total liabilities	**862,555**	**841,678**	**827,527**	**732,751**	**733,262**
Ordinary equity	49,993	49,590	49,472	49,477	48,004
Equity hybrids	0	0	0	0	0
Minority interests	0	0	0	0	0
Total liabilities and equity	**912,548**	**891,268**	**876,999**	**782,228**	**781,266**
Core tier 1/ common equity tier 1 capital	*45,538*	*45,632*	*45,658*	*45,614*	*45,474*
Income statement summary (DKK m)					
Net interest income	6,905	6,496	6,285	6,110	3,057
Net fee & commission income	-528	-21	-127	18	2
Net trading income	219	-410	-327	-236	256
Other income	117	114	136	84	39
Operating income	**6,713**	**6,179**	**5,967**	**5,976**	**3,354**
Operating expenses	812	864	995	1,105	516
Pre-provision income	**5,901**	**5,315**	**4,972**	**4,871**	**2,838**
Credit and other financial impairments	265	335	269	212	-14
Other impairments	NA	NA	NA	NA	NA
Non-recurring income	0	0	0	0	0
Non-recurring expense	0	0	0	0	0
Pre-tax profit	**5,636**	**4,980**	**4,703**	**4,659**	**2,852**
Income from discontinued operations	0	0	0	0	0
Income tax expense	1,240	1,097	1,034	1,033	711
Other after-tax Items	0	0	0	0	0
Net profit attributable to minority interests	0	0	0	0	0
Net profit attributable to parent	**4,396**	**3,883**	**3,669**	**3,626**	**2,141**

Source: SNL, Scope Ratings

III. Appendix: Selected financial information – Realkredit Danmark A/S

	2019	2020	2021	2022	H1 2023
Funding and liquidity					
Net loans/ deposits (%)	NA	NA	NA	NA	NA
Liquidity coverage ratio (%)	NA	NA	NA	NA	NA
Net stable funding ratio (%)	NA	NA	214%	175%	NA
Asset mix, quality and growth					
Net loans/ assets (%)	88.0%	91.7%	92.4%	92.6%	92.9%
Problem loans/ gross customer loans (%)	1.3%	1.5%	2.1%	1.2%	1.2%
Loan loss reserves/ problem loans (%)	26.1%	23.9%	17.3%	32.9%	34.2%
Net loan growth (%)	0.8%	1.7%	-0.8%	-10.6%	0.3%
Problem loans/ tangible equity & reserves (%)	20.3%	22.7%	32.7%	16.9%	16.5%
Asset growth (%)	4.7%	-2.3%	-1.6%	-10.8%	-0.2%
Earnings and profitability					
Net interest margin (%)	0.8%	0.7%	0.7%	0.7%	0.8%
Net interest income/ average RWAs (%)	4.5%	3.9%	3.7%	3.8%	3.8%
Net interest income/ operating income (%)	102.9%	105.1%	105.3%	102.2%	91.1%
Net fees & commissions/ operating income (%)	-7.9%	-0.3%	-2.1%	0.3%	0.1%
Cost/ income ratio (%)	12.1%	14.0%	16.7%	18.5%	15.4%
Operating expenses/ average RWAs (%)	0.5%	0.5%	0.6%	0.7%	0.6%
Pre-impairment operating profit/ average RWAs (%)	3.9%	3.2%	2.9%	3.0%	3.5%
Impairment on financial assets / pre-impairment income (%)	4.5%	6.3%	5.4%	4.4%	-0.5%
Loan loss provision/ average gross loans (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Pre-tax profit/ average RWAs (%)	3.7%	3.0%	2.8%	2.9%	3.6%
Return on average assets (%)	0.5%	0.4%	0.4%	0.4%	0.5%
Return on average RWAs (%)	2.9%	2.4%	2.2%	2.3%	2.7%
Return on average equity (%)	9.1%	8.1%	7.6%	7.5%	8.9%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	30.7%	26.9%	24.9%	28.6%	28.6%
Tier 1 capital ratio (%, transitional)	30.7%	26.9%	24.9%	28.6%	28.6%
Total capital ratio (%, transitional)	31.1%	27.4%	25.3%	29.1%	29.1%
Leverage ratio (%)	4.9%	5.0%	5.1%	5.7%	NA
Asset risk intensity (RWAs/ total assets, %)	16.3%	19.0%	20.9%	20.4%	20.4%
Market indicators					
Price/ book (x)	NA	NA	NA	NA	NA
Price/ tangible book (x)	NA	NA	NA	NA	NA
Dividend payout ratio (%)	NA	NA	NA	NA	NA

Source: SNL, Scope Ratings

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