Totens Sparebank Boligkreditt

Norwegian Mortgage-Covered Bonds – Performance Update

Rating rationale (summary)

The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued by Totens Sparebank Boligkreditt (TSBB) is based on the bank's A- issuer rating enhanced by six notches of cover pool support. Five notches of the support reflect our assessment of the strong governance support provided by the Norwegian legal covered bond and resolution framework.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 June 2022	NOK 5.35bn	Residential mortgage loans	NOK 4.53bn	AAA/Stable

Cover pool support is the primary rating driver. Together with the programme's governance support, it provides eight notches of uplift above the issuer rating. Only six notches are needed to raise the covered bond ratings to the highest achievable level.

We classified the interplay between complexity and transparency with a cover pool complexity category of 'low', allowing the maximum additional uplift from cover pool support of three notches on top of the governance support uplift. Together, the programme benefits from a two-notch buffer against an issuer downgrade.

Governance support provides the covered bonds with five notches of uplift above the issuer rating. As such, only one additional notch from cover pool support is needed to raise the covered bonds' rating to the highest achievable level.

GOVERNANCE SUPPORT	COVER POOL SUPPORT	MAXIMUM RATING DISTANCE	RATING UPLIFT
	Cover pool support +3	D8	(unused)
	Cover pool support +2	D7	(unused)
	Cover pool support +1	D6	AAA
Resolution regime +3	Covered bond rating floor = Governance support	D5	AA+
Resolution regime +2		D4	AA
Resolution regime +1		D3	AA-
Legal framework +2		D2	A+
Legal framework +1		D1	A
Issuer rating		D0	A-

Stable Outlook

The Stable Outlook on the covered bonds reflects the rating buffer provided by governance and cover pool support, which shield the covered bond rating from a multi-notch issuer rating deterioration.

Changes since the last performance update

Since June 2021, the cover pool has increased to NOK 5.3bn (+16%). This was driven by new business that resulted from a rise in gross lending as well as the ongoing asset reallocation from mortgage loans previously registered in the EIKA covered bond programme. The indexed loan-to-value ratio (LTV) improved to 52.0% (down from 53.1%), mainly fuelled by strong house price increases. However, the trend of increasing house prices seems have come to an end based on the recent house price updates. We have reflected our housing market outlook in our base market value declines.

Ratings & Outlook

Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	8 Sep 2022
Issuer rating	**A-**
Outlook	Stable
Last rating action	Affirmation
Last rating action date	19 Sep 2022

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Related Research

Scope affirms Totens Sparebank Boligkreditt's mortgage covered bonds at AAA/Stable, September 2022

Scope affirms Toten Sparebank's issuer rating of A- with Stable Outlook, September 2022

Legal framework analysis: Norway, September 2022

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The issuer

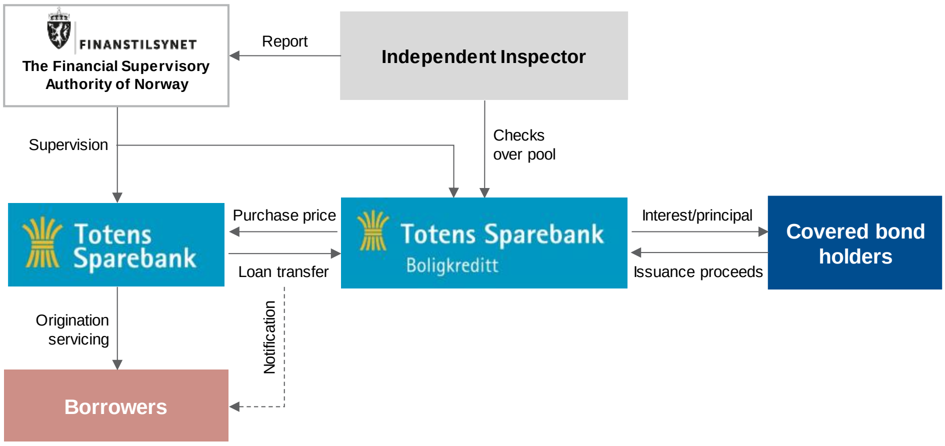
The A-/Stable issuer rating also applies to TSBB, a wholly owned subsidiary of Totens Sparebank. TSBB provides secured funding for its parent through the issuance of covered bonds. Established in 1854, Totens Sparebank is a savings bank with a strong market position in south-eastern Norway. Macroeconomic conditions in Norway are supportive, with the country having recovered from a fall in oil prices in 2014. The bank operates primarily in the Mjos region, where agriculture, manufacturing and the public sector are important economic drivers. Over 70% of the bank's lending concerns residential mortgages. For further details on our bank credit analysis, see the full bank rating report available on www.scoperatings.com.

Programme structure

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the country's Financial Institutions Act (Lov om finansforetak og finanskonsern) and related regulation on mortgage credit institutions, both introduced in 2007. The act was last amended to transpose the European Covered Bond Directive. Such amendments came into force on 8 July 2022 in parallel with the application date in the EU. The act itself provides the general structure of the main framework and references to regulations provided by Norway's Ministry of Finance. As such, the Norwegian regulation on capital requirements and the national adoption of CRR/CRD IV[1] provides further details on the requirements for Norwegian covered bonds and issuers.

Under this framework, issuance is permitted through specialist covered bond issuers. Like TSBB, most issuers of covered bonds (generally called Boligkreditt, or specialised residential mortgage institutions) are subsidiaries that rely on loans originated by their respective parent banks. The parent banks generally also provide most of the services for these subsidiaries, allowing the latter to keep staff numbers low.

Issuance structure



Source: Scope Ratings

[1] Forskrift om endring av forskrift 22. august 2014 nr. 1097 om kapitalkrav og nasjonal tilpasning av CRR/CRD IV (CRR/CRD IV-forskriften) og forskrift 9. desember 2016 nr. 1502 om finansforetak og finanskonsern (finansforetaksforskriften)

Governance credit support analysis

The Norwegian covered bond framework, relevant for TSBB's mortgage-covered bonds, combined with our positive view on the resolution regime, provides the covered bonds with a governance-supported credit differentiation of five notches above the issuer rating.

A more comprehensive assessment of governance support factors relevant for Norwegian covered bonds can be found here.

Legal framework analysis

Two notches of uplift based on legal framework analysis

The Norwegian covered bond framework meets our criteria for protecting investors, allowing us to assign the highest credit differentiation of two notches.

The covered bond law meets our criteria to assign the maximum credit differentiation. The provisions ensure that: i) the cover pool is segregated from the issuer's insolvency estate; ii) bond payments continue after insolvency; and iii) identified risks can be mitigated by overcollateralisation and other enhancements that generally remain available after insolvency. Norwegian covered bonds also benefit from specific regulatory oversight.

Resolution regime analysis

Three notches of uplift reflecting resolution regime

TSBB's covered bonds benefit from an additional three-notch uplift that reflects their exemption from bail-in and the support from a strong stakeholder community. This is based on: i) a moderate to high likelihood that the covered bond issuer will be maintained in a resolution scenario; and ii) the high systemic importance of covered bonds in Norway. However, we also recognise the low visibility and importance of TSBB as a covered bond issuer.

In theory, the current capital structure allows regulators to restructure issuing banks using available resolution tools should the need arise. However, the likeliest scenario is the transfer or take-over by another bank. An orderly winddown is also plausible. As a result, investors might not benefit from an issuer being maintained as a going concern.

TSBB's covered bond-issuing activities and market share result in a low to moderate systemic importance. The bank only issues domestically, which would reduce negative repercussions on other issuers should it fail. However, TSBB's low to moderate systemic importance also reflects that, like TSBB, most of Norway's 24 covered bond issuers are subsidiaries of small to midsize banks. Therefore, even the failure of a covered bond issuer with the size and setup of TSBB could result in contagion, effectively creating systemic problems for other issuers reliant on this refinancing channel for their core product, residential mortgage lending.

Pool characteristics

Reporting date	June 2022	June 2021
Balance (NOK bn)	5.35	4.49
Residential (%)	92.9	97.7
Substitute (%)	7.1	2.3

Property type (%)

Reporting date	June 2022	June 2021
Single-family houses	70.9	71.2
Apartments	13.7	12.7
Shares*	8.2	8.0
Holiday homes	3.7	4.1
Others	3.5	4.0

*Shares in housing associations

General information

Reporting date	June 2022	June 2021
No. of loans	2,865	2,662
Avg. loan size (NOK m)	1.7	1.7
Top 10 (%)	1.8	1.9
LTV (%)*	52.0	53.1

*Indexed

Interest rate type (%)

Reporting date	June 2022	June 2021
Floating	100	100
Fixed	0.0	0.0

Repayment type (%)

Reporting date	June 2022	June 2021
Bullet	6.8	5.7
Amortising	93.2	94.3

Cover pool analysis

TSBB's mortgage-covered bond ratings are cover pool-supported, providing six of the eight notches of uplift needed to achieve the highest rating. Governance support provides a five-notch rating uplift and an effective floor against a deterioration in cover pool credit quality. Our assessment on the interplay between complexity and transparency translates into a cover pool complexity category of 'low', which allows for the maximum three-notch uplift on top of the governance support uplift.

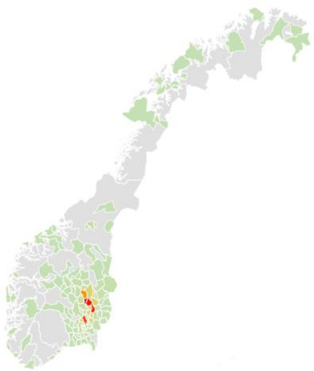
The minimum overcollateralisation needed to achieve the highest rating has increased to the legal minimum of 5%, which applies following the transposition of the European Covered Bond Directive into national law. The rating remains supported by the sound credit metrics of the cover pool and its low market risks. Market risks arise from maturity mismatches, which are partly mitigated by the bonds' soft-bullet structure.

Cover pool composition

The cover pool is predominantly secured by Norwegian residential mortgage loans denominated in Norwegian krone. The cover pool also comprises substitute assets, mainly constituting sovereign or other highly rated Norwegian covered bonds. As of June 2022, the bank operates primarily in the Mjos region in south-eastern Norway, namely Innlandet (52.6%), Viken (34.8%) and Oslo (9.5%).

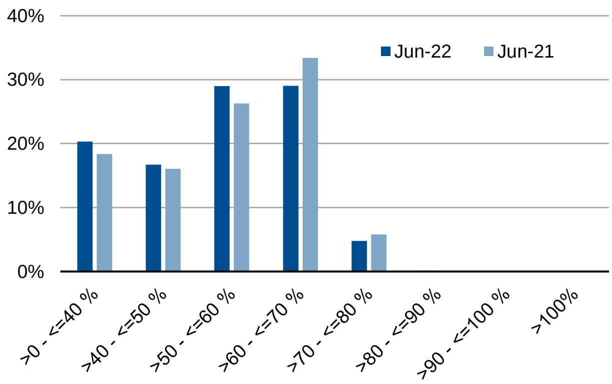
The mortgage pool consists of 2,865 loans granted to 2,759 obligors with an average loan size of NOK 1.74m. The 10 largest obligors account for 1.8%. Granularity has improved since our last review, reflecting the mortgage portfolio's growth by 10%.

Figure 1: Regional distribution



Source: Scope Ratings, TSBB

Figure 2: LTV distribution (indexed)



Source: Scope Ratings, TSBB

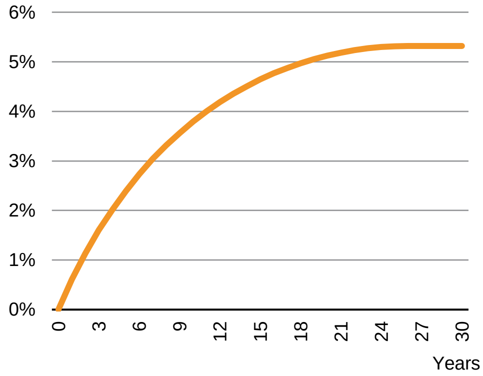
Most of TSBB's cover pool continues to be backed by mortgage loans granted to residential borrowers and mostly secured by single-family houses (71%) followed by apartments and shares in housing associations. The indexed LTV is 52.0%, 1.1pp down since our last review.

Asset risk analysis

Strong credit quality translates into low credit risk

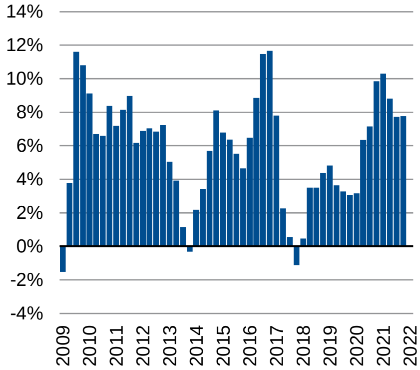
The cover pool's credit quality remains strong. Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on available credit performance data provided by the bank (in particular, historical delinquencies and the portfolio loss rate) and benchmarking. The average probability of default of the borrowers is commensurate with a BBB- rating. This translates into a cumulative term default rate of 6.0%, unchanged since the last rating review. We have further maintained our assumption of a coefficient of variation of 50% for the mortgage assets.

Figure 3: Expected term defaults, cumulative



Source: Scope Ratings, TSBB

Figure 4: House price growth Norway, annualised



Source: Scope Ratings, statOECD

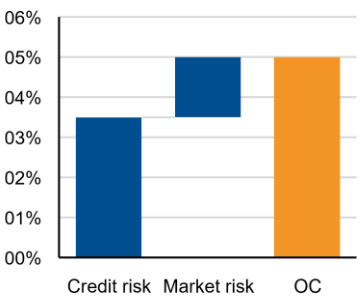
Stressed mortgage recovery rates[2] remained relatively stable at 71.3%, up from 70.0% assessed 12 months ago. The recovery rate reflects the moderate drop in the portfolio's LTV as well as the more conservative value haircuts reflecting the extraordinary growth in property values during the Covid-19 pandemic. We consider the price growth in Norway of well above 3% as unsustainable and hence have increased our stressed market value haircuts (MVD) by 2.5%.

Figure 5: Norwegian security value haircuts (SVH)

Region	Base MVD	Stressed MVD	Fire-sale discount	Stressed SVH
Oslo	5%	55.0%	20%	65.0%
South-western Norway	5%	35.0%	20%	47.5%
Rest of Norway	5%	42.5%	20%	55.0%

Our base recovery expectation remains very strong at 99.6% (from 99.8%). We have further aligned our base market value decline assumptions to 5% (from 0%), reflecting our expectation of moderately falling housing prices owing to lower demand in the region. We further kept our fire-sale discount unchanged at 20%, which we apply to properties sold under non-standard market or distressed conditions. In our recovery analysis, we further size for 2.5% of variable costs and NOK 70,000 of fixed costs.

Breakdown of rating-supporting overcollateralisation



Source: Scope Ratings

Due to the low number of substitute assets, we considered the sub-pool as a single exposure to a financial institution rated A- combined with a typical three-year maturity and a stressed recovery rate of 50%.

Cash flow risk analysis

The revised rating-supporting overcollateralisation of 5.0% reflects the programme's market risks, including asset-liability maturity mismatch risk accounting for 1.5pp (down from 2.4pp) and credit risk accounting for 3.5pp (up from 1.6pp). The components of overcollateralisation have shifted since last year's rating analysis, a result of a different scenario within our cash flow risk analysis. In the previous analysis, the combination of low prepayments and decreasing interest rates resulted in the most severe stresses; now it is low prepayments under rising rates. The updated legal act resulted in the increase in

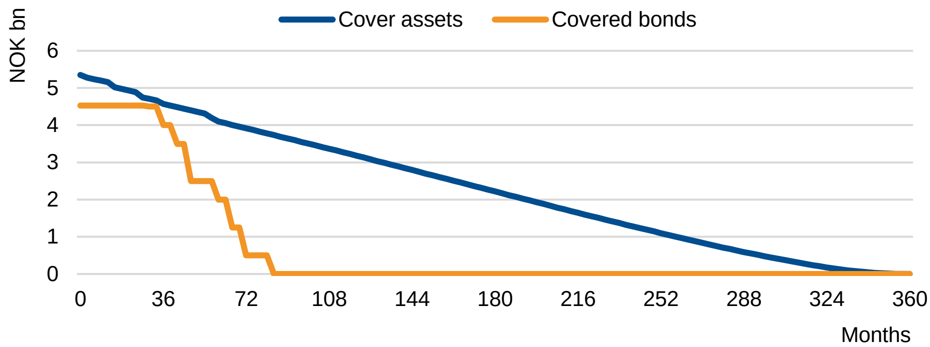
[2] Commensurate with highest stresses (D8), while the applied stresses (D6) denote stresses commensurate with the rating distance between TSBB's issuer rating and the covered bond ratings.

supporting overcollateralisation to 5% as this is the mandatory minimum to be maintained.

Market risks are driven by the programme's sensitivity to high prepayments, which generate large cash balances. This cash reduces the transaction's available excess spread – especially in sensitivity scenarios featuring both margin compression and front-loaded default timings. Market risks have mainly increased due to lower asset margins.

We have calculated asset margins based on loan-by-loan data, resulting in a weighted average of 155 bp (up from 128 bp) for the mortgage loans, which generates high excess spreads during the life of the programme. Volatility in excess spread is driven by the mandatory notification period that delays changes in interest rate on mortgage loans.

Figure 6: Amortisation profile



Source: Scope Ratings, TSB

As of Q2 2022, the weighted average life of the outstanding covered bonds is 3.8 years when accounting for their soft-bullet structure, down from 4.5 years in the previous analysis. This compares to the (scheduled until final legal maturity) weighted average life of the cover pool of 8.9 years (as calculated based on provided asset cash flows). The asset's weighted average life reduces to five years when assuming prepayments of 15%.

In the event of recourse to the cover pool, we assume that such excess cash from asset repayment and prepayment generates no margin, which negatively affects excess spread.

We further assume that 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 programme benefits from 7.1% of highly rated liquid substitute assets.

Other market risks are limited as cover assets and bonds have floating rates. There is no foreign exchange risk as assets and liabilities are denominated in Norwegian krone. No foreign currency-denominated issuances are expected at this stage.

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

The bond's amortisation calculation assumes the execution of the one-year maturity extensions.

We tested the programme's resilience against high (15%) and low (1%) prepayments as well as a set of rising and declining interest rate scenarios. The covered bonds are most exposed towards a high prepayment scenario in combination with low interest rates.

Further, we tested sensitivities towards a 50% margin compression, frontloaded defaults, 25% prepayments and a liquidity premium up to 200 bp.

Asset-liability mismatches

	Assets	Liabilities
NOK	100%	100%
Fixed**	0.0%	0.0%
Floating	100%	100%
WAL (years)	8.9**	3.9*

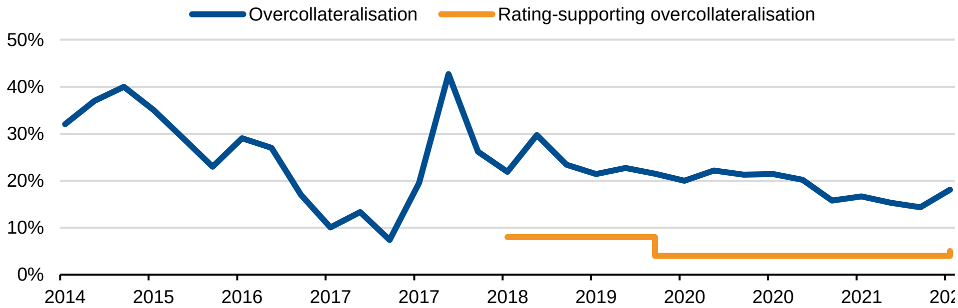
*incl. one year extension **own calculation

Availability of overcollateralisation

Overcollateralisation fully taken into account

The current rating of TSBB allows us to fully account for the provided overcollateralisation. We are not aware of plans that would significantly change the programme's risk profile or reduce the available overcollateralisation to levels that would no longer support the current rating uplift.

Figure 7: Available overcollateralisation versus rating-supporting level



Source: Scope Ratings, TSBB

Other risk considerations

Counterparty risk mitigated by alignment of interests between stakeholders

The rated covered bonds have counterparty exposures to the issuer and to the issuer's parent as loan originator, servicer, bank account provider and paying agent. 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 that collections are generally made via direct debit, allowing for a relatively swift redirection of payments if needed.

Country risk does not affect the rating

Sovereign risk does not limit the ratings of TSBB's mortgage covered bonds. We believe the risks of an institutional framework meltdown, legal insecurity or currency-convertibility problems are currently remote.

No impact from ESG

Governance factors constitute a key element of our analysis of Norwegian covered bonds and therefore drive our legal and resolution regime analysis. However, our quantitative analysis of TSBB's covered bonds do not directly include environmental, social and governance (ESG) aspects. The issuer has no ESG underwriting guidelines that result in positive/negative adjustments to a loan's terms and conditions if minimum ESG conditions are met/not met. However, we understand TSB is looking to make ESG risks part of its credit underwriting process.

Data constraints prevented us from performing a specific analysis of environmental or social factors or their impact on the cover assets' probability of default or recovery proceeds. At the same time, we have indirectly included environmental aspects in our analysis as collateral valuations reflect the condition of the collateral.

The bank follows environmental, sustainability and governance-related guidelines. The bank's endowment scheme also donates regularly to regional charities. TSB actively seeks to contribute to its region's development, which indirectly strengthens its local market position.

Sensitivity analysis

Two-notch buffer against potential change in issuer rating

TSBB's mortgage-covered bond ratings benefit from a buffer against an issuer downgrade of up to two notches. Assuming the issuer is willing to support the highest ratings and a stable covered bond risk profile, a one-notch downgrade would have no impact on rating-supporting overcollateralisation.

Summary of covered bond characteristics

Reporting date	30 June 2022	30 June 2021	30 June 2020	30 June 2019
Issuer name	Totens Sparebank Boligkreditt			
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 = 92.9	Residential = 97.7%	Residential = 96.9%	Residential = 91.4%
	Substitute = 7.1	Substitute = 2.3%	Substitute = 3.1%	Substitute = 8.6%
Issuer rating	A-/Stable	A-/Stable	A-/Stable	A-/Stable
Current covered bond rating	AAA/Stable	AAA/Stable	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullet	Soft bullet	Soft bullet	Soft bullet
Cover pool currencies	NOK (100%)	NOK (100%)	NOK (100%)	NOK (100%)
Covered bond currencies	NOK (100%)	NOK (100%)	NOK (100%)	NOK (100%)
Fundamental cover pool support	5	5	5	5
Maximum achievable covered bond uplift	8	8	8	8
Potential covered bond rating buffer	2	2	2	2
Cover pool (NOK bn)	4.53	4.49	3.54	2.76
thereof, substitute assets (NOK bn)	0.38	0.10	0.11	0.24
Covered bonds (NOK bn)	5.35	3.97	2.90	2.28
Overcollateralisation: current / legal minimum	18.0% / 5%	15.8% / 2%	22.1% / 2%	21.2% / 2%
Overcollateralisation to support current rating	5.0%	4.0%	4.0%	4.0%
Overcollateralisation upon a one-notch issuer downgrade	5.0%	5.0%	5.5%	5.5%
Weighted average life of assets	8.9 years [3]	13.4 years	13.2 years	12.5 years
Weighted average life of liabilities [1]	3.9 years	4.5 years	4.4 years	4.5 years
Number of loans	2.865	2.662	2,163	1,713
Average loan size (NOK m)	1.7	1.7	1.6	1.5
Top 10 residential	1.8%	1.9%	2.2%	2.9%
Interest rate type – assets	Floating 100%	Floating 100%	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%	Fixed 0%	Fixed 0%
Interest rate type – liabilities	Floating 100%	Floating 100%	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%	Fixed 0%	Fixed 0%
Weighted average LTV (indexed)	52.0%	53.1%	55.5%	52.6%
Geographic split (top 3)	Innlandet = 53%	Innlandet = 55%	Oppland = 45%	Oppland = 45%
	Viken = 35%	Viken = 33%	Akershus = 28%	Akershus = 26%
	Oslo = 10%	Oslo = 10%	Oslo = 12%	Oslo = 13%
Default measure	Inverse Gaussian/ Non-Parametric	Inverse Gaussian/ Non-Parametric	Inverse Gaussian/ Non-Parametric	Inverse Gaussian/ Non-Parametric
Weighted average default rate (mortgage/substitute)	6.0% / 0.32%	6.0% / 0.32%	10.5%/ 0.15%	9.5%/ 0.21%
Weighted average coefficient of variation (mortgage/substitute)	50% / N/A	50% / N/A	50%/ 1,696%	50%/ 1,353%
Weighted average recovery assumption (D0/D6)[2]	99.6% / 78.4%	99.8% / 77.4%	98.3% / 78.6%	97.3% / 77.7%
Share of loans > three months in arrears (NPL)	0.00%	0.00%	0.00%	0.04%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	n/a	n/a	n/a	n/a
Max liquidity premium (mortgage/substitute)	150 bp / 200 bp	150 bp / 200 bp	150 bp / 200 bp	150 bp / 200 bp
Average servicing fee (mortgage/substitute)	25 bp / 10 bp	25 bp / 10 bp	25 bp / 10 bp	25 bp / 10 bp

[1] Including the 12-month extension
[2] D0 and D6 denote the stresses commensurate with the rating distance between our issuer rating and the covered bond ratings. Only mortgage subportfolio
[3] Calculated based on provided cash flows

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