SSB Boligkreditt Update Report

Norwegian Mortgage Covered Bonds – Performance Update

Rating rationale (summary)

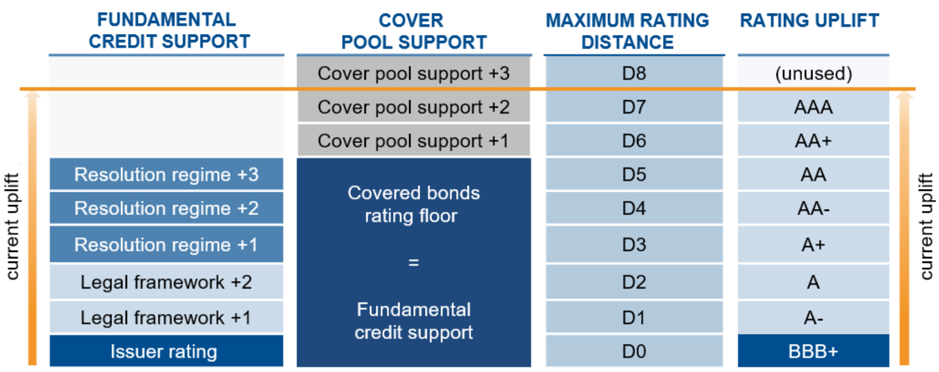
The AAA ratings with a Stable Outlook on the Norwegian covered bonds (obligasjoner med fortrinnsrett) issued by SSB Boligkreditt (SSBB) are based on the bank's issuer rating of BBB+, enhanced by seven notches of cover pool support. Five notches thereof reflect the strong fundamental credit support provided by the Norwegian legal covered bond and resolution frameworks.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 Sept 2019	NOK 8.23bn	Residential mortgage loans	NOK 6.65bn	AAA/Stable

SSBB is a wholly owned, specialised credit institution dedicated to providing secured covered bond funding for its parent, Sandnes Sparebank (SSB). Our BBB+ issuer rating on SSBB reflects its full ownership by SSB (BBB+) and its ability to refinance residential mortgage loans using covered bonds.

Fundamental credit support factors from the Norwegian legal and resolution framework provide a five-notch uplift above the bank's rating. This effectively forms a rating floor at AA. Cover pool support enables the programme to be rated AAA, with another two-notch uplift reflecting the credit strength of the covered bond programme.

The programme may further benefit from a buffer of one notch against an issuer downgrade as the maximum theoretical uplift constitutes eight notches, as opposed to the seven notches used to achieve the highest rating for these covered bonds.



Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectations that: i) the credit performance of SSB, SSBB and its mortgage borrowers will continue to be stable; ii) the issuer will maintain the prudent risk profile of its covered bond programme; and iii) both the parent and direct issuer will remain willing and able to provide sufficient overcollateralisation to support the covered bonds' very strong credit quality.

Changes since the last performance update

Since September 2018 the cover pool has increased to NOK 8.23bn (+3%). Relevant risk metrics such as the loan-to-value ratio and the remaining term have remained stable.

Ratings & Outlook

Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	14 Nov 2019
Issuer rating	**BBB+**
Outlook	Positive
Last rating action	New Rating
Last rating action date	19 Dec 2018

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Related Research

Scope affirms at AAA/Stable the mortgage-covered bonds issued by SSB Boligkreditt, 14 November 2019

Scope assigns first-time Issuer Rating of BBB+, Positive Outlook, to Sandnes Sparebank (Norway), 19 December 2018

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The issuer

The issuer ratings of SSBB reflect those of its parent bank, SSB.

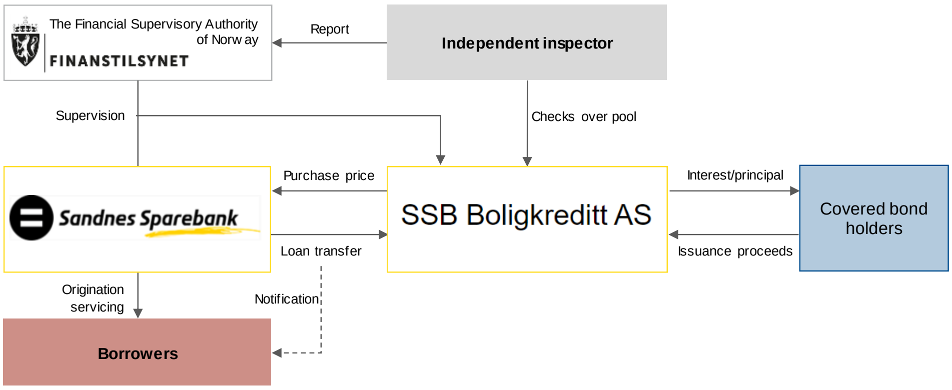
Founded in 1875, Sandnes Sparebank is considered the bank of the city of Sandnes in south-west Norway. Serving about 42,000 retail customers and about 5,000 corporate customers, the bank's main office and branch is in the city centre. In addition, the bank has two other small branches – in Stavanger (five employees) and Oslo (two employees). The bank also operates in the broader region of Rogaland, competing against Sparebank 1 SR-Bank, DNB, Danske and other smaller players.

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 Financial Institutions Act and a related regulation on mortgage credit institutions, both introduced in 2007. Under this framework, issuance is permitted only through specialist covered bond issuers. Like SSBB, 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

Fundamental credit support analysis

Fundamental credit support factors enhance the covered bond rating by five notches above SSBB's 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 SSBB's covered bonds.

Two notches of uplift based on legal framework analysis…

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

…and three notches of uplift on top to reflect resolution regime and systemic importance

SSBB's covered bonds benefit from an additional three-notch uplift to reflect their exemption from bail-in and 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 SSBB as a covered bond issuer. Generally, we provide four additional notches of support for Norwegian covered bonds issued by resolvable and very visible entities. For more information, see our related research.

Pool characteristics

Reporting date	Sept 2019	Sept 2018
Balance (NOK bn)	8.28	7.49
Residential (%)	93.5	94.8
Substitute (%)	6.5	5.2

Property type (%)

Reporting date	June 2019	Sept 2018
Single-family house*	78.8	78.1
Apartment	20.9	21.1
Others	0.3	0.8

*includes terraced house

General information

Reporting date	June 2019	Sept 2018
No. of obligors	4,641	4,438
Avg. size (NOK m)*	1,67	1.51
Top 10 (%)	1.2	1.2
Remaining life (y)	19	19
LTV (%)	54.9	54.9

*per Scope aggregated borrower

Interest rate type (%)

Reporting date	June 2019	Sept 2018
Floating	100	100
Fixed	0	0

Repayment type (%)

Reporting date	June 2019	Sept 2018
Flexible loan	34	36
Annuity loan	36	36
Annuity with IO	29	27
Linear	1	1

Cover pool analysis

We have established that an overcollateralisation of 5% can mitigate identified credit and market risk stresses and support the uplift under our rating methodology.

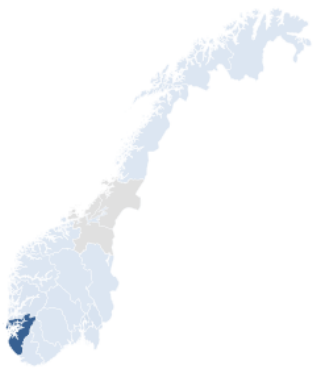
This represents a drop in rating-supporting overcollateralisation since our last analysis based on September 2019 data (from 8.5%). The drop is driven by: i) a methodological alignment of our market value haircuts, resulting in an effective reduction in stressed haircuts by 2%-3%; ii) our lower term default expectation; and iii) our criteria update, which has introduced interest paid on the cash account into our cash flow analysis. The latter has changed the programme's worst-case scenario from a low to a high prepayment scenario, positively impacting supporting overcollateralisation.

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 other highly rated Norwegian covered bonds. The bank operates primarily in the Stavanger region in south-western Norway. Hence, as of September 2019, 90% of financings are exposed to the region of Rogaland, 5% to Oslo and 2% to Akershus. The remaining 3% are spread across Norway.

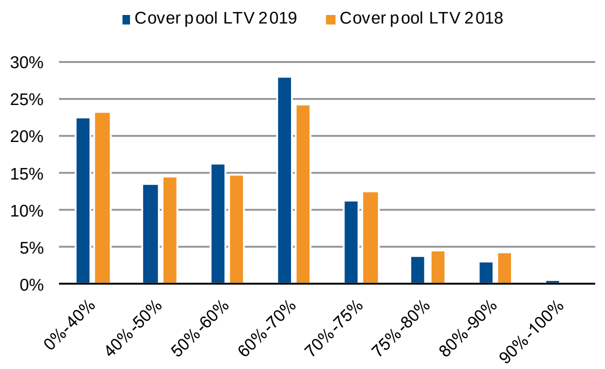
The mortgage pool consists of 5,032 loans granted to 4,641 obligors with an average loan size of NOK 1.67m (around EUR 167,000). The largest obligor only accounts for 18 bps. Since our last review, granularity has improved slightly, reflecting 3% growth in the mortgage portfolio.

Regional distribution



Source: Scope Ratings, SSBB

LTV distribution



Source: Scope Ratings, SSBB

Most of SSBB's cover pool continues to be backed by mortgage loans to residential borrowers secured by single-family and terraced houses (79%), followed by apartments. The loan-to-value (LTV) was 55%, stable since the last review.

Flexible loans accounted for 34% (by maximum drawable amount), down from 36% compared to our previous analysis. Such loans allow borrowers to redraw the loan up to a certain maximum amount. New flexible loans will only be granted for loans not exceeding an LTV of 60%. The remaining 66% of the loans are amortising loans. 29% (up from 27%) of these are interest-only loans which start to amortise once the 'out-of-cover' loan part which stays with the parent is fully amortised.

Asset risk analysis

Strong credit quality translates into low credit risk

The credit quality of the cover pool remains strong. We have revised our annual average default probability down to 55 bps from 64 bps supported by the performance data provided.

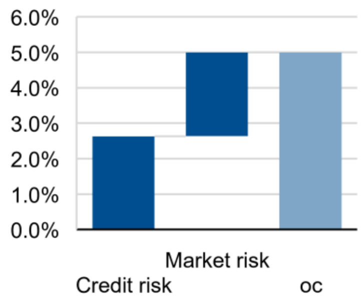
Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on credit performance data provided by the bank (in particular, default vintages and probability-of-default back-testing) and benchmarking. In addition to the revised default probability we maintained our assumption regarding the mortgage assets' volatility of default (weighted average coefficient of variation) of 60% which factors in the higher sensitivity to economic shocks in the western regions of Norway (oil regions).

Recovery rates have improved in the stressed scenario, mainly driven by our revisions to security value haircuts. For the mortgage loans we estimate a weighted average recovery rate of 97.9% (from 99%) under a base case and 79.5% (from 74%) under the most stressful scenario.

We also analysed the credit risk of the substitute assets. The average lifetime mean default rate was 0.1% with a very high coefficient of variation. The recovery rate was 90% in the base-case scenario and 60% in the most stressed scenario. Our projections of default on substitute assets follow a non-parametric distribution calculated using a Monte Carlo analysis.

Cash flow risk analysis

Figure 1: Components of rating-supporting overcollateralisation

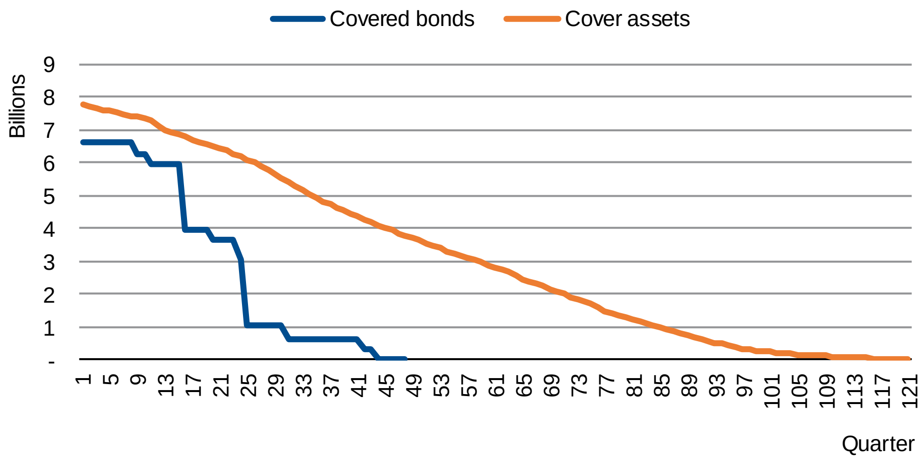


The cover pool is mainly exposed to credit risk, which accounts for 2.6 pp of the rating-supporting overcollateralisation. Despite credit risk being the main driver of supporting overcollateralisation, it remains low on an absolute level, reflecting the strong credit quality of the pool.

Market risks account for 2.4 pp of rating-supporting overcollateralisation. However, given that the programme is most exposed to a high prepayment scenario, overcollateralisation is driven by cost of carry as excess cash bears no margin. Asset sales do not drive the supporting overcollateralisation due to the high prepayment scenario.

The assets are floating. Interest rate mismatches from the 34% fixed rate covered bonds are fully hedged with eligible swap-counterparties according to our counterparty criteria. The interest rate hedges expire together with the bonds' maturity date. The bonds will pay a floating coupon if they are extended.

Figure 2: Amortisation profile



Source: Scope Ratings, SSBB

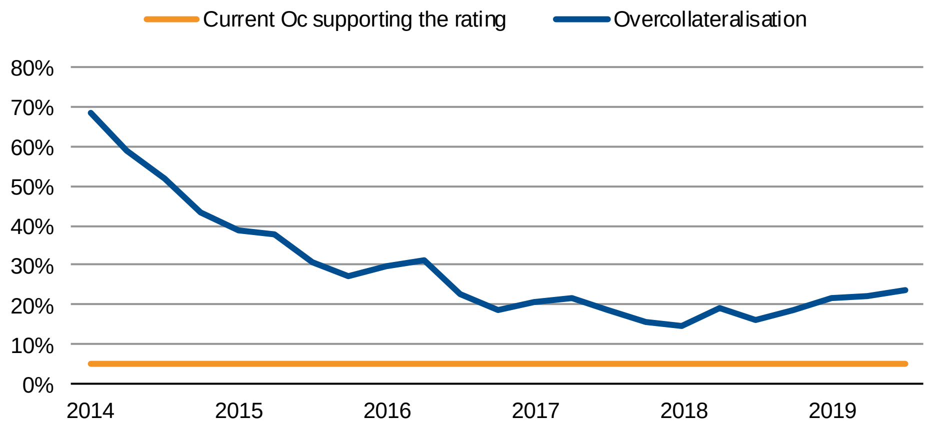
There is no foreign exchange risk as assets and liabilities are denominated in Norwegian krone. At this stage we do not expect any foreign currency-denominated issuances.

Availability of overcollateralisation

Overcollateralisation fully taken into account

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

Figure 3: Available overcollateralisation versus rating-supporting level



Source: Scope Ratings

Other risk consideration

Counterparty risk mitigated by alignment of interests between stakeholders

The rated covered bonds have counterparty exposures to the issuer, as well as 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. Collections are generally made via direct debit. We view this positively because it allows for a relatively swift redirection of payments if needed.

Country risk does not affect the ratings

Sovereign risk does not limit the ratings of SSBB'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

We have not directly included ESG aspects in the rating of covered bonds issued by SSBB. The issuer has no specific ESG underwriting guidelines which would provide for positive or negative adjustments to the terms and conditions of a mortgage loan if minimum ESG conditions are met. However, additional requirements exist for industries with higher risk related to environmental, corporate citizenship and corporate governance issues.

As is typical for most banks, SSB seldom records environmental aspects (particularly Norwegian energy efficiency standards) in its main underwriting databases. We therefore have not been able to perform a specific analysis of environmental or social factors and their impact on the cover assets' probability of default or their recovery proceeds. At the same time, we have indirectly included environmental aspects in our analysis because collateral valuations reflect the condition and energy efficiency of the collateral.

SSB follows environmental, sustainability and corporate governance-related guidelines. The bank also operates an endowment scheme (gift fund) from which it allocates some of its profits to customer dividends and beneficial purposes. SSB actively seeks to contribute to growth and development in the region which indirectly strengthens the bank's local market position.

Summary of covered bond characteristics

Reporting date	30 June 2019	30 Sept 2018
Issuer name	SSB 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 = 93.5% Substitute = 6.5%	Residential = 94.8% Substitute = 5.2%
Issuer rating	BBB+/Stable	BBB+/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullets	Soft bullets
Cover pool currencies	NOK (100%)	NOK (100%)
Covered bond currencies	NOK (100%)	NOK (100%)
Fundamental cover pool support	5	5
Maximum achievable covered bond uplift	8	8
Potential covered bond rating buffer	1	1
Cover pool (NOK bn)	8.28	7.49
thereof, substitute assets and deposits (NOK bn)	0.54	0.39
Covered bonds (NOK bn)	6.65	6.45
Overcollateralisation: current / legal minimum	23.8% / 2%	16.0% / 2%
Overcollateralisation to support current rating	5.0%	8.5%
Overcollateralisation upon a one-notch issuer downgrade	6.0%	9.0%
Weighted average life of assets	11.9 years	11.6 years
Weighted average life of liabilities[1]	5.1 years	4.9 years
Weighted average life gap	6.8 years	6.8 years
Number of borrowers	4,614	4,342
Average loan size per borrower (NOK m)	1.67	1.51
Top 10 residential	1.2%	1.2%
Interest rate type – assets	Floating 100% Fixed 0%	Floating 100% Fixed 0%
Interest rate type – liabilities (hedged)	Floating 100% Fixed 0%	Floating 100% Fixed 0%
Weighted average LTV (indexed)	54.9%	54.9%
Geographic split (top 3)	Rogaland = 89.6% Oslo = 4.7% Akershus = 2.1%	Rogaland = 89.8% Oslo = 4.8% Akershus = 2.0%
Default measure	Inverse Gaussian/ non-parametric	Inverse Gaussian/ non-parametric
Weighted average default rate (mortgage) (annualized/cumulative)	55bps / 10.5%	64bps / 11.5%
Coefficient of variation (mortgage)	60%	60%
Weighted average recovery assumption (D0/D8)[2] (mortgage)	97.9% / 79.5%	99.4% / 73.8%
Share of loans > three months in arrears (NPL)	0.0%	0.0%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	n/a	n/a
Max liquidity premium	150bps	150bps
Average servicing fee	24bps	24bps

[1] Including the 12-month extension
[2] D0 and D8 denote the stresses commensurate with the rating distance from the minimum and maximum achievable covered bond uplift

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