Bank Burgenland

Austrian Mortgage-Covered Bonds – Performance Update

Ratings

Cut-off date	Eligible cover pool	Cover asset type	Covered bonds*	Rating/Outlook
30 Sep 2018	EUR 828.9m	Mortgage loans	EUR 234.2m	AAA/Stable

*Hypothekenpfandbrief – Austrian mortgage-covered bonds issued under the Pfandbriefgesetz
Scope's covered bond ratings constitute an opinion about the relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity. See Scope's website for the covered bond rating definitions.

Mortgage-covered bonds

Fundamental credit support	Distance	Cover pool analysis*
	D7 (AAA)	Cover pool support +7
	D6	Cover pool support +6
	D5	Cover pool support +5
Resolution regime +2	D4	Cover pool support +4
Resolution regime +1	D3	Cover pool support +3
Legal framework +2	D2	Cover pool support +2
Legal framework +1	D1	Cover pool support +1
Issuer rating floor (N/D)	D0	Issuer rating floor (N/D)

Covered bond uplift

*Cover pool analysis supported uplift of seven notches: four notches (fundamental credit support) + max three notches (cover pool analysis)

Rating rationale (summary)

Scope has rated AAA with Stable Outlook the Austrian mortgage-covered bonds issued by HYPO-BANK BURGENLAND Aktiengesellschaft (Bank Burgenland). This reflects the bank rating enhanced by:

1. Four notches of fundamental support reflecting the Austrian covered bond legal and resolution frameworks, constrained by the issuer's low relevance in covered bonds and the moderate importance of covered bonds in Austria; plus
2. Three notches of cover pool support reflecting the credit- and market-risk assessment of the cover pool.

Bank Burgenland's ratings reflect a well-established, profitable, regionally-focused banking franchise in the Austrian state of Burgenland and bordering areas in eastern Austria, with access to real estate markets in the greater Vienna area and Styria. The bank has been owned by Grazer Wechselseitige Versicherung AG (Graz Mutual Insurance Company, Grawe) since 2006.

On 17 July 2018 we upgraded Bank Burgenland's covered bonds to AAA from AA+. This was driven by an upgrade of the issuer due to an amendment to section 131 of the Austrian Bank Recovery and Resolution Act.

Outlook

Our Stable Outlook on the covered bonds reflects: i) the continuous availability of high overcollateralisation, which provides a significant buffer against a rise in credit and market risks, thereby maintaining the cover pool-based support; ii) our Stable Outlook on the issuer rating; and iii) our view that European covered bond harmonisation will not negatively impact the fundamental support factors relevant for the issuer and Austrian mortgage-covered bonds in general.

Ratings & Outlook

Issuer rating	**N/D***
Outlook	N/D*
Last rating action	Upgrade*
Last rating action date	N/D*
Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	22.11.2018

*N/D – Not disclosed; Scope has assigned a private, monitored issuer rating to the bank. The issuer has solicited the assigned rating and participated in the rating process.

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Bloomberg: SCOP

Rating-change drivers

A downgrade may occur if: i) the issuer's credit rating is downgraded by one notch or more; ii) risk in the covered bond programme increases and the overcollateralisation provided no longer supports a seven-notch rating uplift; or iii) we revise downwards the fundamental support factors relevant to the issuer and Austrian mortgage-covered bonds.

Rating drivers and mitigants (summary)

Positive rating drivers	Negative rating drivers and mitigants
The issuer. Regionally focused bank with a recent track record of adequate asset quality and profitability since integration into the wider Grawe group. The bank has a business strategy which is fully aligned with that of its parent; a conservative funding and liquidity profile; prudent capitalisation; and lean business structures. The economic environment in Austria is benign and prosperous.	**The issuer.** Business model under pressure from the lower-for-longer interest rate environment
Austrian covered bond legal framework (+2 notches). The laws address all rating-relevant aspects, allowing the full legal framework uplift.	**Covered bond legal framework.** Not applicable
Resolution regime assessment (+2 notches). Austrian covered bonds' exclusion from bail-in; issuer's resolvability due to sufficient level of bail-inable liabilities	**Resolution regime assessment.** Only moderate importance of covered bonds in Austria; issuer's limited visibility in covered bond markets and low cohesiveness among domestic shareholders
Cover pool support (+3 notches). High overcollateralisation and sound asset quality	**Cover pool support.** High asset-liability mismatch risk resulting in negative carry from the bonds' long duration; substantial interest rate mismatches

Positive rating-change drivers	Negative rating-change drivers
Issuer and group. A solid improvement in financials and the stabilisation of profitability at Bank Burgenland and its main shareholder – particularly during a period of weaker macro-economic fundamentals – could provide an uplift to the bank's ratings. The formalisation of support commitments/guarantees by the current shareholder could positively influence the bank's ratings.	**Issuer/group.** Any adverse risk exposure or risk-taking on the part of the bank, its majority shareholder or financial subsidiaries could put pressure on the issuer's rating. Any decreased commitment from the current shareholder or capital depletion would lead to a downgrade of Bank Burgenland's ratings.
Covered bond legal framework. Not applicable as highest rating uplift already achieved	**Legal covered bond framework.** Weakening of rating-relevant provisions during the implementation of upcoming European covered bond directive with the result that it does not address all rating-relevant aspects
Resolution regime assessment. Increased relevance for the issuer in covered bonds and for Austrian covered bonds in general; improved cohesion among Austrian covered bond stakeholders	**Resolution-regime assessment.** Significantly reduced capitalisation and/or market share that lowers the regulator's incentive to maintain the issuer as a going concern
Cover pool support. Not applicable as highest rating already achieved	**Cover pool support.** Significant deterioration in cover pool's asset quality; sharp reduction in overcollateralisation and issuance activity (particularly jumbo formats) resulting in an excessive increase in the asset-liability mismatch – all of which are not mitigated

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1. The issuer

We monitor and maintain a private rating on Bank Burgenland. The bank is owned by Grazer Wechselseitige Versicherung AG (Graz Mutual Insurance Company, Grawe) since 2006.

In 2008, Bank Burgenland became the controlling financial institution within the Grawe group. Bank Burgenland sits at the apex of 'Grawe banking group' and consolidates the group's other financial subsidiaries. The group pursues a multi-brand strategy with the aim of gaining access to a more widely diversified customer base. The individual entities are managed at arm length as part of an integrated business model. This allows various specialised financial services to complement each other and more targeted access to customers.

Bank Burgenland is fully owned by Grawe. It does not benefit from a formalised guarantee, but all group members are integrated into the Grawe group's risk control strategy. It is our understanding that Grawe's management is highly focused on a conservative, mutual business ethos with success primarily evaluated in terms of client services and customer satisfaction. In accordance with its overall strategy, the group's management is also strongly focused on capital preservation and building up intrinsic strength via early provisioning. This focus is reflected in its own prudential metrics and also in the wider management of other group entities.

Over the past years, Bank Burgenland's asset quality has been adequate and profitability has improved. In accordance with Grawe group's conservative management, bank profits are typically used to strengthen the bank's capital basis.

Bank Burgenland's financials have been improving due to certain intrinsic factors such as its restructured business profile, which is now more closely integrated with its subsidiaries, and a conservative risk control strategy aligned with the larger Grawe group. We especially highlight the positive profit contribution made by the asset management business related to Bank Burgenland's fully consolidated subsidiary Capital Bank. In addition, the more benign macro-economic environment in Austria and the neighbouring CEE countries has provided positive momentum.

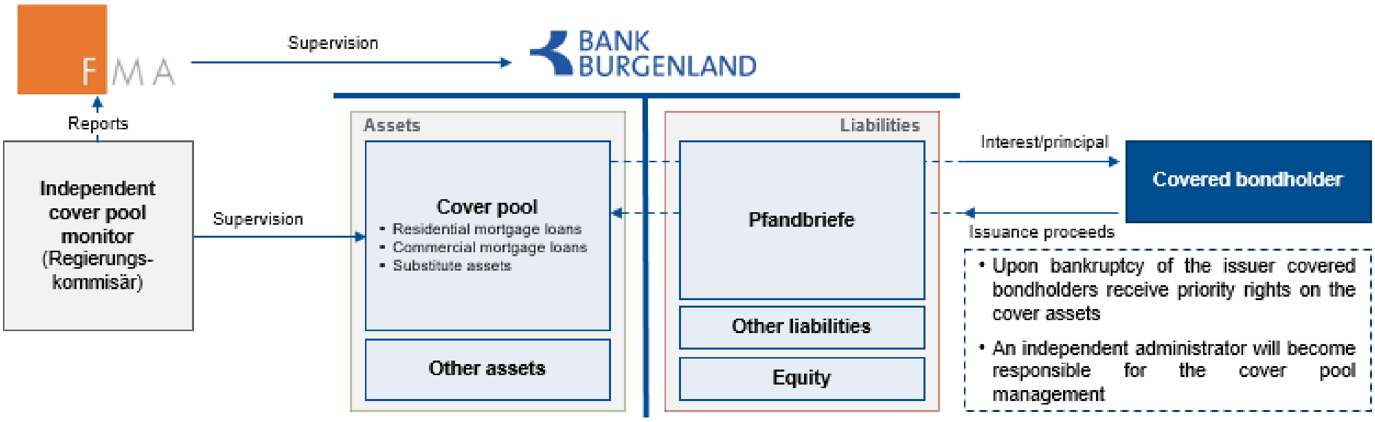
Bank Burgenland's ratings also reflect the concentration risk in mortgage lending within a regional market, as well as the bank's limited potential for growth without greater risk-taking.

The Bank is supervised by the Austrian Financial Market Authority.

For further details on our bank credit analysis see Appendices I to III.

2. Covered bond structure

Figure 1: On-balance sheet issuance structure



Source: Scope

Bank Burgenland issues covered bonds using an on-balance sheet structure, which is typical for most Austrian issuers of covered bonds. As a former Landeshypothekenbank, its issuances of mortgage-covered bonds are governed by the 'Gesetz über die Schuldverschreibungen und verwandte Schuldverschreibungen öffentlich-rechtlicher Kreditanstanalten' (21 December 1927 dRGBL – PfandbriefG; see 'Legal Framework' for further details), supervised by Austria's Financial Market Authority (FMA) as well as a dedicated trustee (Treuhänder).

3. Covered bond rating analysis

Maximum credit differentiation of seven notches based on fundamental and credit analysis

Bank Burgenland's covered bond ratings are supported by a cover pool uplift of seven notches. This reflects: i) fundamental credit support of four notches; and ii) the maximum cover pool support of three notches.

Ample available overcollateralisation mitigates credit, market and liquidity risks commensurate with the rating assigned to the bank's mortgage-covered bonds.

3.1. Fundamental credit support

The Austrian covered bond framework, particularly the Pfandbriefgesetz relevant for Bank Burgenland's mortgage-covered bonds, combined with our positive view on the resolution regime, provides the covered bonds with a fundamental analysis-based credit differentiation of four notches above the bank's rating.

3.1.1. Legal framework

A credit differentiation of two notches is driven by the benefits of the Austrian legal covered bond framework.

Two-notch rating uplift reflects minimum fulfilment of criteria for the legal framework

Our analysis of the Pfandbriefgesetz confirms that the framework just meets the criteria to assign the maximum credit differentiation under our methodology. The provisions ensure that the cover pool is segregated from the issuer's insolvency estate; bond payments continue after insolvency; and identified risks can be mitigated by overcollateralisation, which generally remains available after insolvency. Austrian covered bonds also benefit from specific regulatory oversight. However, we recognise the framework's lack of clarity on liquidity or risk management for covered bonds.

The Austrian covered bond framework currently just meets the minimum standards under our methodology. We believe ongoing industry efforts will improve and consolidate the three existing frameworks, reinforced by the upcoming European covered bond directive that we expect will reduce complexity and improve credit protection for covered bond investors.

For a more comprehensive assessment of the fundamental support factors relevant for Austrian covered bonds, please see our related research.[1]

3.1.2. Resolution regime and systemic importance

Bank Burgenland's covered bonds benefit from an additional two-notch uplift which reflects the general benefits provided by the resolution regime. Issuer-specific aspects or the relevance of the Austrian covered bond market do not justify an additional uplift.

Resolution-regime analysis supports two-notch additional credit differentiation

In our resolution framework assessment, we analyse how likely it is that regulatory intervention in the issuer will preserve the credit quality of a covered bond and assess whether:

1. Austrian covered bonds comply with regulatory definitions so as to benefit from preferential status;
2. The issuer is bail-inable and regulators would use available tools to preserve the covered bond issuer;
3. Mortgage-covered bonds in general and the issuer's covered bonds in particular are systemically important in the domestic context; and
4. An active domestic stakeholder group (issuers, regulators and investors) is working together to maintain confidence in covered bonds and preserve their high credit quality.

One notch of uplift reflects the exclusion of Austrian covered bonds from bail-in in the hypothetical scenario of regulatory intervention in the bank, in line with the Bank Recovery and Resolution Directive.

Another notch of uplift reflects our view on the resolvability and likely maintenance of Bank Burgenland in a resolution scenario. The issuer's high level of bail-inable liabilities allows the use of available resolution tools if needed. This reflects the bank's high capitalisation, which, as a first defence, would encourage its restructuring (excluding potential additional parental support).

In an extremely adverse scenario in which available capital and potentially bail-inable debt are fully used up and regulators are not able to establish the bank as a going concern, we would expect an orderly wind-down. This is because the bank does not provide critical services, and its core activity, retail banking, can be easily substituted by other banks in the already overbanked Austrian market.

We have not provided additional, resolution framework-based support to Bank Burgenland's covered bonds because of the bank's limited prominence as a covered bond issuer, the lack of support from stakeholders and the weak proactivity of regulators.

In our view, product-driven support from market stakeholders is unlikely due to Bank Burgenland's relatively small volume of outstanding covered bonds. Although it is a longstanding issuer of covered bonds, the bank has only recently started to reissue covered bonds under its own name. It has not issued larger, internationally placed covered bonds and is expected to remain active in private placements, primarily to better manage asset-liability mismatches and regulatory ratios (the net stable funding ratio). With only EUR 234m of outstanding covered bonds to date, the bank captures a mere 73 bps of the Austrian mortgage-covered bond market (end-2017) and 53 bps of total outstanding covered bonds (including the bank's EUR 30m public sector-covered bonds). Most of the issues are placed with domestic investors and are not represented in relevant indices.

[1] Covered Bond Framework Analysis – Analytical Considerations: Austria.

Weak proactive communication by regulators and a lack of support from stakeholders was demonstrated during the prolonged period of uncertainty over the credit quality of covered bonds for two banks in workout (HETA and Kommunalkredit). Both banks were supervised closely by regulators, placed under moratorium, or split into a 'good' and 'bad' bank. However, covered bond investors were not regularly updated on the impact the workout would have on outstanding covered bonds.

Accordingly, our fundamental resolution-based uplift is constrained to two notches. Austria's low (but increasing) covered bond intensity, coupled with less predictable support from stakeholders and regulators, makes its resolution framework fundamentally weaker from a credit standpoint than the framework in countries with a more active issuance and support history.

3.2. Cover pool analysis

Cover pool provides additional three-notch uplift, supporting the highest achievable rating

The cover pool substantially enhances the covered bonds' credit quality. The seven-notch cover pool uplift incorporates the maximum additional cover pool uplift of three notches above the four-notch rating floor provided by fundamental factors.

Supporting overcollateralisation has fallen to 28% from 40% since we assigned ratings to the mortgage covered bonds. Bank Burgenland has stated that it intends to manage the cover pool more actively. This will be reflected in the reduction of whole loan/value (LTV), currency- and additional liquidity monitoring metrics risk.

More active management of cover pool evident in removal of Swiss franc and high LTV loans; both positive for credit risk

The supporting overcollateralisation reflects the cover pool's current credit quality as well as the planned issuance structure. Based on discussions with the issuer, we expect sufficient overcollateralisation to remain available to allow the maintenance of the maximum cover pool support.

We limit the credit benefit provided by the cover pool to three notches above our fundamental support assessment, even though the eligible loan cover pool balance is more than three times that of the outstanding covered bonds. This reflects the cover pool's dynamic nature and the general ability of the issuer to significantly and swiftly reduce overcollateralisation.

Figure 2: Key cover pool characteristics

Reporting date	01 Aug 17	30 Sep 18
Total assets/eligible assets (EUR m)	910.4 / 761.4	952.4 / 828.9
Covered bonds outstanding (EUR m)	186.0	234.2
Current overcollaterisation (eligible)	309%	254%
Legal minimum OC	2.0%	2.0%
Duration/WAM (eligible assets)	5.64y / 5.94y	4.3y / 6.1y
Duration/WAM (covered bonds)	9.69y / 11.01y	6.4y / 9.1y[1]
Duration/WAM mismatch	-4.1y / -5.1y	-2.1y / -3.1y
Interest rate type – assets (fix/float)	12.6% / 87.4%	23.9% / 76.1%
Interest rate type – bonds (fix/float)	97.3% / 2.7%	97.9% / 2.1%
Cover pool currency (EUR/CHF)	91.8% / 8.2%	100% / 0%
Covered bonds currency (EUR/CHF)	100% / 0%	100% / 0%
OC to support current rating / OC to maintain uplift upon one-notch issuer rating downgrade	40% / 38%	28% / 27%
Main cover asset type	Mortgages	Mortgages
Number of loans	4,166	3,855
Average eligible loan size [EUR'000s]	182	215
Average whole loan LTV/eligible LTV	123.4% / 47.4%	61.5% / 49.4%
Top 10 exposures	15.1%	16.7%
Top 20 exposures	21.5%	23.9%
Geographic split (top three)	Vienna (38.9%) Burgenland (35.7%) Lower Austria (12.1%)	Vienna (44.7%) Burgenland (31.2%) Styria (10.0%)

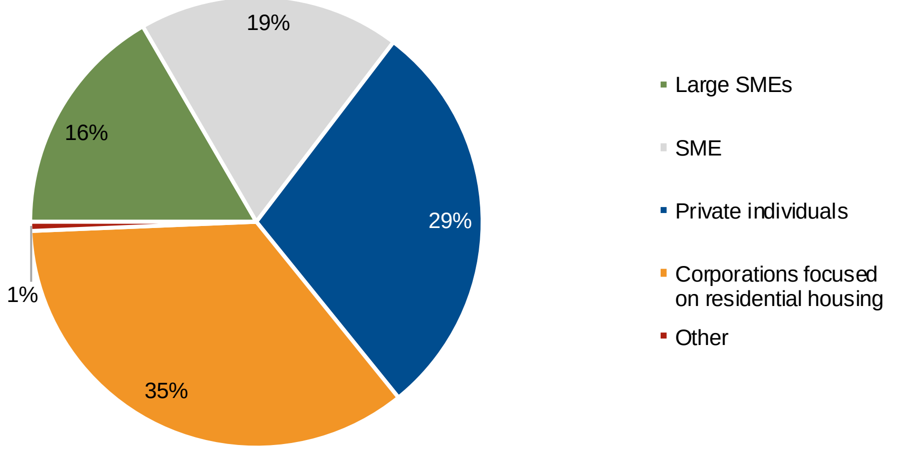
Source: Bank Burgenland and Scope

[1]Assuming first call option exercised

3.2.1. Cover pool composition

The cover pool is granular and purely domestic. It comprises residential and commercial mortgage loans, which have an average size of EUR 215,008 per loan and EUR 291,954 on a borrower level. Bank Burgenland applies the same prudent underwriting criteria to the cover pool's mortgage loans as it does to those granted in its ordinary course of business.

Figure 3: Cover pool by borrower type



Source: Bank Burgenland and Scope

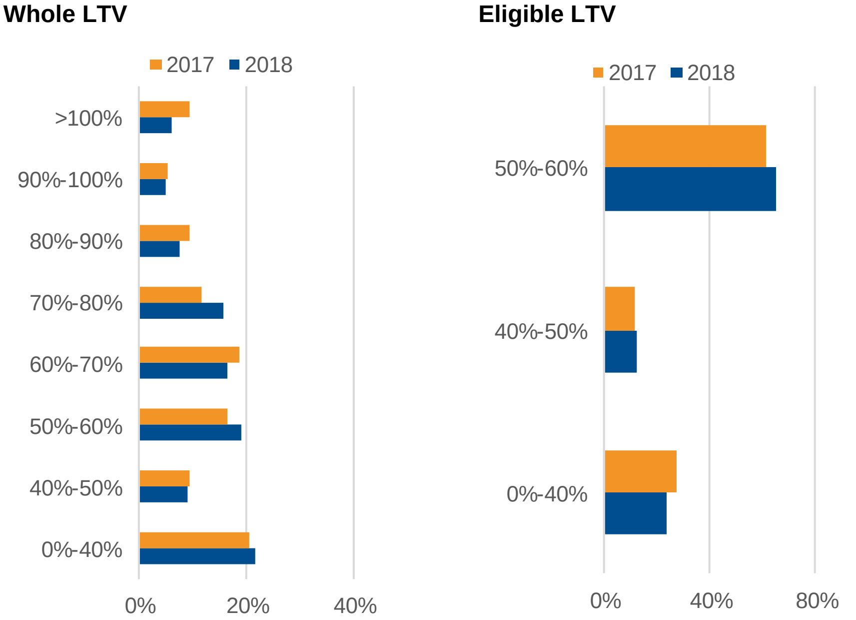
The cover pool consists of 3,855 loans granted to 2,839 obligors, comprising SMEs (36%), private individuals (29%) and corporations focused on residential housing (35%). The share of private individuals has remained fairly stable compared to 31% in August 2017, while we observe that the share of corporations focused on residential properties has increased to 35% from 22%. However, this shift may also have been caused by re-segmentation performed by the bank.

Purely Austrian cover pool, with low whole LTV of 61.5%, secured with residential and commercial properties

The Austrian Pfandbriefe act does not stipulate a maximum LTV for cover pool assets. However, Bank Burgenland has voluntarily limited its eligible LTV to a maximum of 60%. Accordingly, if a mortgage loan with a higher LTV is granted, the whole loan becomes part of the cover pool and the LTV limits effectively the issuances.

The cover pool has a weighted average whole LTV of 61.5% and a corresponding eligible loan LTV of 49.4%. This indicates high protection against credit losses in the event of borrower default. Since our initial analysis, the average whole LTV has halved. However, this is not due to a fundamental change in portfolio composition but rather because of the removal of a limited number of (very) high LTV loans that were driving the average. Furthermore, the issuer has removed all Swiss franc-denominated loans. This has reduced re-denomination risk in our asset recovery analysis and our cash flow analysis. The share of fixed rate loans has also increased since our last analysis, accounting for 23.9% compared to only 12.6% in 2017. While fixed rate loans soften affordability pressure in a rising interest rate scenario, they also lower interest mismatch for the programme as 98% of the bonds pay a fixed rate.

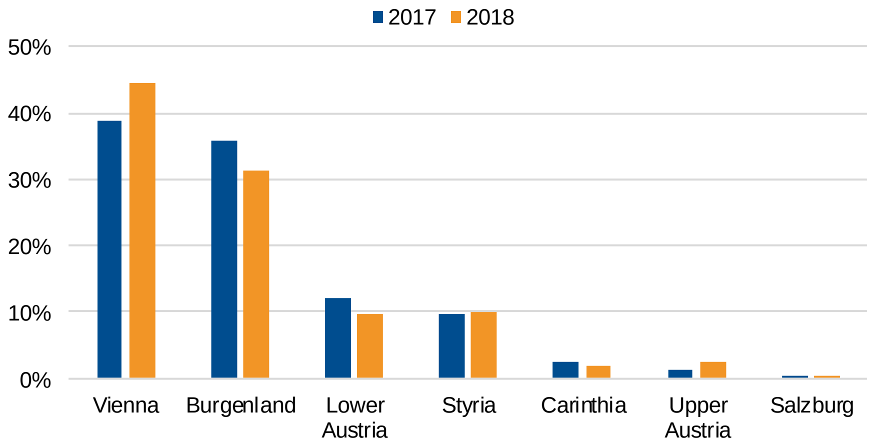
Figure 4: Cover pool by LTV



Source: Bank Burgenland and Scope

Bank Burgenland has a strong regional focus, which is evident in the cover pool. Most properties securing the loans are located in Vienna and Burgenland (together 77%), with the remainder in bordering areas. Compared to 2017, we see that the exposure to Vienna has increased while the exposure to Burgenland has decreased by roughly the same amount.

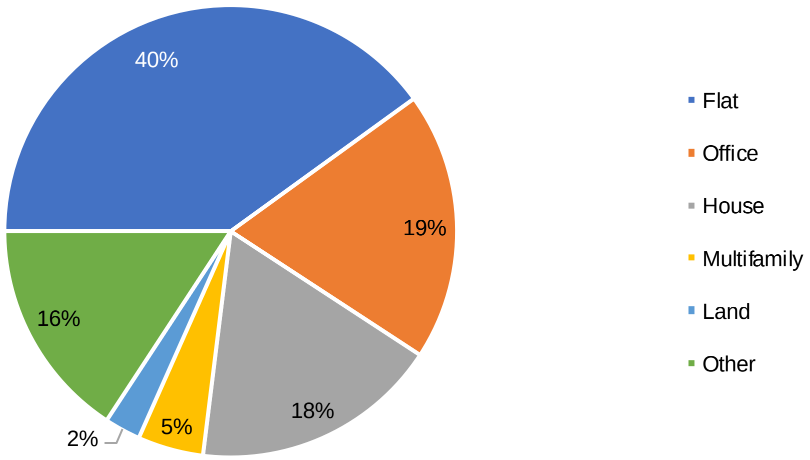
Figure 5: Geographic split by Austrian state



Source: Bank Burgenland and Scope

By property type, 66% of total (eligible) loan exposure is secured by residential properties. Flats account for most of the portfolio's exposure at 40%, largely related to flats located in Vienna. This is followed by office space (19%) and houses (18%). Other collateral accounts for 16% and generally comprises small to medium sized commercial exposures such as industrial, agriculture, hotel, logistics and retail.

Figure 6: Cover pool by property type



Source: Bank Burgenland and Scope

Most of the mortgage cover pool consists of amortising loans (77%; eligible portion). This portion is stable compared to 2017 data; the rest is granted as bullet loans. 76% of the loans are floating loans predominantly linked to three-months Euribor. The remaining fixed rate loans are fixed for life.

The mortgage loans have a seasoning of 4.4 years (down from 5.1 years) and a remaining term of 11.1 years. The latter differs for commercial loans which have an average remaining term of 8.8 years and residential loans with an average remaining term of 16.6 years.

Besides the mortgage loans, the cover pool consists of EUR 5.2m of substitute assets which are sovereign bond exposure to Austria.

The cover pool has no delinquent or defaulted loans because the issuer voluntarily removes overdue loans.

3.2.2. Credit risk assessment

Moderate credit risk …

We assess credit risk in the covered bond programme as moderate, given the bank's prudent underwriting and the current weighted average (eligible) LTV of 49.4%.

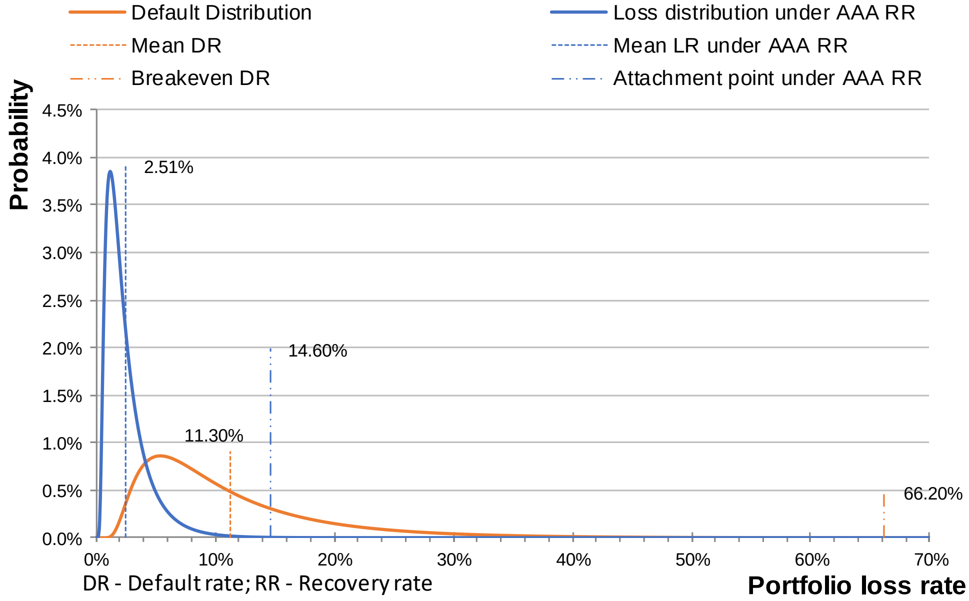
Our default projections for the cover pool use a non-parametric distribution with a mean default rate of 11.3% and a coefficient of variation of 73.2% for the mortgage loans. Compared to our last analysis, the default rate has decreased significantly from 19.4%. This was predominantly driven by the removal of Swiss franc loans that were assumed to default at maturity in a scenario in which the Swiss franc was appreciating.

The parameters for the default distribution were based on the internal loan-by-loan risk assessments of the bank.

We estimate a weighted average recovery rate of 97.6% under a base case scenario(D0) and 77.8% under the most stressful scenario (D7). This translates into a mean loss rate of 2.5% under the most stressful weighted average recovery rate, compared with a 0.3% mean loss rate under our base case recovery assumptions.

Refer to Appendix IV for details of our recovery rate analysis.

Figure 7: Default and loss distribution



Source: Bank Burgenland and Scope

3.2.3. Market risks

…but market risks remain high, driven by the long weighted average maturity of liabilities resulting in a negative duration gap

Ample overcollateralisation shields the covered bonds against market and interest-rate risks. The highest rating uplift is supported by a 28% overcollateralisation level, well above the current level. We have incorporated the bank's latest issuances and considered the banks projections in our analysis to determine uplift-supporting overcollateralisation.

Bank Burgenland currently issues most covered bonds as private placements, with relatively long-dated maturities. The covered bond maturity structure does not exhibit high concentrations, and the maximum issuance size to date is EUR 30m.

The cover pool provides sufficient inflows in a stand-alone and run-down scenario of the cover pool, allowing the full and timely payment of maturing covered bonds and interest due.

Figure 8: Unstressed cash flow characteristics

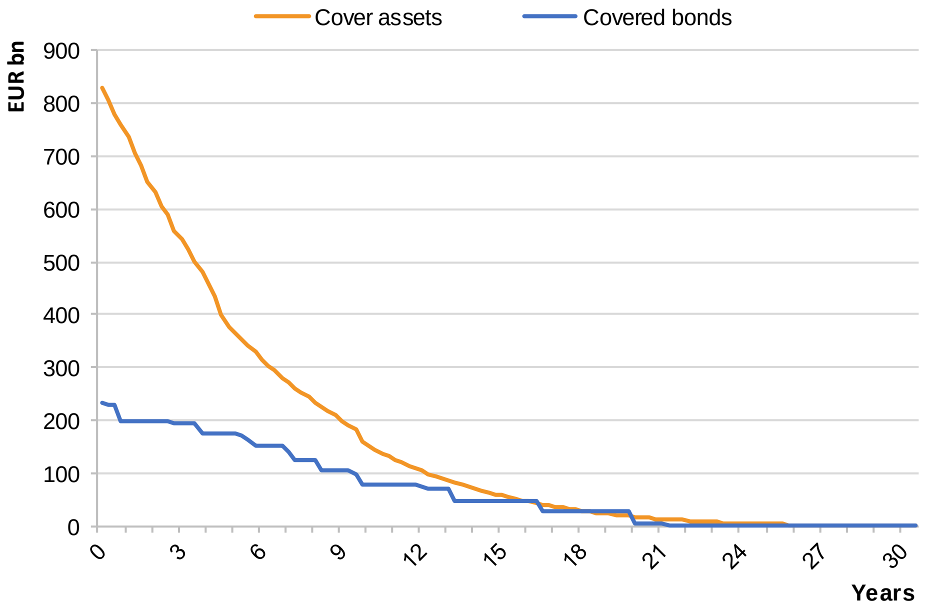
Date	Total assets EUR m	NPV EUR m	WAM years	Duration years	Fixed rate %	Floating rate
30 Sept 2018	828.9	901.9	6.1	4.3	23.9	76.1

Date	Total liabilities EUR m	NPV EUR m	WAM years	Duration years	Fixed rate %	Floating rate
30 Sept 2018	234.2	255.4	9.1	6.4	97.9	2.1

Current nominal OC	253.9%	Current WAM gap	-3.1y
Current NPV OC	253.1%	Current duration gap	-2.1y

Source: Bank Burgenland and Scope

Figure 9: Redemption profile



Source: Bank Burgenland and Scope

3.2.4. Interest rate risk

High interest rate risk with only 24% of fixed rate loans compared to 98% of fixed rate bonds

There is a high interest rate mismatch between the cover pool and the covered bonds. As is typical for Austria, most mortgage loans are granted at floating rates (76%), while covered bonds are issued at fixed rates (98%). We have tested the resilience of the covered bond structure to a deterministic set of adverse interest rate scenarios with rising and falling interest rates (starting at different times) and complemented the stresses with high and low prepayment scenarios.

Our analysis shows that the rating supporting overcollateralisation is predominantly driven by a low prepayment scenario together with a decreasing interest rate scenario. In this environment, the assets' floating interest would not be sufficient to cover fixed interest on the liabilities. Accordingly, overcollateralisation is needed to cover the negative carry over the life of the transaction. In addition, in a low prepayment scenario overcollateralisation is also driven by the higher allocation of defaults during the assets' remaining term to maturity.

3.2.5. Foreign exchange risk

There is no foreign exchange risk as both assets and liabilities are denominated in euros.

No forex risk following removal of Swiss franc loans

Since our 2017 analysis, the issuer has removed all Swiss franc-denominated cover assets from its cover pool. According to the issuer there are currently no plans to add foreign-denominated mortgage loans, or to issue any foreign currency-denominated covered bonds.

3.2.6. Overcollateralisation

Bank Burgenland's covered bond ratings are cover pool-supported and therefore hinge on the issuer's ability and willingness to provide overcollateralisation above the legal minimum.

Our credit view of Bank Burgenland allows us to fully consider available overcollateralisation for the analysis. Upon a two-notch issuer downgrade, we would identify whether Bank Burgenland's capital market communication on its intended overcollateralisation is sufficiently robust to continue taking available overcollateralisation into account. If this is not the case, we would establish a sustainable level against which we would compare the rating-supporting overcollateralisation in order to determine whether we can maintain the ratings.

As Bank Burgenland's covered bond programme is still small, we expect the current supporting overcollateralisation of 28% to remain more volatile than that of other programmes. A rise in issuance volumes and increase in the seasoning of the cash flow profile will temper this sensitivity over time.

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.

3.3. Counterparty risk

The rated bonds are exposed to Bank Burgenland's roles as originator, servicer, bank account provider and paying agent. There are no documented replacement mechanisms that would automatically shield the covered bonds from a credit deterioration of, for instance, the counterparties providing bank accounts. However, in such a scenario we believe the strong alignment of interests between the bank and covered bond holders would prevent any negative impact before regulatory intervention becomes necessary. As part of its risk management process, the bank regularly monitors its external bank accounts to ensure that any remedial action required is taken early on. We also note positively that most collections are made via direct debit, allowing for a relatively swift redirection of payments if needed.

We expect that a regulatory intervention in Bank Burgenland would involve the use of available resolution tools with the aim of maintaining the issuer. We do not expect the active management and servicing of the cover pool to be severely impacted in such a scenario.

4. Rating stability

We check the stability of the rating by considering current overcollateralisation, the issuer's credit migration and planned issuances.

4.1. Changes to the issuer assessment

Changes in our assessment of the bank will directly translate into a rating change for the covered bonds

An issuer downgrade or negative change in the issuer's Outlook would result in commensurate changes for its covered bond ratings. This is because the covered bond programme benefits from the maximum uplift available to covered bonds issued by Bank Burgenland.

In the case of an issuer upgrade, the covered bond rating would not change but the minimum overcollateralisation required to support the current rating could decrease, reflecting the issuer's improved ability to shield the covered bonds from higher losses.

4.2. Changes to overcollateralisation

If the issuer were downgraded by one notch, the covered bond rating would also be downgraded by one notch. The minimum rating-supporting overcollateralisation under a seven-notch uplift would also decrease to 27% from 28%.

If there was no change in our credit assessment of the issuer and overcollateralisation fell below 28%, the rating could be downgraded by up to three notches.

The issuer has addressed some of the credit and market risks relevant for rating-supporting overcollateralisation, including the removal of Swiss franc and high LTV loans. We also observe a trend towards fixed rate loans that reduces interest rate mismatches for the programme. Provided this trend continues and no additional risks are introduced into the covered bond programme, we may reduce the rating-supporting overcollateralisation in our next review.

5. Sovereign risk

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

6. Data adequacy

Detailed cover pool data provided by the bank

We consider the quality of the data provided to be adequate in light of the cover pool's high granularity.

Bank Burgenland has provided us with both public and confidential information on the cover pool composition, including asset performance data and information that allows us to establish a cash flow profile. We received detailed loan-level data with the relevant credit characteristics for the mortgage segment. We ensured, as far as possible, that sources were reliable before drawing upon them but did not verify each item of information independently.

Scope analysts visited Bank Burgenland and interviewed key personnel to gain a detailed understanding of the bank's origination, monitoring and workout processes. We also discussed key trends relevant for the development of the cash flow profile, including issuance plans.

7. Monitoring

We will monitor the transaction using information provided regularly by the issuer. The ratings will be monitored and reviewed at least once a year, or earlier if warranted by events.

8. Applied methodology

The mortgage-covered bonds were analysed using Scope's Covered Bond Rating Methodology, published on 31 July 2018. The asset and cash flow analysis was performed according to the principles of the General Structured Finance Rating Methodology, dated 28 August 2017. The principles of the Bank Rating Methodology were also applied in order to establish our credit view on the issuer. All rating methodologies are available on Scope's website at www.scoperatings.com.

Appendix I: Issuer rating rationale

Highlights

- Bank Burgenland's ratings reflect a well-established, profitable, regionally-focused banking franchise in the Austrian state of Burgenland and bordering areas in eastern Austria, with access to real estate markets in the greater Vienna area and Styria. The bank is owned by Grazer Wechselseitige Versicherung AG (Graz Mutual Insurance Company, Grawe) since 2006.
- In 2008, Bank Burgenland was established as the controlling financial institution in the Grawe group to oversee its various financial subsidiaries (Figures 1 & 2). This group of financial institutions comprises banks and financial service companies within Austria and Hungary. Although the group pursues a multi-brand strategy with the aim of gaining access to a more widely diversified customer base, the entities are managed as part of an integrated business model, allowing various specialised financial services to complement each other as well as providing access points to funds.
- Despite its 100% ownership by Grawe, Bank Burgenland is managed at arm's length and does not benefit from any formalised guarantee commitments. Nevertheless, group members are integrated into the Grawe group's risk control strategy. We believe that Grawe management is highly focused on a conservative, mutual business ethos with success primarily evaluated in terms of client services and customer satisfaction. In accordance with its overall strategy, the group's management is also strongly focused on capital preservation and building up intrinsic strength via early provisioning. This focus is reflected in its own prudential metrics and also in the wider management of other group entities.
- Bank businesses take up about half of the Grawe group's balance sheet size, contributing nearly 45% of profits from ordinary business. The shareholder cooperates closely with Bank Burgenland and its subsidiaries on various levels, e.g. with regard to group-internal asset management agreements, the commercial real estate business, as well as the utilisation of the bank network as an alternative distribution platform for insurance products. Given this, combined with the insurance company's strong financial position, we would assume that the group has a great interest, and also the ability, to support any group member in need. Nevertheless, the lack of any formalised support and guarantee structures does not permit an explicit rating uplift in the case of Bank Burgenland. Instead, the group structure and set up are reflected in the intrinsic strength of Bank Burgenland.
- Over the past years, Bank Burgenland's asset quality has been adequate and profitability has improved. In accordance with Grawe group's conservative management, bank profits are used to strengthen the bank's capital basis rather than being distributed.
- Bank Burgenland's financials have been improving due to certain intrinsic factors such as a business profile, which is more closely integrated with its subsidiaries, and a conservative risk control strategy aligned with the larger Grawe group. We especially highlight the positive profit contribution made by the asset management business related to Bank Burgenland's fully consolidated subsidiary Capital Bank. In addition, the more benign macro-economic environment in Austria and the neighbouring CEE countries has provided positive momentum to the establishment of some profitable business.
- Bank Burgenland's ratings also reflect the concentration risk in mortgage lending within a regional market, as well as the bank's limited growth potential without greater risk-taking.
- Bank Burgenland is supervised by the Austrian Financial Market Authority.

Rating drivers (summary)

The rating drivers, in decreasing order of importance in the rating assignment, are:

- Regionally focused bank with a recent track record of adequate asset quality and profitability since integration into the wider Grawe group, with the group providing an underlying conservative and mutually defined business strategy
- Conservative funding and liquidity profile, as well as prudent capitalisation
- Lean business structures equip the banking group with the competitive advantage of a faster and more individualised response to client needs; but the multi-brand strategy combined with the lack of a unified, integrated IT platform may pose some risk management challenges
- Austrian state of Burgenland currently provides a benign and prosperous economic environment, supportive of growth

Rating-change drivers

Any changes in the shareholder structure could affect the issuer's ratings.

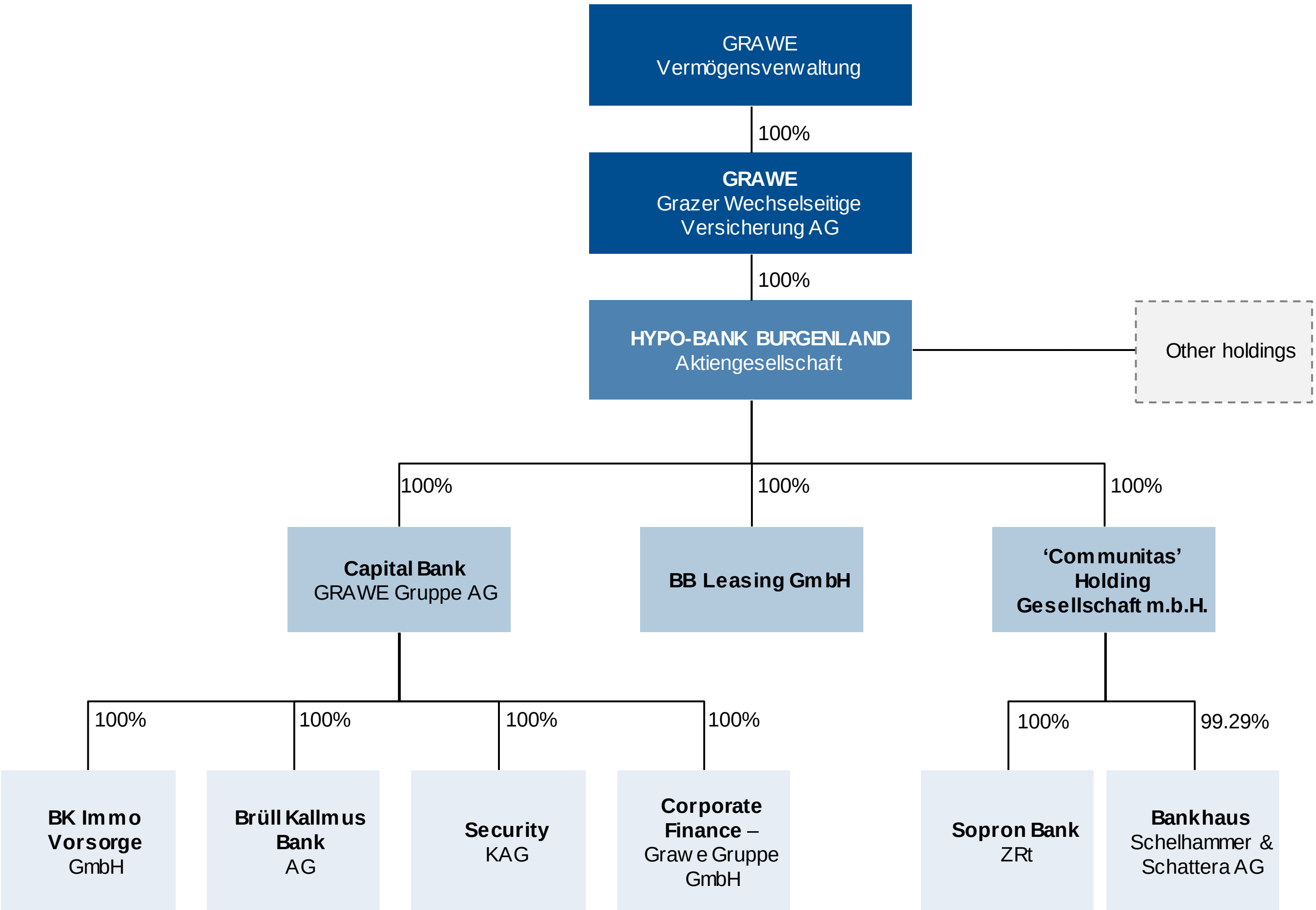
A solid improvement in the financials coupled with a stable profitability of Bank Burgenland and its main shareholder – particularly during a period of weaker macro-economic fundamentals – could provide an uplift to the bank's ratings.

The formalisation of support commitments/guarantees from the current shareholder could positively influence the bank's ratings.

Any adverse risk exposure or risk-taking on the part of the bank, its majority shareholder or financial subsidiaries could put pressure on the issuer's rating.

Any decreased commitment from the current shareholder or capital depletion would lead to a downgrade of Bank Burgenland's ratings.

Figure 10: Bank Burgenland ownership and group structure overview



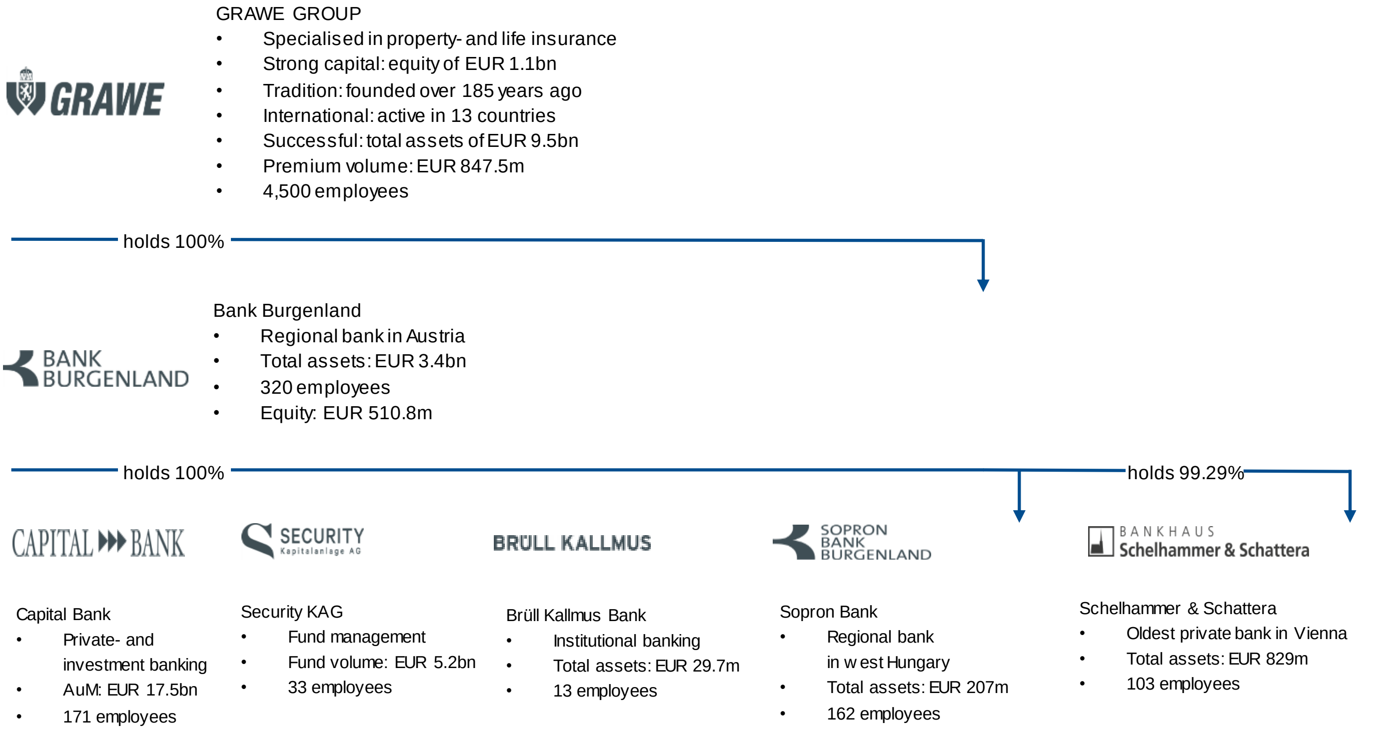
Source: Company data, Scope Ratings

Rating drivers (details)

Regionally focused bank with a recent track record of adequate asset quality and profitability since integration into the wider Grawe group, with the group providing an underlying conservative and mutually defined business strategy

Bank Burgenland's business profile has been substantially re-shaped over the past decade, since the takeover of the bank by Grawe. As a banking institution, Bank Burgenland focuses on the retail and small business segment, as well as continuing to benefit from its status as the 'house bank' for the regional state of Burgenland. Furthermore, in 2008 the Grawe group established Bank Burgenland as the financial institution which oversees the group's various financial subsidiaries. Within the 'Grawe banking group', Bank Burgenland is the center of competence for real estate business, including commercial real estate lending. Other members of the Grawe banking group mainly provide complementary services that focus on asset management and private banking (Figure 2). Capital Bank and Schelhammer & Schattera, the private banking institutions in the group, are among the largest, independent private banks in Austria. Fund manager Security KAG has achieved strong growth in fund volumes over the past few years.

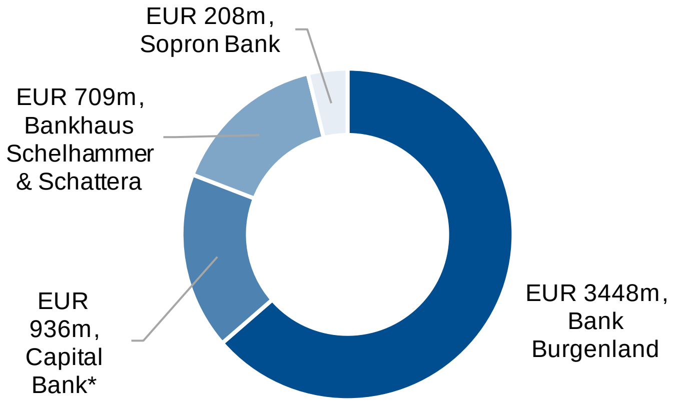
Figure 11: Overview Bank Burgenland group: main financial institutions and selected key information

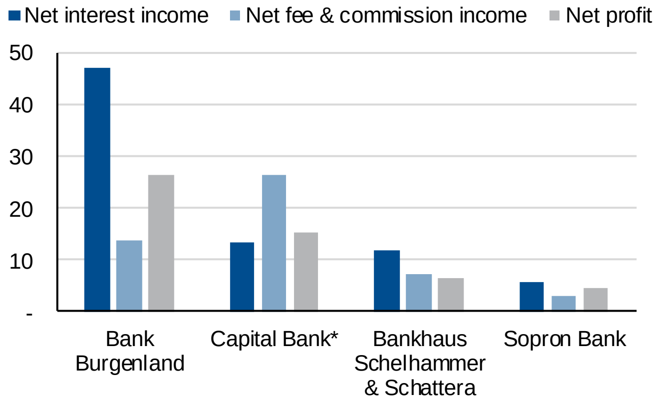


Source: Company data, Scope Ratings

As the group's controlling financial institution, Bank Burgenland benefits from strong contributors to profit on a consolidated basis. This is particularly the case for Capital Bank – including its subsidiaries Brüll Kallmus Bank AG, Security KAG and BK Immo Vorsorge GmbH – and the recent addition, Bankhaus Schelhammer & Schattera AG (Figures 3 & 4). Within the Grawe group, the banking arm has around EUR 17.5bn in assets under management, with the majority being overseen by Capital Bank and its subsidiary Security KAG.

Figure 12 / Figure 13: **Overview Bank Burgenland group – total assets & selected key figures of member institutions (EUR m, as of year-end 2017)**



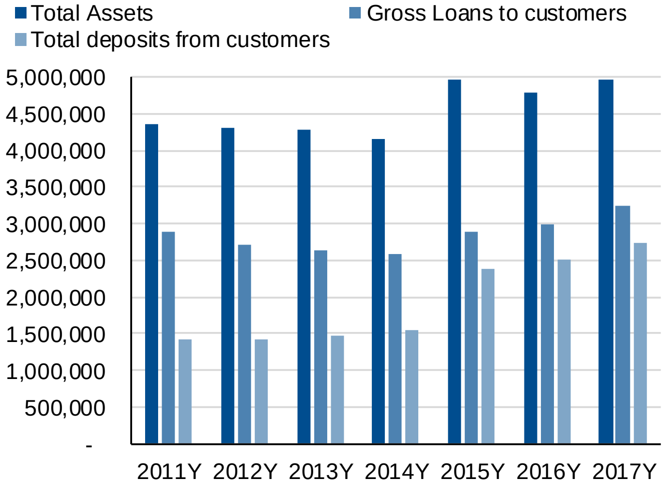


*Note: Including key subsidiaries Brüll Kallmus Bank AG and Security Kapitalanlage Aktiengesellschaft; Source: SNL, Scope Ratings

Bank Burgenland maintained relatively moderate balance sheet growth until 2014. However, due to additions to the banking group, a general improvement in the economic environment, as well as enhanced access to funding via primary funds (Figure 5), the bank is currently pursuing a more focused growth strategy.

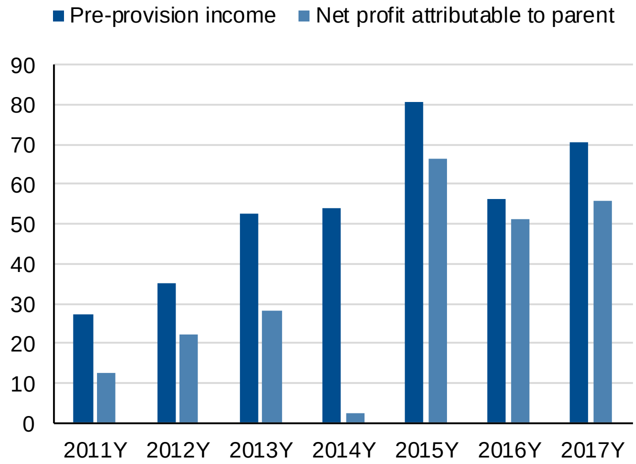
The bank's performance has improved somewhat over the past years, although various one-off effects, related to the bank's Heta exposures for example, somewhat distort the picture of the underlying business trend (Figure 6).

Figure 14: Bank Burgenland (consolidated) – historic balance sheet trends



Source: SNL, Scope Ratings

Figure 15: Bank Burgenland (consolidated) – historic business performance

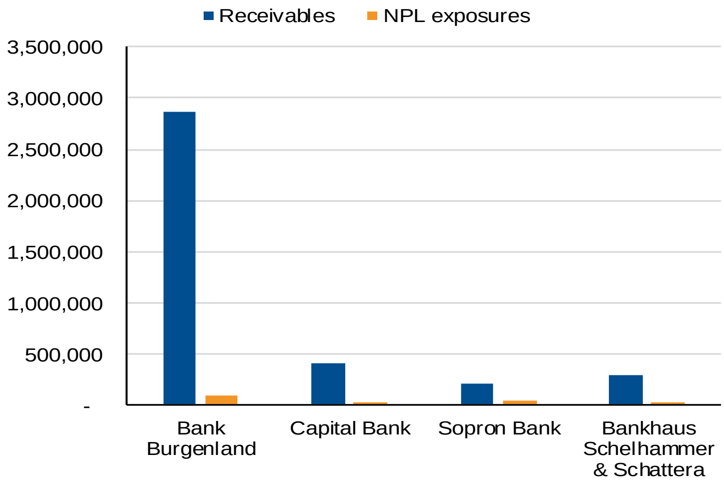


*Note: Provisions / NPL; Source: SNL, Scope Ratings

With regard to the wider Grawe group level, where business ethos is strongly influenced by mutual principles, the success of group members is partly measured by customer satisfaction and not solely in terms of monetary results. Nevertheless, all group members are expected to have profitable and sustainable business profiles and to achieve leading market shares in their respective business segments. We therefore believe that the bank's growth and profitability profile correspond to the wider strategy of the Grawe group.

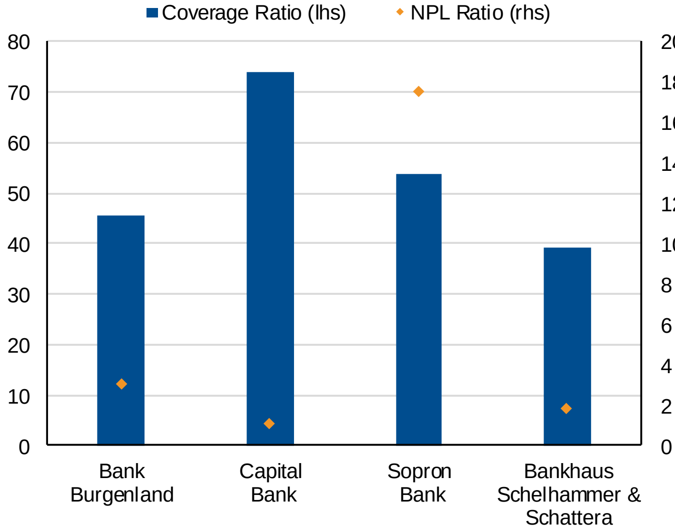
The asset quality of the bank is good. Non-performing loan (NPL) ratios of members of the banking group are typically below 3% of total loans (Figures 7 & 8). However, in this context it is important to note that Bank Burgenland is the main risk taker in the group due to the bank's larger lending businesses. In Hungary, greater risks and NPL exposures denominated in Swiss francs and euros have now mostly been converted, into domestic currency and Sopron Bank is not engaging in any further forex-based mortgage lending activities.

Figure 16: Receivables and NPLs held by group banks, 12/2017



Source: Company data, Scope Ratings

Figure 17: NPLs and coverage ratios with group banks, 12/2017



Source: Company data, Scope Ratings

Conservative funding and liquidity profile, as well as prudent capitalisation

The prudent metrics of Bank Burgenland have demonstrated strong stability over the past years, with owner Grawe supporting intrinsic capital build up and conservation at the banking level.

Risk-weighted asset levels have remained stable over the past years and growth in capital is based on retained profits. All financial entities within the group have prudent capitalisation levels (Figure 9). Bank Burgenland does not benefit from an explicit guarantee from its owner. However, our view is that the integration of the bank within the group, as the leading institution for its financial arm, as well as the strategy of intrinsic capital build up, reflect a strong strategic commitment on the part of Grawe.

Figure 18: Overview of Bank Burgenland group: financial institutions, selected key figures

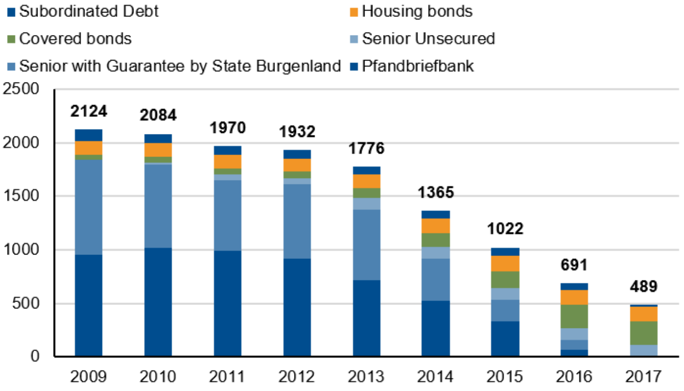
Data as of 2017/ in EUR m if not indicated otherwise	Total assets	RWAs	Core capital	Operational result	Pre-tax profits	Employees
Bank Burgenland	3,448	1,864,750	22.40%	26.26	32,81	320
Capital Bank	935.48	573.31	21.3%	14.91	17.30	170
Bruell Kallmus Bank	29.728	18.07	70.10%	2.560	2.558	13
Schelhammer & Schattera	709.4	514.43	19.4%	3.254	5.94	92
Sopron Bank	207.16	165.52	14.45%	4.919	4.572	162

Source: Company data, SNL

After the discontinuation of state guarantees for Landes-Hypothekenbank funding in 2003, Bank Burgenland had to gradually shift its funding profile in line with upcoming maturities. Increased primary funds enabled the bank to decrease market funding substantially (Figures 19 & 20). However, we believe that a changed market environment and regulatory requirements will shift the bank's focus once again, this time towards more regular access to capital markets via Pfandbrief (covered bond) issuance, as well as senior unsecured funding.

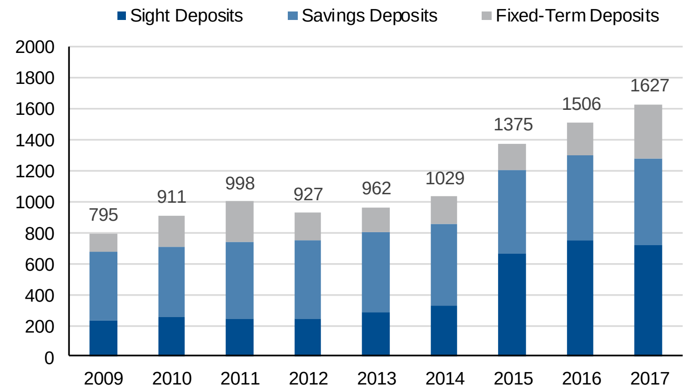
Liquidity is managed adequately. We note however that mutual financial dependence leads to some complexities within the group. In 2015, Bank Burgenland initiated the purchase of Bankhaus Schelhammer & Schattera AG, a private bank based in Vienna. The exposure to this entity represents one of the largest within the group. In Q1 2017, Bankhaus Schelhammer & Schattera also established a new online bank 'DADAT – Die ALLES Direktbank'. Both entities provide the group with access to funding via deposits.

Figure 19: Historic development of funding profile



Source: Company data, Scope Ratings

Figure 20: Development of deposit base



Source: Company data, Scope Ratings

Lean business structures equip the group with the competitive advantage of a faster and more individualised response to client needs; but the multi-brand strategy combined with the lack of a unified, integrated IT platform may pose some risk management challenges

Bank Burgenland benefits from relatively lean business and flat hierarchy structures which support fast, streamlined decision-making processes. The bank, and overall Grawe group, promote a sustainable business model by providing long-term commitments to its employees. This governance structure helps to preserve know-how in the bank which may help to maintain flatter, more flexible hierarchies.

The Grawe group established a multi-brand strategy to access various diversified business segments. Bank Burgenland is the leading institute for the financial arm of the group, providing a centralised risk management function for the banking group.

Bank Burgenland services its subsidiaries via various administrative departments. Back office, risk control, legal & compliance, treasury functions, accounting and other sections are centralised with Bank Burgenland.

Although the group benefits from lean, centralised administrative and risk management functions, it is our understanding that the individual group members still have ample room to develop their own market strategies and promote their business profiles to ultimately increase their respective market shares.

We acknowledge the various advantages of multi-brand platforms. Nevertheless, we believe that diversified business entities provide a risk of silo functions which can develop their own risk cultures within the overall framework. To mitigate such risks, the bank has established cross-supervisory management positions in all member institutions. However, despite established reporting lines, we note that the banking group still lacks a unified IT system. A uniform IT platform is planned to become available to all entities in April 2019. Hence, from a risk management point of view, operational risk is currently the main concern within the group. Although the bank seems to have adequate risk management structures and capabilities in place, we believe that a centralised IT platform would provide some additional comfort in this respect.

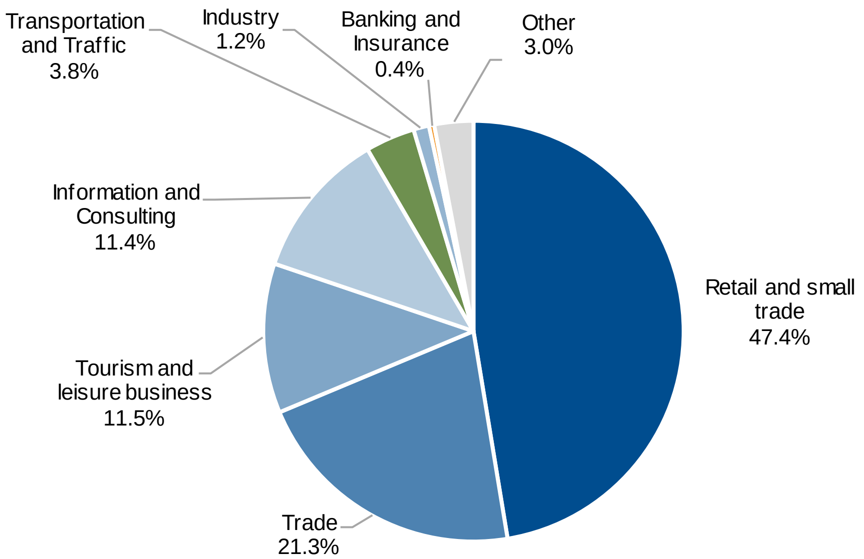
Austrian state of Burgenland currently provides a benign and prosperous economic environment, supportive of growth

As a regionally-focused bank, Bank Burgenland's growth and performance is highly dependent on the development of the local economy. That said, access to the greater Vienna area and Styria diversifies risk somewhat.

The state of Burgenland benefited from the enlargement of the European Union with the integration of eastern European countries during the 1990s. Over the past three years in particular, the economy of the state of Burgenland has revived in line with the recovery and stabilisation of the neighbouring CEE economies. The region receives much of the transitional economic traffic from its eastern neighbours and many CEE citizens living near the border also work and have banking relationships in Austria.

Due to these dynamics, the economic growth of the state of Burgenland has been, in part, been greater than the average growth achieved in other Austrian states. Business activities in retail, industry, and tourism have predominantly contributed to this growth.

Figure 21: Economy of the state of Burgenland by sector



Source: Company data, Scope Ratings

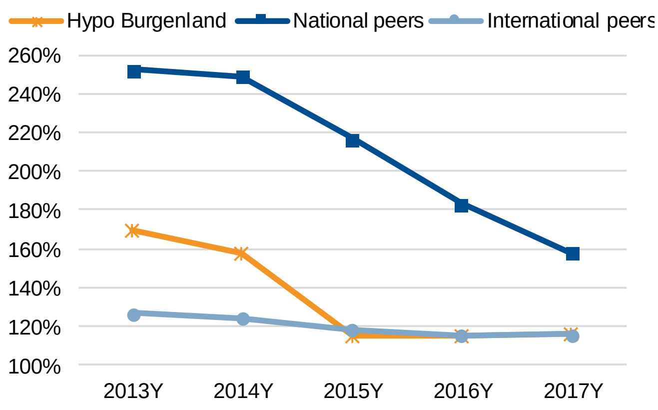
We note that the economy in the state of Burgenland tends to be based on small businesses with a strong focus on retail and trade (Figure 12). About 37% of the 133,200 people in paid work commute to other areas such as Vienna and Lower Austria. As a consequence, we would argue that economic growth is partly imported and hence also heavily dependent on developments in the neighbouring regions.

Economic growth in the region is particularly visible via the price rises in residential real estate, with house price changes over the past five years or so partly exceeding developments in neighbouring areas. Although Austria has experienced major price changes for real estate across various regions, we note that to date the Austrian Central Bank is not materially concerned about substantial real estate risks in the country.

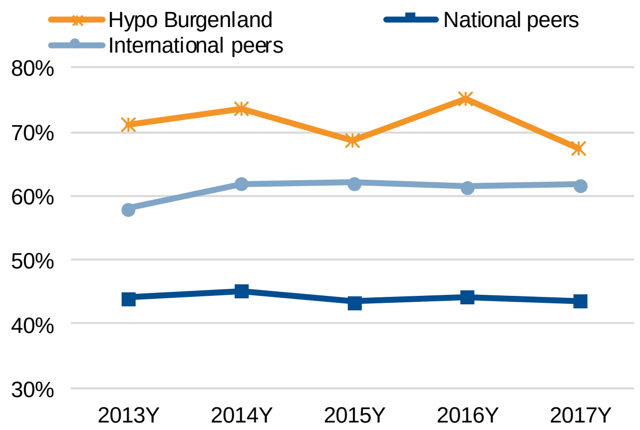
Going forward, the potential for regional growth for Bank Burgenland may remain rather limited. As is the case for any regional business profile, concentration risks may lead to greater asset quality problems for the bank in the event of an economic downturn, than would be experienced by national/more diversified peers.

Appendix II: Peer comparison

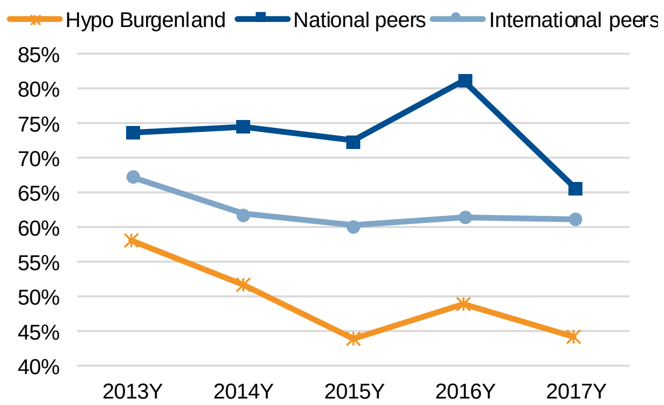
Amortised loans % deposits



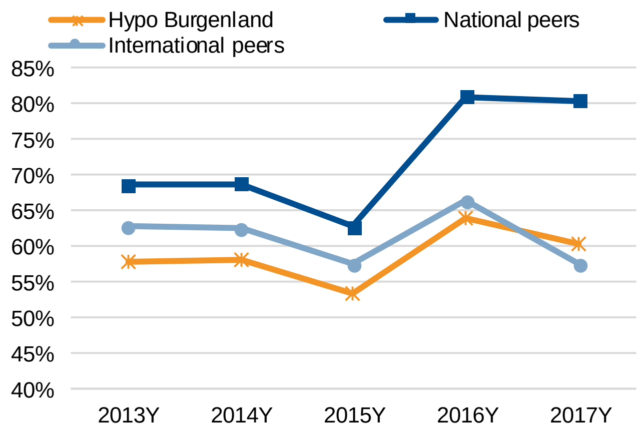
Asset risk intensity (RWAs % total assets)



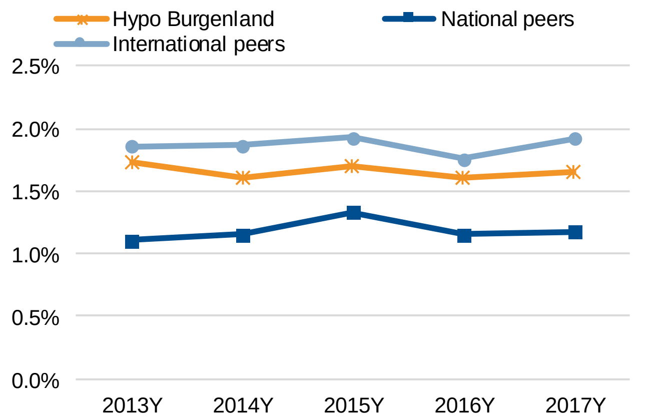
Net interest income % revenues



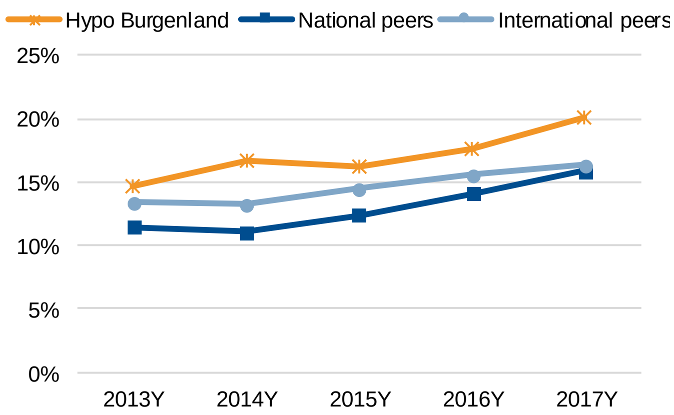
Cost income ratio (%)



Net interest margin (%)



Common equity tier 1 ratio (%, transitional)



Source: SNL, Scope Ratings

*Hypo peers: Salzburger Landes-Hypothekenbank, Hypo NOE, Hypo Oberoesterreich, Hypo Steiermark, Hypo Tirol, Hypo Vorarlberg, Anadi Bank, Hypo Burgenland.

**Other national peers: Bankhaus Carl Spaengler, Bank Tirol, BAWAG, BKS Bank, Oberbank, Volkskreditbank, Steiermaerkische Bank und Sparkassen, RLB Steiermark, Hypo Burgenland.

Appendix III: Selected Financial Information – HYPO-BANK BURGENLAND AG

	2013Y	2014Y	2015Y	2016Y	2017Y
Balance sheet summary (EUR m)					
Assets					
Cash and interbank assets	457	396	578	235	296
Total securities	1,244	1,225	1,492	1,527	1,371
of which, derivatives	91	99	80	63	58
Net loans to customers	2,501	2,461	2,768	2,903	3,190
Other assets	95	78	126	129	119
Total assets	**4,297**	**4,160**	**4,965**	**4,794**	**4,977**
Liabilities					
Interbank liabilities	88	219	368	352	456
Senior debt	1,857	1,487	1,165	891	793
Derivatives	47	35	33	36	29
Deposits from customers	1,467	1,547	2,396	2,520	2,743
Subordinated debt	75	72	74	72	16
Other liabilities	217	238	264	219	191
Total liabilities	**3,750**	**3,599**	**4,300**	**4,090**	**4,228**
Ordinary equity	547	561	636	703	747
Equity hybrids	0	0	0	0	0
Minority interests	0	0	29	1	2
Total liabilities and equity	**4,297**	**4,160**	**4,965**	**4,794**	**4,977**
Core tier 1/Common equity tier 1 capital	448	514	553	637	673
Income statement summary (EUR m)					
Net interest income	73	66	76	76	78
Net fee & commission income	52	54	60	67	72
Net trading income	1	3	29	2	10
Other income	-1	5	8	11	18
Operating income	**125**	**129**	**173**	**156**	**178**
Operating expense	72	75	92	100	107
Pre-provision income	**53**	**54**	**81**	**56**	**70**
Credit and other financial impairments	28	47	34	-30	-4
Other impairments	0	0	0	0	0
Non-recurring items	NA	NA	NA	NA	NA
Pre-tax profit	**25**	**7**	**77**	**87**	**75**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	-3	5	10	35	18
Net profit attributable to minority interests	0	0	0	1	1
Net profit attributable to parent	**28**	**2**	**67**	**51**	**56**

Source: SNL

Appendix IV: Ratios - HYPO-BANK BURGENLAND AG

	2013Y	2014Y	2015Y	2016Y	2017Y
Funding and liquidity					
Net loans/deposits (%)	169.3%	158.0%	114.7%	114.5%	115.5%
Liquidity coverage ratio (%)	NA	NA	NA	NA	NA
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/assets (%)	58.2%	59.2%	55.7%	60.6%	64.1%
NPLs/net loans (%)	8.7%	14.6%	12.5%	5.3%	4.4%
Loan-loss reserves/NPLs (%)	59.5%	36.5%	36.9%	50.7%	50.1%
Net loan growth (%)	-3.1%	-1.6%	12.4%	4.9%	9.9%
NPLs/tangible equity and reserves (%)	32.2%	51.6%	43.6%	19.7%	16.9%
Asset growth (%)	-0.2%	-3.2%	19.3%	-3.4%	3.8%
Earnings and profitability					
Net interest margin (%)	1.7%	1.6%	1.7%	1.6%	1.6%
Net interest income/average RWAs (%)	2.3%	2.2%	2.3%	2.2%	2.2%
Net interest income/operating income (%)	58.1%	51.6%	43.9%	48.8%	44.0%
Net fees & commissions/operating income (%)	41.6%	42.0%	34.6%	43.0%	40.4%
Cost/income ratio (%)	57.8%	58.0%	53.3%	64.0%	60.3%
Operating expenses/average RWAs (%)	2.3%	2.4%	2.8%	2.8%	3.1%
Pre-impairment operating profit/average RWAs (%)	1.7%	1.8%	2.5%	1.6%	2.0%
Impairment on financial assets /pre-impairment income (%)	52.2%	86.6%	42.8%	-54.1%	-6.1%
Loan-loss provision charges/net loans (%)	0.8%	1.8%	1.1%	-1.2%	-0.2%
Pre-tax profit/average RWAs (%)	0.8%	0.2%	2.4%	2.5%	2.1%
Return on average assets (%)	0.7%	0.0%	1.5%	1.1%	1.2%
Return on average RWAs (%)	0.9%	0.1%	2.1%	1.5%	1.6%
Return on average equity (%)	5.2%	0.4%	10.9%	7.6%	7.8%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	14.7%	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	14.7%	16.8%	16.2%	17.6%	20.1%
Tier 1 capital ratio (%, transitional)	14.7%	16.8%	16.2%	17.6%	20.1%
Total capital ratio (%, transitional)	17.2%	17.9%	17.0%	18.1%	20.4%
Leverage ratio (%)	NA	NA	NA	NA	NA
Asset risk intensity (RWAs/total assets, %)	71.0%	73.6%	68.8%	75.3%	67.4%
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

Appendix V: Quantitative analysis

Default risk analysis

We analysed Bank Burgenland's cover pool with a non-parametric distribution calculated using a Monte Carlo analysis.

We used the issuer's internal rating system, migration matrixes, the issuer's back-testing and third-party information to establish a default assumption for each borrower. In the absence of detailed performance data on the corporate and the medium sized enterprise ('MU') segments, we conservatively assumed their probabilities of default to be aligned with those of the issuer's small enterprise ('Retail') segment.

We assumed a general correlation of 7% for the commercial and private residential sub-portfolios considering that all assets are exposed to Austria. For residential loans we assumed a regional correlation of 20% for collateral in Burgenland and Vienna and 15% for the remaining regions. For the commercial sub-portfolio we assumed 10% and 8% respectively. Furthermore, we assumed an industry-specific correlation of 20% within the commercial segments. A large obligor stress was applied to 30 (exceeding 50 bps of the total cover pool) out of 2,841 obligors with an additional correlation of 20%. We assumed a 100% correlation for substitute assets, as they are all exposed to the Austrian sovereign.

Rating-conditional security value haircuts

For our collateral analysis we applied distance-conditional recovery rates as a function of the seven-notch distance between the covered bond rating of AAA and the issuer rating. The stress levels are divided into seven levels with the highest stresses applied to the highest achievable uplift (D7). This is because fundamental support provides a four-notch uplift and the cover pool provides the maximum three-notch uplift – hence seven stress levels, D0 to D7.

Scope calculated the recovery rate on the mortgages by analysing movements in the collateral's market value[2]. The recovery analysis considers the distance to a long-run or sustainable price for the underlying asset, as well as fire-sale discounts, e.g. during a property's foreclosure.

Austrian total security value haircuts

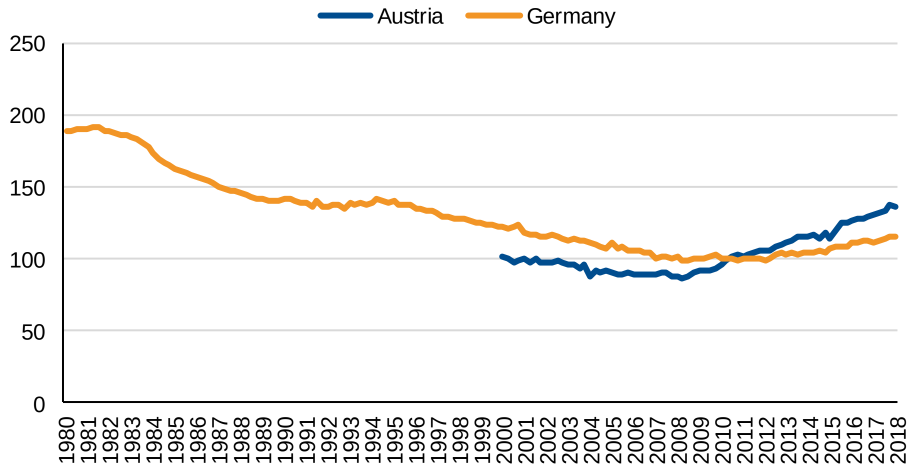
Our security value haircut assumptions are based on our view of sustainable price levels and the observed volatility of the affordability indices for Germany, Austria and Vienna provided by the OECD and the Austrian National Bank.

Our affordability analysis used a longer historical series for Germany because of the limited timeframe of the comparable index for Austria. This also reflects our view that fundamental risk factors for both countries are comparable.

Scope measured current over/under valuation from the sustainable average in the regions with available historical house price data for Vienna and Austria excluding Vienna.

[2] Scope applied the covered bond analysis framework to establish market value haircuts and rating-distance conditional recovery assumptions.

Figure 22: Affordability index (price-to-income index)

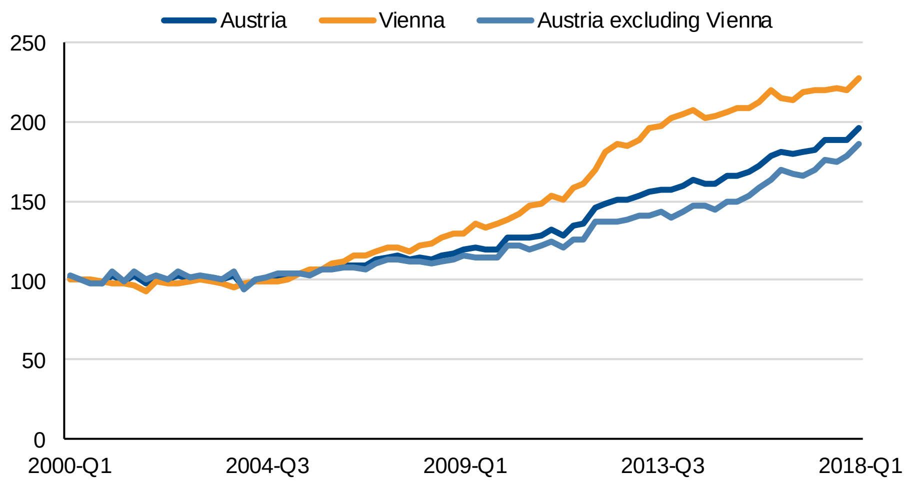


Source: OECD

We used the affordability index as a proxy for the volatility of commercial and residential real estate. In the absence of data regarding commercial house prices we also benchmarked our assessment to German over/under valuation from the sustainable average.

The total security value haircuts applied range between 53.5% for commercial collateral and 50.7% for residential collateral in the highest stress scenarios (D7), and 35.7% and 33.6% respectively in a base (D0) scenario.

Figure 23: Residential house price development in Austria



Source: Austrian National Bank

In the scenario needed to support the maximum achievable uplift, we calculated a weighted average recovery rate of 77.8%, which compares to our base case recovery assumption of 97.1%.

The recovery rates considered in the analysis reflect the outstanding notional of the loans as of closing, reduced by applying Scope's stressed security value haircut and by applying costs for the foreclosure and purchase process. For the latter we assumed 7% of the stressed market value.

Other parameters

Our segment-specific recovery rates and the relevant average liquidity premium are based on the cover pool’s composition. The highest stress assumptions only apply in the scenario which, if passed, allows the maximum credit differentiation between the issuer and its covered bonds.[3]

Liquidity premium. We added an average 150 bps liquidity discount to the Austrian residential mortgage assets, 300 bps to the commercial assets and 200 bps to the substitute assets, which we determined by analysing the historical trading spreads of other Austrian covered bonds.

Market risk stresses. In our cash flow analysis, we assumed deterministic interest rate stresses, which we established via a common framework. This allows us to establish stresses that equate to the maximum achievable rating uplift.

Interest rate modelling. We tested the covered bonds against several scenarios with rising and falling interest rates. The covered bonds are most vulnerable to a non-reverting negative interest rate scenario (Japanese scenario) as the covered bonds are fixed rate with relatively long maturities.

Prepayment rate assumption. We tested both 0% and 15% constant prepayment assumptions for all cover assets. The covered bonds are most vulnerable to low prepayments.

Default timing: Scope considered different default timings, from mid-loaded to front-loaded. Back-loaded default scenarios are not as severe for the covered bonds, mainly as a result of amortisation.

Servicing fee. Our analysis applies asset type-specific servicing fees that the cover pool must pay annually should Bank Burgenland default. An average annual 43 bps servicing fee was applied to Bank Burgenland’s cover pool.

Foreclosure timing: We assumed a recovery lag of 24 months for residential loans originated by Bank Burgenland, 36 months for commercial loans and 48 months for the substitute assets.

Default timing: We considered different default timings, from mid-loaded to front-loaded. Back-loaded default scenarios are not as severe for the covered bonds, mainly as a result of amortisation.

Data: We were not provided with a breakdown of prior liens or external prior liens within a borrower group. As we calculated recoveries at borrower level, internal (registered) prior liens are neutral. We used the whole LTV calculated by the issuer in order to calculate external prior liens.

[3] The maximum credit differentiation between the rating of the issuer and its covered bond is typically determined by our fundamental assessment of the legal and resolution framework. In accordance with our methodology, the maximum credit differentiation can only be three notches higher than this fundamental uplift. For Bank Burgenland, we determined fundamental support of four notches. According to our methodology, the maximum achievable uplift is seven notches (4+3).

Appendix VI: Summary of characteristics

Reporting date	01 Aug 17	30 Sep 18
Issuer name	Bank Burgenland	Bank Burgenland
Country	Austria	Austria
Covered bond name	Hypothekenpfandbrief (Hypf) Austrian mortgage-covered bonds issued under the PfandG	Hypothekenpfandbrief (Hypf) Austrian mortgage-covered bonds issued under the PfandG
Covered bond legal framework	Austrian legal covered bond framework	Austrian legal covered bond framework
Cover pool type	Residential and commercial mortgages	Residential and commercial mortgages
Issuer rating	Not disclosed	Not disclosed
Current covered bond rating	AA+ / Stable	AAA / Stable
Covered bond maturity type	Hard bullets	Hard bullets
Cover pool currency	EUR (91.75%) / CHF (8.25%)	EUR (100%)
Covered bonds currency	EUR (100%)	EUR (100%)
Fundamental cover pool support (notches)	4	4
Max. achievable covered bond uplift (notches)	7	7
Potential covered bond rating buffer	0	0
Cover pool/eligible assets [EUR m]	910.4 / 761.4	952.4 / 828.9
Covered bonds [EUR m]	186.0	234.2
Substitute assets [EUR m]	0	5.2
Current overcollateralisation/legal minimum OC	389.5% / 2.0%	253.9% / 2.0%
OC to support current rating	40.0%	28.0%
OC to support rating upon a one-notch downgrade	38.0%	n/a
Weighted average seasoning	5.1 years	4.4 years
Duration/WA maturity of assets	5.6 / 5.9	4.3 / 6.1
Duration/WA maturity of liabilities	9.7 / 11.0	6.4 / 9.1[2]
Duration gap/WA Maturity gap	-4.1 / -5.1	-2.1 / -3.1
Number of loan exposures	4,166	3,855
Average eligible loan size (in EUR '000s)	182.8	215.0
Top-10 exposures	15.1%	16.7%
Top-20 exposures	21.5%	23.9%
Interest rate type - of total cover pool	12.6% (fixed) / 87.4% (floating)	23.9% (fixed) / 76.1% (floating)
Interest rate type - covered bonds	97.3% (fixed) / 2.7% (floating)	97.9% (fixed) / 2.1% (floating)
WA whole loan LTV/eligible LTV	123.4% / 47.4%	61.5% / 49.4%
Geographic split (top three)	Vienna (38.9%) Burgenland (35.7%) Lower Austria (12.1%)	Vienna (44.7%) Burgenland (31.2%) Styria (10.0%)
Default measure	Inverse Gaussian	Non-parametric
Weighted average default rate	19.4%	11.3%
Coefficient of variation	52.6%	73.2%
Weighted average recovery assumption (D0/D7)[1]	89.5% / 68.3%	97.1% / 77.8%
Current share of loans > 3 month in arrears	0.0%	0.0%
IR stresses (min./max.; CCY dependent)	-1% to 10%	-1% to 10%
FX stresses (min./max.; CCY dependent)	10% to 75% depreciation (CHF)	n/a
D7[1] Liquidity premium	150bps (residential mortgages) / 300bps (commercial mortgages)	150bps (residential mortgages) / 300bps (commercial mortgages)
Servicing fee (mortgage)	34 bps	43 bps

[1] D0 or D7 denote the stresses commensurate with the rating distance between the issuer rating and the covered bond rating
[2] Assuming first call option is exercised

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