HYPO - Bank Burgenland AG
Austrian Hypothekenpfandbriefe – Performance Update

Rating rationale (summary)

The AAA ratings with a Stable Outlook on the Austrian mortgage-covered bonds (Hypothekenpfandbriefe) issued by HYPO-Bank Burgenland AG (Bank Burgenland) are based on the bank's issuer rating of A-, enhanced by at least six notches of cover pool support.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 September 2022	EUR 1,186.9m	Residential and commercial mortgage loans	EUR 624.9m	AAA/Stable

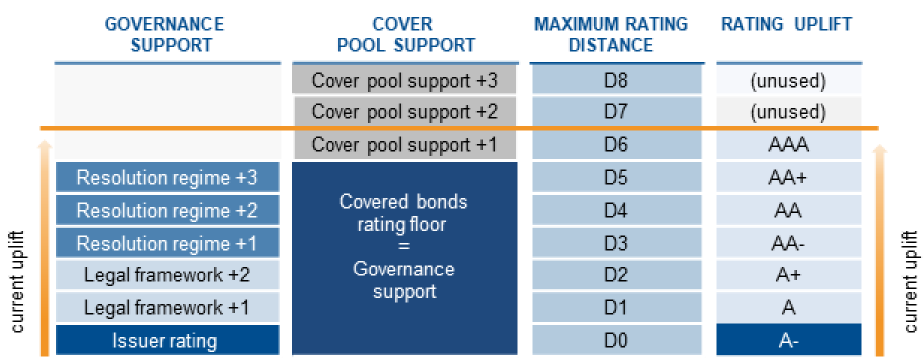
Bank Burgenland's A-/Stable issuer rating reflects its well-established, profitable and regionally focused banking operations in the Austrian regions of Burgenland, Vienna and Styria. Despite a traditional focus on real estate financing, Bank Burgenland's business model is very well-diversified thanks to good market positions in retail and private banking as well as in the institutional business areas of asset management and custodian banking.

Governance support factors from the Austrian legal and resolution framework provide a five-notch uplift above the bank's rating, up from four notches previously, which effectively forms a rating floor. Stronger visibility and higher domestic stakeholder cohesiveness drive the increase in governance support.

We have assigned the covered bonds a cover pool complexity (CPC) category of 'Low' for the interplay between complexity and transparency. This allows for a maximum additional uplift of three notches on top of the governance uplift and enables the programme to be rated AAA, reflecting the credit strength of the covered bond programme.

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

Figure 1: Covered bond rating building blocks



Changes since the last performance update

The minimum level of overcollateralisation (OC) required to support the AAA rating has decreased to 10.0% from 14.0%. The reduction reflects the higher interest rate environment, which creates additional excess spread from the floating rate cover assets, especially under base case stresses and the application of less severe market stresses reflecting the increased maximum cover pool uplift.

Ratings & Outlook

Issuer rating	**A-**
Outlook	Stable
Last rating action date	24 Nov 2022
Covered bond rating	**AAA**
Outlook	Stable
Last rating action date	28 Nov 2022

Rating Team (covered bonds)

Reber Acar
r.acar@scoperatings.com

Mathias Pleissner
m.pleissner@scoperatings.com

Lead Analyst (banks)

Christian van Beek
c.beek@scoperatings.com

Related research

Scope affirms at AAA/Stable the Austrian mortgage-covered bonds issued by Bank Burgenland
November 2022

Scope affirms Bank Burgenland's issuer rating at A- with a Stable Outlook
November 2022

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

The issuer

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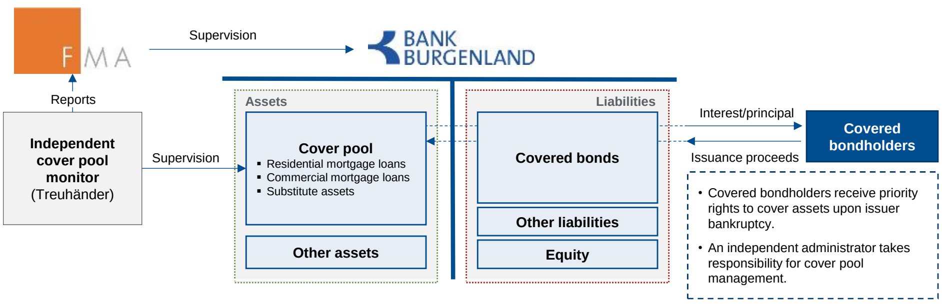
Bank Burgenland along with its subsidiaries is integrated into the risk controls of the GRAWE Group as a fully owned subsidiary of Grazer Wechselseitige Versicherung AG, an Austrian multi-line insurance group. Due to the group's mutual ownership structure, the management of both Bank Burgenland and its subsidiaries is focused on internal capital generation and conservative reserve building.

Further details on our credit assessment of Bank Burgenland are available at www.scoperatings.com.

Programme structure

Bank Burgenland issues covered bonds using an on-balance sheet structure. Its issuances are governed by the new Austrian Covered Bond Act (PfandBG) and supervised by Austria's Financial Market Authority (FMA).

Figure 2: Issuance structure



Source: Scope Ratings.

Governance support analysis

Two notches of legal framework uplift …

We continue to assign the maximum legal framework uplift of two notches following our analysis of the Austrian covered bond framework. The updated legislation came into force on 8 July 2022 and transposed the European Covered Bond Directive into local law. The new framework consolidated the three previous legislations, improved and aligned it more closely with best practice as seen in other covered bond frameworks across Europe.

… plus three notches of resolution regime uplift

Bank Burgenland's covered bonds also benefit from an additional three-notch uplift, up from two notches previously, which reflects the exclusion of covered bonds from bail-in as well as our view on the resolvability and probable maintenance of Bank Burgenland in a hypothetical scenario of regulatory intervention, and the moderate importance of covered bonds in Austria.

Stronger visibility and higher domestic stakeholder cohesiveness drive the increase in governance support. This reflects the consolidation of the previous three covered bond legislations into one, ongoing industry efforts to create a common Austrian covered bond brand and the regular use of public placements, also among mid-size banks.

Our latest assessment of relevant governance support factors for Austrian covered bonds is available here.

Cover pool analysis

Bank Burgenland's mortgage-covered bond ratings are cover pool-supported, with six out of eight possible notches currently needed to achieve the highest rating. Governance support provides a five-notch rating uplift and, effectively, a floor against a deterioration in cover pool credit quality.

Since our last review in 2021, the minimum supporting OC needed to achieve the highest rating has decreased to 10.0% from 14.0%. The reduction reflects the higher interest rate environment, which creates additional excess spread from the floating rate cover assets, especially under base case stresses and the application of less severe market stresses reflecting the increased maximum cover pool uplift.

Cover pool characteristics

Reporting date	Q3 2021	Q3 2022
Balance (EUR m)	853.9	1,186.9
Residential	72.0%	68.7%
Commercial	26.7%	30.1%
Substitute	1.3%	1.2%

General information

Reporting date	Q3 2021	Q3 2022
No. of loans	3,903	4,565
Avg. size (EUR)	215,853	256,815
Top 10 (%)	14.3%	17.5%
Remaining life (y)	11.8	13.2
Seasoning (y)	5.4	4.5
WA eligible-loan LTV	47.4%	49.4%

Repayment type (%)

Reporting date	Q3 2021	Q3 2022
Annuity	81.2%	82.2%
Interest-only	18.8%	17.8%

Interest rate type (%)

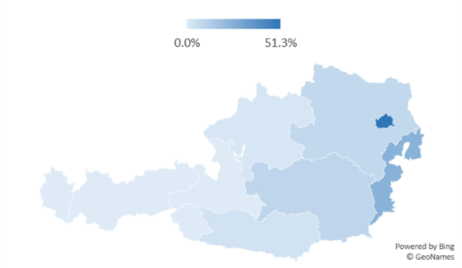
Reporting date	Q3 2021	Q3 2022
Fixed	27.0%	31.4%
Floating	73.0%	68.6%

Cover pool composition

The cover pool comprises well-seasoned, domestic commercial and residential mortgage loans in eastern Austria. The low weighted average loan-to-value (LTV) ratio of 49.4% on an eligible-loan basis indicates high protection against credit losses in the event of borrower default. The new Austrian Covered Bond Act stipulates a maximum LTV ratio of 80% for residential mortgage assets. However, Bank Burgenland continues to voluntarily limit its eligible LTV ratio to 60%.

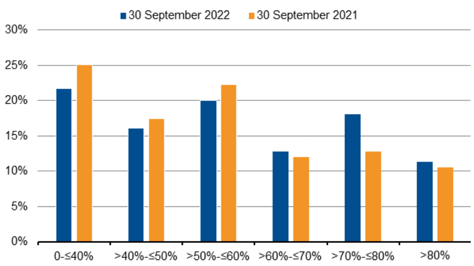
Commercial debtors are SMEs (around 20%) and larger housing corporations (around 50%). Non-recourse and special purpose vehicle structures are rare. By property usage, around 70% of the pool is secured by residential properties. Multifamily houses and flats account for most of the portfolio and are largely located in Vienna.

Figure 3: Regional distribution



Source: Scope Ratings, Bank Burgenland

Figure 4: LTV distribution (whole loan)



Source: Scope Ratings, Bank Burgenland

Asset risk analysis

The residential sub-pool is highly granular, which enables us to analyse it using an inverse Gaussian distribution. We established a mean default rate of 9.5% and a coefficient of variation of 60%. The parameters for the default distribution were derived using the bank's loan-by-loan risk assessments and benchmarking.

For the commercial sub-pool, our projections of default in the cover pool used a non-parametric default distribution, which can be approximated with a mean default rate of 11.2% and a coefficient of variation of 60.1%. We used a correlation framework along with the bank's loan-by-loan risk assessments to incorporate the impact of geographical, industry and obligor concentrations.

We estimated a recovery rate of 95% under a base case scenario (D0) for both the residential and the commercial pool. In the most stressful scenario (D8), we estimated a recovery rate of 72.5% for the residential pool and 62.5% for the commercial pool. Our recovery rate calculations reflect rating distance-dependent market value declines as well as assumptions regarding the Austrian housing market and its unique characteristics.

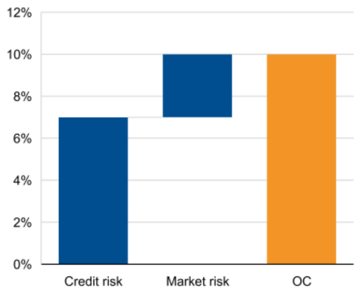
Cash flow risk analysis

The rating-supporting OC of 10.0% reflects the programme's sensitivity to high prepayments in combination with a stressed lower-for-longer interest rate scenario. Combined, these factors result in a cost of carry for the programme. Market risks account for 3 pp of the supporting OC of 10.0%.

As of Q3 2022, the weighted average life (WAL) of the outstanding covered bonds is 7.0 years, after accounting for call rights that may be exercised by the issuer. In comparison, the WAL of the scheduled cover pool is 7.5 years. In a high prepayment scenario, the WAL of the assets falls to around three years, creating a gap between the cover assets and the covered bonds. As is typical of Austrian mortgage-covered bonds, there is structural interest rate risk. Around 70.0% of the cover assets pay a variable rate, while all the covered bonds pay fixed rates.

In total, credit risk accounts for another 7 pp of the supporting OC. This is moderate, reflecting the portfolio's mean default rate of 10.7%, a coefficient of variation of 59.9% and a stressed recovery rate of 65.2%. It also reflects the high prepayment scenario that drives the results, reducing the lifetime of the assets and consequently limiting the allocation of defaults.

Rating-supporting OC: breakdown

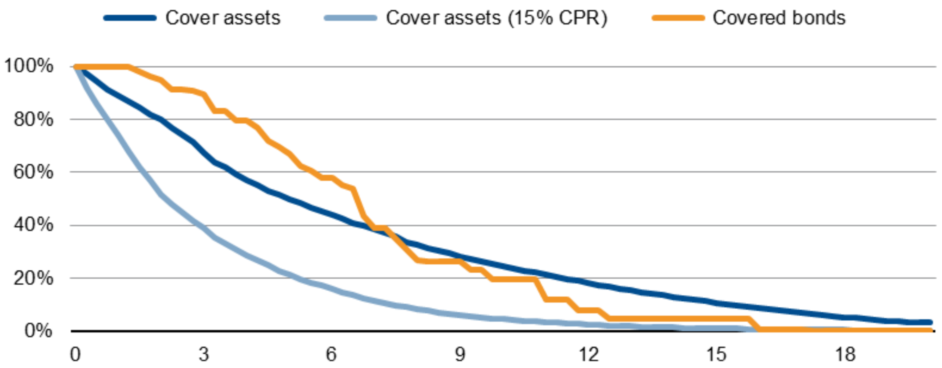


Source: Scope Ratings

Asset-liability mismatches

	Assets	Liabilities
EUR	100.0%	100.0%
Fixed	31.4%	100.0%
Floating	68.6%	0.0%
WAL (years)	7.5	7.0

Figure 5: Amortisation profile (relative)

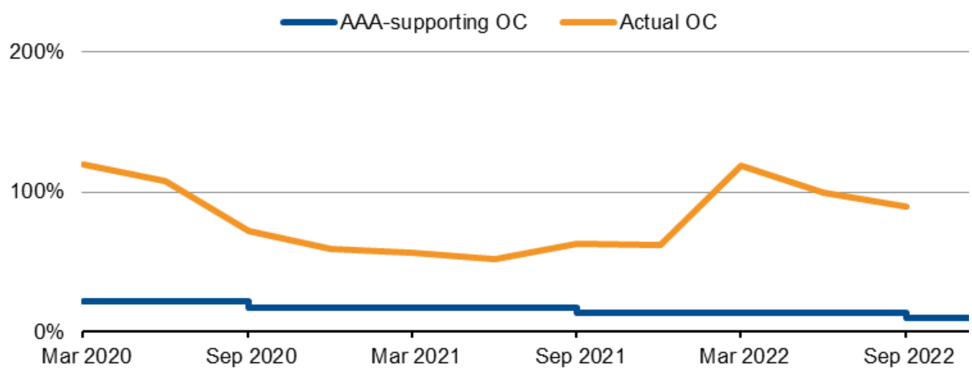


Source: Scope Ratings, Bank Burgenland

Availability of overcollateralisation

Bank Burgenland's credit strength allows us to fully account for the provided OC of 89.9%. We are not aware of plans that would significantly change the risk profile or reduce available OC to levels that would no longer support the current rating uplift.

Figure 6: OC development



Source: Scope Ratings, Bank Burgenland

Other risk considerations

Main counterparty exposure relates to Bank Burgenland

The rated bonds are exposed to Bank Burgenland's roles as originator, servicer, account provider and paying agent. No documented replacement mechanisms 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 the covered bondholders would prevent negative impacts before a regulator intervenes. As part of its risk management process, the bank regularly monitors its accounts to ensure that any required remedial action is taken at an early stage.

In addition, we expect any regulatory intervention in Bank Burgenland to 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.

Country risk does not affect the ratings

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

Governance remains key ESG factor

Governance considerations such as the strength of supervision and prudent management play a major role in our covered bond analysis, reflected in both our governance analysis and our cover pool support analysis. In addition, our CPC category measures the issuer's management of the interplay between complexity and the level of transparency provided to investors. For Bank Burgenland, this allows for the maximum additional cover pool support uplift of up to three notches on top of the governance uplift.

Information provided by the issuer did not enable us to incorporate potential credit benefits from ESG-compliant cover assets in our analysis (e.g. better recovery prospects for more energy-efficient collateral or a lower liquidity premium).

Sensitivity analysis

Two-notch buffer against potential change in issuer rating

Bank Burgenland's mortgage-covered bond ratings benefit from a buffer against an issuer downgrade of up to two notches. Assuming the issuer's willingness to support the highest ratings as well as a stable covered bond programme risk profile, a one-notch downgrade would increase the rating-supporting OC requirement to 14.0%.

Constraint through rating-supporting OC unlikely

The current OC of 89.9% greatly exceeds the 10.0% needed to support the AAA rating. We do not expect rating-supporting OC to constrain the rating in the short to medium term. This assumption reflects the issuer's stable underwriting criteria and the fact that the cover pool's credit quality does not materially differ from the additional, available eligible assets or the bank's loan book.

Appendix: Summary of covered bond characteristics

Reporting date	30 September 2021	30 September 2022
Issuer name	Hypo-Bank Burgenland AG	
Country	Austria	
Covered bond name	Hypothekenpfandbrief (Hypf) Austrian mortgage-covered bonds issued under the PfandBG	
Covered bond legal framework	Austrian legal covered bond framework	
Cover pool type	Residential and commercial mortgages	
Composition	Residential = 72.0% Commercial = 26.7% Substitute assets = 1.3%	Residential = 68.7% Commercial = 30.1% Substitute assets = 1.2%
Issuer rating	A-/Stable	A-/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Hard bullets	Hard bullets
Cover pool currencies	EUR (100%)	EUR (100%)
Covered bond currencies	EUR (100%)	EUR (100%)
Governance support (notches)	4	5
Maximum additional uplift from CPC Cat (notches)	3	3
Maximum achievable covered bond uplift (notches)	7	8
Covered bond rating buffer (notches)	1	2
Cover pool/eligible assets (EUR m)	961.9 / 853.9	1,371.2 / 1,186.9
of which substitute assets and deposits (EUR bn)	11.4	14.5
Covered bonds (EUR m)	524.9	624.9
Overcollateralisation: current/legal minimum	62.7% / 2.0%	89.9% / 2.0%
Overcollateralisation to support current rating	14.0%	10.0%
Overcollateralisation upon a one-notch issuer downgrade	16.0%	14.0%
Weighted average life of assets	6.8	7.5
Weighted average life of liabilities*	7.3	7.0
Number of loans	3,903	4,565
Average loan size (EUR)	215,853	256,815
Top 10 exposures	14.3%	17.5%
Interest rate type – assets	Fixed: 27.0% Floating: 73.0%	Fixed: 31.4% Floating: 68.6%
Interest rate type – liabilities	Fixed: 100.0% Floating: 0.0%	Fixed: 100.0% Floating: 0.0%
Weighted average eligible-loan LTV ratio (unindexed)	47.4%	49.4%`
Geographic split (top three)	Vienna (47.6%) Burgenland (29.5%) Styria (12.7%)	Vienna (51.3%) Burgenland (24.8%) Styria (9.4%)
Default measure (residential / commercial)	Inv. Gaussian / Non-parametric	Inv. Gaussian / Non-parametric
Mean default rate (residential / commercial)	12.5% / 8.6%	9.5% / 11.5%
Coefficient of variation (residential / commercial)	60.0% / 72.7%	60.0% / 60.1%
Base – recovery assumption (residential / commercial)	95.0% / 95.0%	95.0% / 95.0%
Stressed – recovery assumption (residential / commercial)	82.5% / 65.0%	72.5% / 62.5%
Max. liquidity premium (residential / commercial)	200 bps / 400 bps	200 bps / 400 bps
Servicing fee (residential / commercial)	25 bps / 50 bps	25 bps / 50 bps

*Assuming first call option is exercised by the issuer

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

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

Phone +49 69 66 77 389 0

Paris
10 avenue de Messine
FR - 75008 Paris

Phone +33 6 6289 3512

Oslo
Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid
Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan
Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30315 814

Scope Ratings UK Limited

London
52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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