Totens Sparebank Boligkreditt

Norwegian Mortgage-Covered Bonds – Performance Update

Rating rationale (summary)

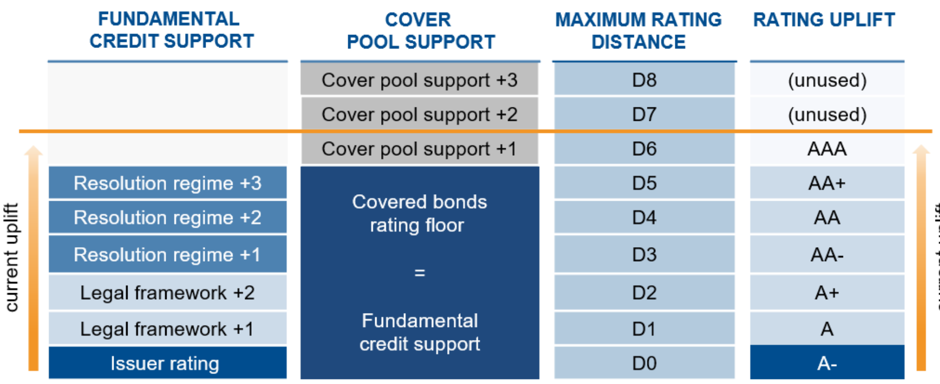
The AAA ratings with a Stable Outlook on the Norwegian covered bonds (obligasjoner med fortrinnsrett) issued by Totens Sparebank Boligkreditt (TSBB) are based on the bank's issuer rating of A-, enhanced by six notches of cover pool support. Thereof, five notches reflect the strong fundamental credit support provided by the Norwegian legal covered bond and resolution frameworks.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 June 2020	NOK 3.54bn	Residential mortgage loans	NOK 2.90bn	AAA/Stable

TSBB is a wholly owned, specialised credit institution dedicated to providing secured covered bond funding for its parent, Totens Sparebank (TSB). Our A- issuer rating with a stable outlook on TSBB reflects its full ownership by TSB (A-/ Stable) and its ability to refinance residential mortgage loans using covered bonds.

Fundamental credit support factors from the Norwegian legal and resolution framework provide an issuer specific 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 one-notch uplift reflecting the credit strength of the covered bond programme.

The programme may further benefit from a buffer of two notches 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.



Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectations that: i) the credit performance of TSB, TSBB 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 June 2019 the cover pool has increased to NOK 3.54bn (+28%). This follows new business from a rise in gross lending to customers as well as the ongoing asset reallocation from mortgage loans that were registered in the EIKA covered bond programme. Some risk metrics have naturally increased from lower seasoned assets. For instance, the average indexed loan-to-value (LTV) increased by 2.9pp to 55%.

Ratings & Outlook

Covered bond rating	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action date	16 Oct. 2019
Issuer rating	**A-**
Outlook	Stable
Last rating action	New Rating
Last rating action date	30 Oct. 2018

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Related Research

Scope affirms the mortgage-covered bonds issued by TSBB, 16 October 2019

New analysis on Totens Sparebank, 1 November 2019

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The issuer

The issuer ratings of TSBB reflect those of its parent bank, TSB.

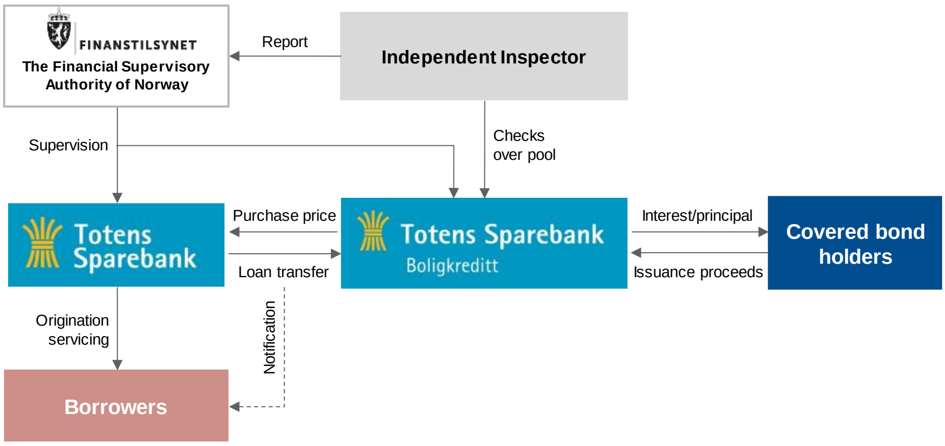
Established in 1854, TSB is a savings bank with a strong market position in south-eastern Norway. Macroeconomic conditions in Norway are supportive, with the country having recovered from a fall in oil prices in 2014. The bank operates primarily in the Mjos region, where agriculture, manufacturing and the public sector are important economic drivers. Over 70% of the bank's lending concerns residential mortgages.

For further details on our bank credit analysis see the full bank rating report available on www.scoperatings.com.

Programme structure

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the 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 TSBB, most issuers of covered bonds (generally called Boligkreditt, or specialised residential mortgage institutions) are subsidiaries that rely on loans originated by their respective parent banks. The parent banks generally also provide most of the services for these subsidiaries, allowing the latter to keep staff numbers low.

Issuance structure



Source: Scope Ratings

Fundamental credit support analysis

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

Two notches of uplift based on legal framework analysis…

We consider the Norwegian covered bond framework to be 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 to reflect the resolution regime and systemic importance

TSBB's covered bonds benefit from an additional three-notch uplift to reflect their exemption from bail-in and the support from a strong stakeholder community. This is based on: i) a moderate to high likelihood that the covered bond issuer will be maintained in a resolution scenario; and ii) the high systemic importance of covered bonds in Norway. However, we also recognise the low visibility and importance of TSBB as a covered bond issuer. 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	June 2020	June 2019
Balance (NOK bn)	3.54	2.76
Residential (%)	96.9	91.4
Substitute (%)	3.1	8.6

Property type (%)

Reporting date	June 2020	June 2019
Single-family houses	72.0	71.0
Apartments	11.2	11.6
Shares*	8.5	9.3
Holiday homes	3.8	4.0
Others	4.5	4.1

*Shares in housing associations

General information

Reporting date	June 2020	June 2019
No. of loans	2.163	1,713
Avg. loan size (NOK m)	1,6	1,5
Top 10 (%)	2.2	2.9
Remaining life (years)	13.2	12.5
LTV (%)*	55.5	52.6

*Indexed

Interest rate type (%)

Reporting date	June 2020	June 2019
Floating	100	100
Fixed	0	0

Repayment type (%)

Reporting date	June 2020	June 2019
Bullet	6.5	9.2
Amortising	93.5	90.8

Cover pool analysis

We have established that an unchanged overcollateralisation of 4% can mitigate identified credit and market risk stresses and support the uplift under our rating methodology.

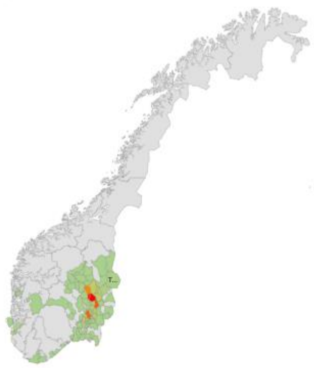
Credit risk remains low but contributes most to the supporting overcollateralisation. It has increased slightly since our last analysis, mainly driven by lower expected recoveries. The increase in credit risk has been offset by a slight fall in market risks, benefitting from a higher excess spread. Market risks account for both interest rate risks and maturity mismatches.

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. As of June 2020, the bank operates primarily in the Mjos region in south-eastern Norway, namely Oppland (44%), Akershus (28%), Oslo (12%) and Hedmark (11%).

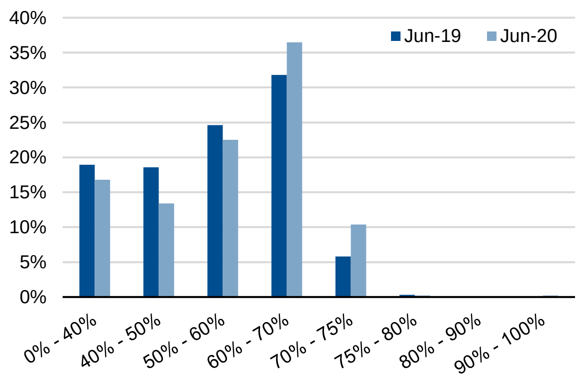
The mortgage pool consists of 2,163 loans granted to 2,104 obligors with an average loan size of NOK 1.59m. The largest obligor only accounts for 0.3%. Since our last review, granularity has improved, reflecting the mortgage portfolio's growth by 28%.

Figure 1: Regional distribution



Source: Scope Ratings, TSBB

Figure 2: LTV distribution (indexed)



Source: Scope Ratings, TSBB

Most of TSBB's cover pool continues to be backed by mortgage loans granted to residential borrowers secured by single-family houses (72%), followed by apartments and shares in housing associations. The indexed LTV is 55.5%, an increase by nearly 3pp since our last review. Lower recoveries primarily reflect the 10pp increase to 47.3% of loans exceeding 60% LTV (see Figure 2). Foreclosure proceeds for such loans are more strongly impacted by market value declines.

Asset risk analysis

Strong credit quality translates into low credit risk

The credit quality of the cover pool remains strong, but we aligned both the lifetime mean default rate and stressed recovery rates. Changes were driven by newly added and less seasoned assets but not by any observed deterioration in loan performance or property values.

Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on credit performance data provided by the bank (in particular, probability-of-default back-testing) and benchmarking. Based on the higher remaining life of the underlying portfolio, we increased our assumptions regarding the effective weighted-average lifetime mean default rate. We increased this to 10.5% from 9.5% reflecting the increase in the assets' weighted average life by nine months to now 13.2 years. The assumed assets' volatility of default (weighted average coefficient of variation) of 50% was kept constant.

For the mortgage loans we estimate a weighted average recovery rate of 98.3% (from 97.4%) under a base case and 72.1% (from 77.7%) under the most stressful scenario.

The base recovery rate is supported by the portfolio's low average LTV; the stressed rate is driven by an increased LTV from the addition of less seasoned loans and a moderate share of prior liens. The prior liens result from senior claims pledged to Eika Boligkreditt, the secured funding platform used by TSB in tandem to its own.

We also analysed the credit risk of the substitute assets. The average lifetime mean default rate was 0.15% with a very high coefficient of variation and a stressed recovery rate of 62%. Our projections of default on substitute assets follows a non-parametric distribution calculated using a Monte Carlo analysis.

Cash flow risk analysis

Credit risk main contributor to supporting overcollateralisation

The cover pool is mainly exposed to credit risk, which accounts for 2.5pp (from 2.3pp) of the rating-supporting overcollateralisation. The slight rise is a result of the increased credit metrics as described above. Despite credit risk being the main driver of supporting overcollateralisation, it remains low at an absolute level, reflecting the strong credit quality of the pool.

Figure 3: Components of rating-supporting overcollateralisation

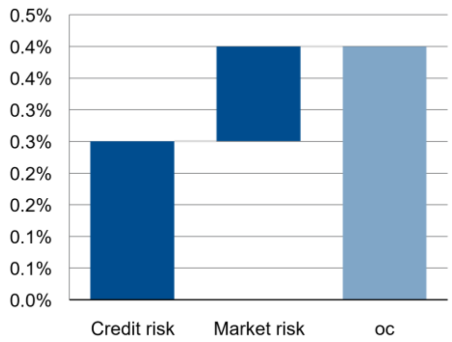
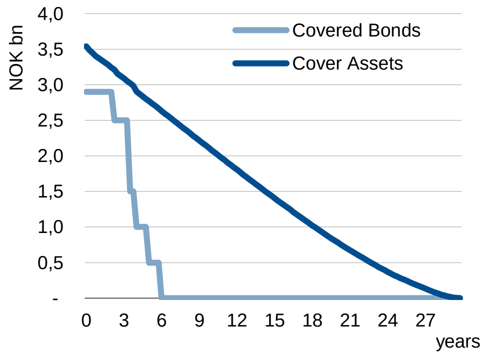


Figure 4: Amortisation profile



Source: Scope Ratings, TSBB

Market risk from cost of carry drives high prepayment scenario

Market risks, mainly asset-liability mismatches, account for 1.5pp (from 1.7pp) of rating-supporting overcollateralisation. They have dropped slightly due to increased excess spread from a rise in interest rates since our last analysis. Asset sales do not drive the supporting overcollateralisation due to the high prepayment scenario. Hence, market risks arise from the loss in excess spread (cost of carry).

Maturity mismatches have grown slightly since our last analysis because the assets' remaining life has increased while the life of the bonds has remained fairly stable.

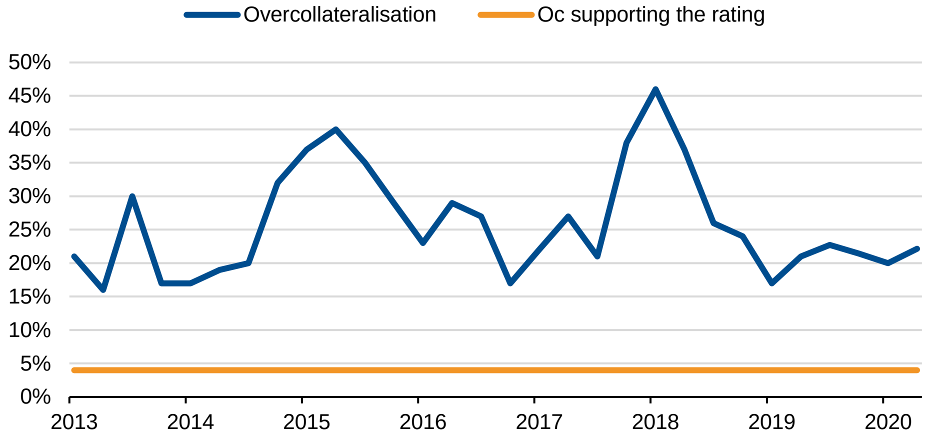
There is no foreign exchange risk as assets and liabilities are denominated in Norwegian krone. At this stage we do not expect any foreign currency-denominated issuances.

Availability of overcollateralisation

Overcollateralisation fully taken into account

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

Figure 5: Available overcollateralisation versus rating-supporting level



Source: Scope Ratings

Other risk considerations

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. We also take a positive view of the fact that collections are generally made via direct debit, allowing for a relatively swift redirection of payments if needed.

Country risk does not affect the ratings

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

No impact from ESG

We have not directly included ESG aspects in our rating of the covered bonds issued by TSBB. The issuer has no specific ESG underwriting guidelines which would provide for positive/negative adjustments to the terms and conditions of a mortgage loan if minimum ESG conditions are met/not met.

As is typical for most banks, environmental aspects, in particular Norwegian energy efficiency standards are seldom recorded in the bank's 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 as collateral valuations reflect the condition of the collateral.

The bank follows environmental, sustainability and corporate governance related guidelines. The bank also operates an endowment scheme from which it regularly donates to regional charities. TSB 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 2020	30 June 2019	30 Sept 2018
Issuer name	Totens Sparebank Boligkreditt		
Country	Norway		
Covered bond name	Obligasjoner med fortrinnsrett (Norwegian mortgage covered bonds)		
Covered bond legal framework	Norwegian legal covered bond framework		
Cover pool type	Residential mortgage loans		
Composition	Residential = 96.9%	Residential = 91.4%	Residential = 90.8%
	Substitute = 3.1%	Substitute = 8.6%	Substitute = 9.2%
Issuer rating	A-/Stable	A-/Stable	A-/Stable
Current covered bond rating	AAA/Stable	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullets	Soft bullets	Soft bullets
Cover pool currencies	NOK (100%)	NOK (100%)	NOK (100%)
Covered bond currencies	NOK (100%)	NOK (100%)	NOK (100%)
Fundamental cover pool support	5	5	5
Maximum achievable covered bond uplift	8	8	8
Potential covered bond rating buffer	2	2	2
Cover pool (NOK bn)	3.54	2.76	2.08
thereof, substitute assets (NOK bn)	0.11	0.24	0.21
Covered bonds (NOK bn)	2.90	2.28	1.71
Overcollateralisation: current / legal minimum	22.1% / 2%	21.2% / 2%	21.9% / 2%
Overcollateralisation to support current rating	4%	4%	8%
Overcollateralisation upon a one-notch issuer downgrade	5.5%	5.5%	9%
Weighted average life of assets	13.2 years	12.5 years	12 years
Weighted average life of liabilities [1]	4.4 years	4.5 years	2.6 years
Number of loans	2,163	1,713	1,452
Average loan size (NOK m)	1.6	1.5	1.4
Top 10 residential	2.2%	2.9%	3.9%
Interest rate type – assets	Floating 100%	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%	Fixed 0%
Interest rate type – liabilities	Floating 100%	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%	Fixed 0%
Weighted average LTV (indexed)	55.5%	52.6%	53.1%
Geographic split (top 3)	Oppland = 45%	Oppland = 45%	Oppland = 47%
	Akershus = 28%	Akershus = 26%	Akershus = 26%
	Oslo = 12%	Oslo = 13%	Hedmark = 12%
Default measure	Inverse Gaussian/ Non-Parametric	Inverse Gaussian/ Non-Parametric	Inverse Gaussian/ Non-Parametric
Weighted average default rate (mortgage/substitute)	10.5%/ 0.15%	9.5%/ 0.21%	9.5%/ 0.11%
Weighted average coefficient of variation (mortgage/substitute)	50%/ 1,696%	50%/ 1,353%	50%/ 1,375%
Weighted average recovery assumption (D0/D6)[2]	98.3% / 72.1%	97.3% / 77.7%	99.0% / 66.5%
Share of loans > three months in arrears (NPL)	0.00%	0.04%	0.04%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	n/a	n/a	n/a
Max liquidity premium	150bps	150bps	150bps
Average servicing fee	25bps	25bps	25bps

[1] Including the 12-month extension

[2] D0 and D6 denote the stresses commensurate with the rating distance between our credit view on the issuer and the covered bond ratings.

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