Landkreditt Boligkreditt AS
Norwegian Covered Bonds – Performance Update

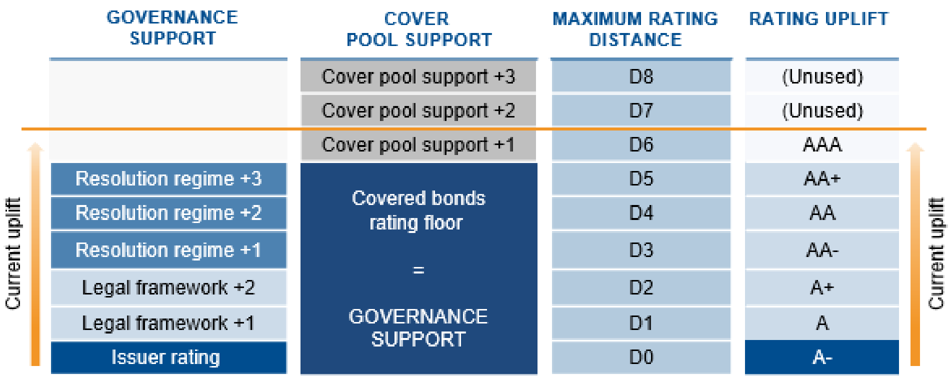
The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued by Landkreditt Boligkreditt AS (LKBol) is based on the bank's A- issuer rating enhanced by six notches of cover pool support. Five of these notches reflect our assessment of the strong governance support provided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

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 Sep 2022	NOK 4.45bn	Residential mortgage loans	NOK 3.81bn	AAA/Stable

LKBol is a wholly owned specialised credit institution dedicated to providing secured covered bond funding for its parent, Landkreditt Bank AS (LKB). The issuer rating on LKBol reflects its full ownership by LKB (both banks rated A-/Stable) and LKBol's ability to refinance residential mortgage loans using covered bonds.

Governance support factors from the Norwegian legal and resolution framework provide a five-notch uplift to 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 interplay between complexity and transparency is classified with a cover pool complexity category of 'low', allowing the maximum uplift of up to three notches on top of the governance uplift. The programme could further benefit from a two-notch buffer against an issuer downgrade as the maximum theoretical uplift is eight notches, as opposed to the six notches needed to achieve the highest rating.



Stable Outlook

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

Changes since the last performance update

Since December 2021, the cover pool has decreased to NOK 4.45bn (-5%). At the same time, the Scope-calculated loan-to-value (LTV) ratio dropped by 1.8 pp to 40.8%. However, our stressed recovery dropped by 0.9 pp driven by more conservative market value declines reflecting continuing above-average market value increases in Norway since our last analysis. At the same time, our lifetime mean-default rate increased by 1.2 pp, driven by our more conservative view on Norwegian mortgage borrowers.

Ratings & Outlook

Issuer rating	A-
Outlook	Stable
Last rating action	12 Mar 2021
Covered bond rating	AAA
Outlook	Stable
Rating action	Affirmation
Last rating action	8 Dec 2022

Rating Team (Covered Bonds)

Mathias Pleißner
+49 69 6677389-39
m.pleissner@scoperatings.com

Reber Acar
+49 69 6677389-50
r.acar@scoperatings.com

Lead Analyst (Banks)

Pauline Lambert
p.lambert@scoperatings.com

Related Research

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Scope affirms Landkreditt Boligkreditt AS mortgage-covered bonds at AAA/Stable, Dec 2022

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

info@scoperatings.com
www.scoperatings.com

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The issuer

The A- issuer rating of Landkreditt Boligkreditt, a wholly owned subsidiary, is aligned with that of its parent Landkreditt Bank. Landkreditt Bank is a leading provider of financial services to Norway's agricultural sector and has pursued a growth strategy in retail customers to scale up and diversify the business. The aim is for retail and agricultural customers to have an equal share of the business. The company is investing to further digitalise customer interactions and automate processes. It is also starting to incorporate ESG factors into its credit assessment. Reflecting its cooperative business model and low-risk culture, LKBol generates relatively stable revenues. Through the issuance of covered bonds, it provides secured funding for its parent.

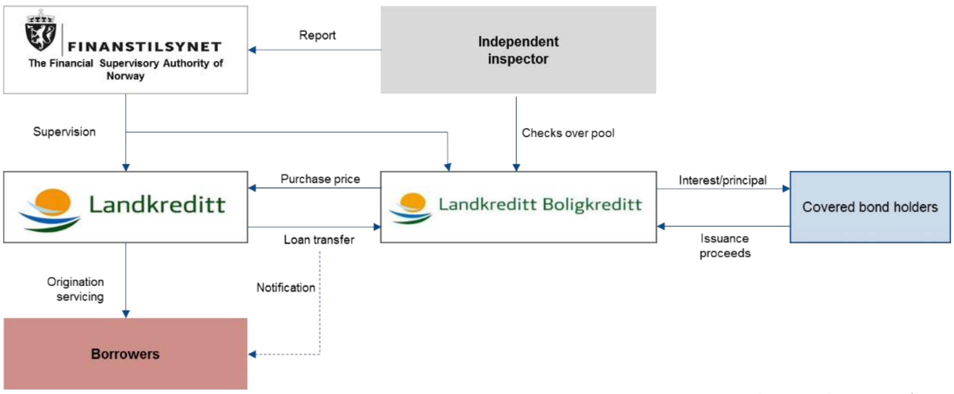
For further details on our bank credit analysis, see the full bank rating report available on www.scoperatings.com.

Programme structure

Specialised mortgage bank issuing covered bonds

The Norwegian legal covered bond framework is mainly based on the covered bonds section of the Financial Institutions Act and a related regulation on mortgage credit institutions, both introduced in 2007. The act was amended to transpose the European Covered Bond Directive and came into force on 8 July 2022, the same day as the directive in the EU. Under this framework, issuance is permitted only through specialist covered bond issuers. Like LKBol, most Norwegian covered bonds issuers (generally called *Boligkreditt*, or specialised residential mortgage institutions) are subsidiaries that rely on loans originated by their respective parent banks. The parent banks generally provide most of the services for these subsidiaries, allowing the latter to keep staff numbers low.

Issuance structure



Source: Scope Ratings

Governance credit support analysis

Governance support factors enhance the covered bond rating by five notches above LKBol'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 LKBol's covered bonds.

Legal framework analysis

Two notches of uplift based on legal framework analysis

Norway has one of the strongest covered bond frameworks is Europe and meets our criteria for protecting investors. Therefore, we assign the highest credit differentiation of two notches.

For more information on our view of the Norwegian legal framework, please refer to Legal framework analysis: Norway.

Resolution regime analysis

Three notches of additional uplift reflecting resolution regime

LKBol’s covered bonds benefit from an additional three-notch uplift that reflects their bail-in exemption 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 LKBol as a covered bond issuer.

We generally classify Norwegian mortgage covered bonds as a systemic refinancing product, particularly for residential mortgages. Covered bonds issuances in 2021 accounted for 32% of GDP. Globally, Norway was the eighth largest issuer in 2021, the tenth largest by total outstanding size.

LKBol’s covered bond activities and market share suggest a low-to-moderate systemic importance. LKBol only issues in the domestic market, and this is likely to soften negative repercussions on other issuers should it fail.

For more information on our view of the Norwegian resolution regime, please refer to Legal framework analysis: Norway.

Cover pool characteristics

Reporting date	Sep 2022	Dec 2021
Balance (NOK bn)	4.5	4.7
Residential (%)	100.0	100.0
Substitute (%)	0.0	0.0

Property type (%)

Reporting date	Sep 2022	Dec 2021
Single-family house	68.1	69.1
Apartment	24.8	24.7
Others	7.1	6.2

General information

Reporting date	Sep 2022	Dec 2021
No. of loans	2,938	2,999
No. of obligors	2,912	2,937
Avg. size (NOK m) *	1.5	1.5
Top 10 (%)	2.5	2.4
Remaining life (years)	16.2	16.0
LTV (%)	40.8	42.6

*Per Scope aggregated borrower

Interest rate type (%)

Reporting date	Sep 2022	Dec 2021
Floating	100.0	100.0
Fixed	0.0	0.0

Repayment type (%)

Reporting date	Sep 2022	Dec 2021
Annuity	57.4	57.1
Flexible loan	24.8	24.7
Interest-only	17.8	18.2

Cover pool analysis

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

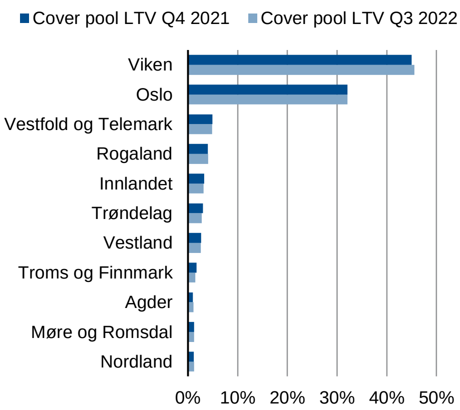
The minimum supporting OC needed to achieve the highest rating remains unchanged at 5%, supported by the sound credit metrics of the cover pool and low market risks. The latter arise from maturity mismatches that benefit from the bonds' soft-bullet structure.

Cover pool composition

The cover pool comprises granular, first-lien Norwegian residential mortgage loans denominated in Norwegian krone. As of September 2022, the loans were granted to 2,912 (down from 2,937) obligor groups. The average loan remains small at NOK 1.5m. The top 10 largest obligors account for 2.5% (up from 2.4% since our last analysis).

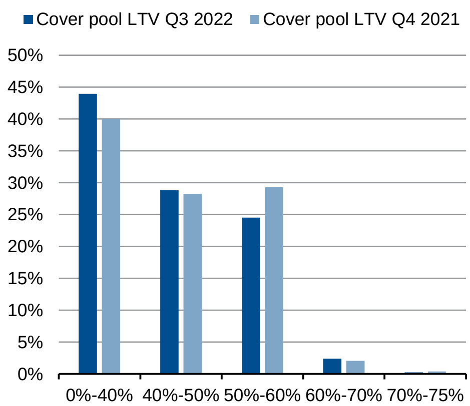
The weighted average whole LTV is 40.8% (down from 42.6%), calculated based on the maximum drawable amount for re-drawable loans (flexible loans). Re-drawable loans make up 25% of the cover pool. Flexible loans have an embedded credit line that can be redrawn without new credit approval. These loans will only be granted if the loan's LTV does not exceed 60%. Existing flexible loans may only be drawn up to 60%. Another 18% of the loans have an interest-only period.

Figure 1: Regional distribution



Source: Scope Ratings, LKBol.

Figure 2: LTV distribution



Source: Scope Ratings, LKBol.

The collateral is primarily located in Oslo and Viken, together accounting for around 77% of the portfolio. The rest of the portfolio is spread across Norway, supported by LKB's online distribution channel. Norway's oil regions (Rogaland and Agder) are less represented.

Around two-thirds of the portfolio is made up of single-family houses and another quarter of flats. Agricultural property account for only 0.4% and holiday homes for 0.1%.

Asset risk analysis

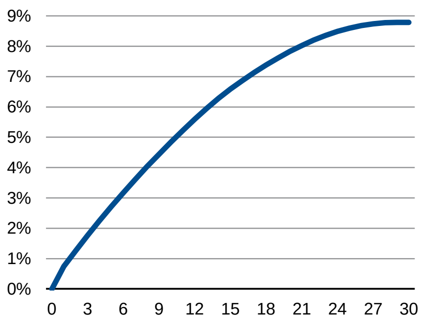
Strong credit quality translates into low credit risk

The cover pool's credit quality remains strong. We assume an annual average default probability of 83 bp, which provides a comfortable cushion against actual defaults observed in the previous benign economic situation. This assumption has been established by taking into account the issuer's risk scoring and our probability of default (PD) mapping benchmarked to that of other Norwegian residential mortgage lenders. The average borrower PD is commensurate with a BB+ rating.

This translates into a cumulative term default rate of 8.8% (up from 7.6%). The higher term default reflects the increased risk scoring in light of the tense economic situation. The legal amortisation profile was calculated assuming all flexible loans have an initial loan term of 30 years and are not amortising throughout their whole remaining life. Further, we assumed them to be fully drawn.

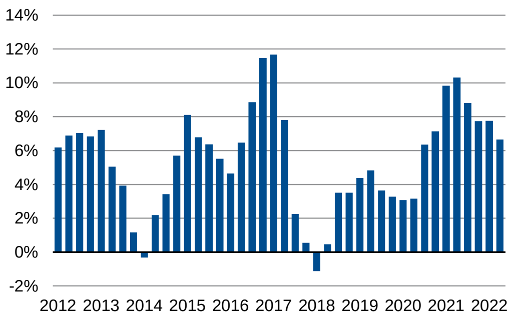
Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on the available credit performance data provided. We have maintained our assumption of a coefficient of variation of 50% for the mortgage assets.

Figure 3: Expected term defaults, cumulative (DP/years)



Source: Scope Ratings, LKBol

Figure 4: House price growth in Norway, annualised



Source: Scope Ratings, statOECD

Stressed recovery rates have dropped to 84.8% from 85.7% despite a decrease in the portfolio LTV. The lower stressed recovery is driven by more conservative value haircuts reflecting the extraordinary property value growth in the past few years. Norway's housing growth has exceeded our expectations as it is has significantly exhibiting its long-term sustainable growth of 3.0%. We have further increased our base market value haircuts to 5% to account for imminent value correction.

Figure 5: Norwegian security value haircuts

Region	Base MVD	Stressed MVD	Firesale discount	Stressed TSVH
Oslo	5%	55.0%	20%	67.5%
Southwest	5%	42.5%	20%	55.0%
Rest of Norway	5%	42.5%	20%	57.5%

MVD: market value decline
SVH: security value haircut

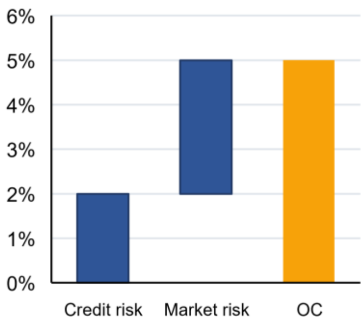
We maintain the firesale discount at 20%, supported by benchmarking. In our recovery analysis, we further account for 2.5% of variable costs and NOK 70.000 of fixed costs.

Cash flow risk analysis

The unchanged rating-supporting OC of 5.0% mainly reflects the programme's asset-liability maturity mismatch risk from the slow scheduled amortisation of the cover assets against the faster redemption of the covered bonds, which creates a sensitivity of OC to low prepayments. Market risk accounts for 3.0 pp (down from 4.0 pp) of the 5% rating-supporting OC.

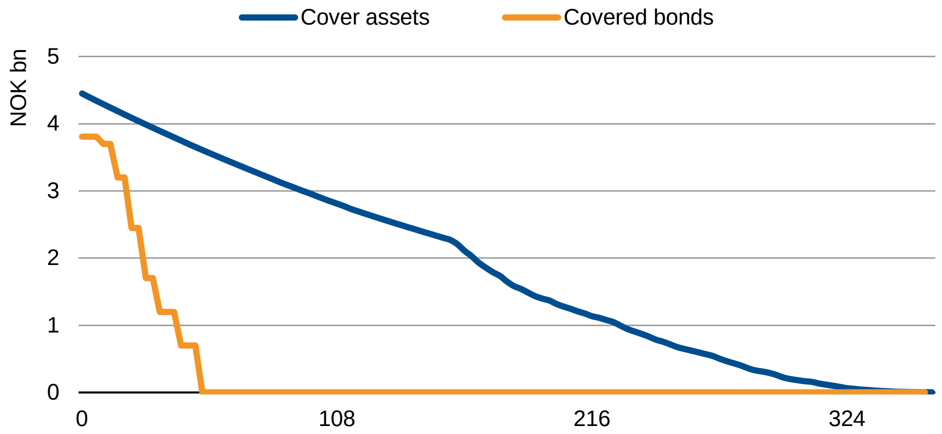
As of Q3 2022, the weighted average life of the outstanding covered bonds is 3.6 years when accounting for their soft-bullet structure, down from 3.7 years in the previous analysis. In comparison, the (scheduled) weighted average life of the cover pool is 16 years assuming a 30-year tenor on flexible loans.

Supporting OC breakdown



Source: Scope Ratings

Figure 6: Amortisation profile



Source: Scope Ratings, Landkreditt

In the event of recourse to the cover pool, we assume assets will be sold at a discount of up to 150 bp if the cash accumulated from cover pool amortisation is insufficient to pay timely interest and principal on the covered bonds. The cover pool does not include short-term substitute assets.

Asset-liability mismatches

	Assets	Liabilities
NOK	100%	100%
Fixed	0.0%	0.0%
Floating	100%	100%
WAL (years)	**16.2**	**3.6**

Other market risks are limited as cover assets and covered bonds both have floating rates. There is no foreign exchange risk as assets and liabilities are denominated in Norwegian krone. At this stage, we do not expect foreign currency-denominated issuances.

Credit risk accounts for 2.0 pp (up from 1.0 pp as of our last review) of the rating-supporting OC reflecting the lifetime mean default rate of 8.8% (up from 7.6%), an unchanged coefficient of variation of 50% and a stressed recovery rate of 84.8% (down from 85.7%).

We have assumed a recovery lag of 18 months reflecting Norway's lean and digital sale procedures as well as the portfolio's concentration towards one of Norway's most liquid areas, Oslo and Viken. Since 2017, the average time on the market for Norwegian residential housing has been around five weeks, whereas in Oslo properties are usually sold within three weeks, although there has been a slowdown recently.

We conservatively established the asset's amortisation profile assuming that all flexible lines were fully drawn. The bond's amortisation profile was calculated assuming the one-year maturity extensions has been executed.

We have tested the programme's resilience against high (15%) and low (1%) prepayments as well as a set of rising and declining interest rate scenarios. The covered bonds are most exposed to a low prepayment scenario in combination with low interest rates. As a consequence, we assume asset sales under discounts in order to meet bond payment obligations.

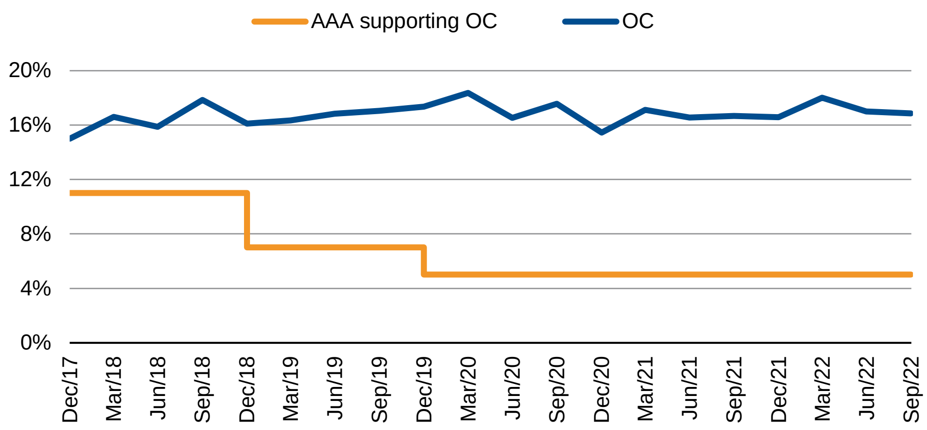
We tested sensitivities of a margin compression, frontloaded defaults, 25% prepayments and a liquidity premium of up to 200 bp.

Availability of overcollateralisation

Overcollateralisation fully taken into account

The current rating of LKBol allows us to fully account for the current OC of 16.9%, which is above the unchanged 5% of OC supporting the programme's AAA rating. 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 7: Available OC versus current rating-supporting level



Source: Scope Ratings, Landkreditt

Other risk considerations

Counterparty risk mitigated by alignment of interests

The rated covered bonds have counterparty exposures to the issuer, as well as to the issuer's parent in its roles as loan originator, servicer, bank account provider and paying agent. However, if a regulator were to intervene, the strong alignment of interests between the bank and the covered bond holders would prevent any negative impact. We also view positively the fact that collections are generally made via direct debit, allowing for a relatively swift redirection of payments if necessary.

Sovereign risk does not affect the ratings

Sovereign risk does not limit the covered bond rating. Risks of an institutional framework meltdown, legal insecurity or currency-convertibility problems are remote.

No impact of ESG

We have not directly included ESG aspects into the covered bond rating. The issuer has introduced a green mortgage product that offers favourable interest rates for the purchase of energy-efficient homes. These loans have a limited share in the cover pool.

Environmental aspects, particularly Norwegian energy efficiency standards, are often not recorded in the bank's main underwriting databases – which is standard for banks. We were therefore unable to perform a specific analysis of environmental or social factors, or their impact on the cover assets' probability of default or recovery proceeds. At the same time, we have indirectly included environmental aspects as collateral valuations reflect the condition of the collateral.

Sensitivity analysis

Two-notch buffer against potential change in issuer rating

LKBol'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 to 7.0%.

Summary of covered bond characteristics

Reporting date	30 Sep 2022	31 Dec 2021
Issuer name	Landkreditt 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 = 100%	Residential = 100%
	Substitute = 0%	Substitute = 0%
Issuer rating	A-/Stable	A-/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Soft bullet	Soft bullet
Cover pool currencies	NOK (100%)	NOK (100%)
Covered bond currencies	NOK (100%)	NOK (100%)
Governance cover pool support	5	5
Maximum additional uplift from cover pool complexity score	3	3
Maximum achievable covered bond uplift	8	8
Potential covered bond rating buffer	2	2
Cover pool (NOK bn)	4.5	4.7
thereof, substitute assets (NOK bn)	0.0	0.0
Covered bonds (NOK bn)	3.8	4.0
Overcollateralisation: current/legal minimum	16.9% / 2.0%	16.6% / 2.0%
Overcollateralisation to support current rating	5.0%	5.0%
Overcollateralisation upon a one-notch issuer downgrade	7.0%	6.0%
Weighted average life of assets	16.2 years	16.0 years
Weighted average life of liabilities [1]	3.6 years	3.7 years
Number of loans	2,938	2,999
Average loan size (NOK m)	1.5	1.6
Top 10 residential	2.5%	2.4%
Interest rate type assets	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%
Interest rate type liabilities	Floating 100%	Floating 100%
	Fixed 0%	Fixed 0%
Weighted average LTV (indexed)	40.8%	42.6%
Geographic split (top 3)	Viken = 45.5%	Viken = 45.0%
	Oslo = 32.1%	Oslo = 32.1%
	Vestfold og Telemark = 4.9%	Vestfold og Telemark = 4.9%
Default measure	Inverse Gaussian	Inverse Gaussian
Weighted average default rate (mortgage/substitute)	83bps / 8.8%	71bps / 7.6%
Weighted average coefficient of variation (mortgage/substitute)	50%	50%
Weighted average recovery assumption (D0/D6)[2]	99.9% / 84.8%	99.9% / 85.7%
Share of loans > three months in arrears (NPL)	0.0%	0.0%
Interest rate stresses (max/min; currency-dependent)	-1 to 10%	-1 to 10%
FX stresses (max/min; currency-dependent)	n/a	n/a
Max liquidity premium	150bps	150bps
Average servicing fee	25bps	25bps

[1] Including the 12-month extension
[2] D0 and D8 denote the stresses commensurate with the rating distance between our credit view on the issuer and the covered bond ratings.

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 09 38 35

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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