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 notches thereof reflect our assessment of the strong governance support provided by the Norwegian legal covered bond and resolution framework.

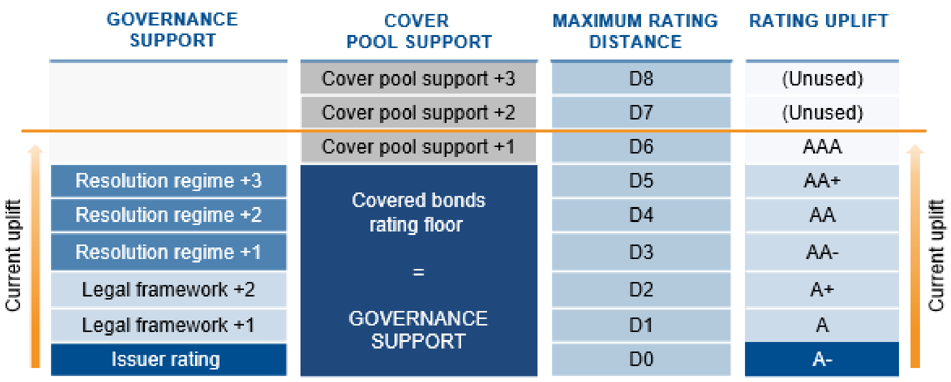
Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 Sep 2023	NOK 4.6bn	Residential mortgage loans	NOK 3.9bn	AAA/Stable

LKBol is a wholly owned, specialised credit institution dedicated to providing secured covered bond funding for its parent, Landkreditt Bank AS. The issuer rating on LKBol reflects its full ownership by Landkreditt Bank (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 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 notch of uplift reflecting the credit strength of the covered bond programme.

The interplay between complexity and transparency is classified with a cover pool complexity (CPC) category of 'low', allowing the maximum uplift of up to three notches on top of the governance uplift.

The programme benefits from a two-notch buffer against an issuer downgrade. This is because the maximum theoretical uplift is eight notches, of which only six are 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 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 (OC) to support the covered bonds' very strong credit quality.

Changes since the last performance update

Since September 2022, the cover pool has increased to NOK 4.6bn (+3.4%) and the Scope-calculated loan-to-value (LTV) ratio has dropped by 0.7pp to 40.1%. The stressed recovery rate has improved by 12 pp, driven by lower market value declines and lifetime mean-default rate has lowered by 1.1 pp thanks to the addition of low-risk loans in the pool.

Ratings & Outlook

Issuer rating	A-
Outlook	Stable
Last rating action	9 Mar 2023
Covered bond rating	AAA
Outlook	Stable
Rating action	Affirmation
Last rating action	6 Nov 2023

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Related Research

Norway maintains strong covered bond framework following alignment with EU Directive Sep 2022

Scope affirms Landkreditt Boligkreditt AS mortgage covered bonds at AAA/Stable Nov 2023

Scope affirms A- issuer rating of Landkreditt Bank AS with Stable Outlook Mar 2023

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The issuer

The A- issuer rating of LKBol, a wholly owned subsidiary of Landkreditt Bank, is aligned with the rating of its parent. Landkreditt Bank's A- issuer rating reflects the credit fundamentals of its cooperative banking group, Landkreditt SA, a leading provider of financial services to Norway's agricultural sector. To expand scale and diversify the business, Landkreditt SA has pursued growth not only within the agricultural sector but also with personal customers.

Landkreditt Bank generates stable but somewhat lower returns than domestic peers. Nevertheless, its earnings are more than sufficient to absorb credit costs, which aim for a roughly equal balance between the two customer segments. Through the issuance of covered bonds, LKBol provides secured funding for its parent. Landkreditt Bank maintains reassuring solvency metrics and is well positioned against current and future expected requirements. For further details on our bank credit analysis see the full bank rating report on www.scoperatings.com.

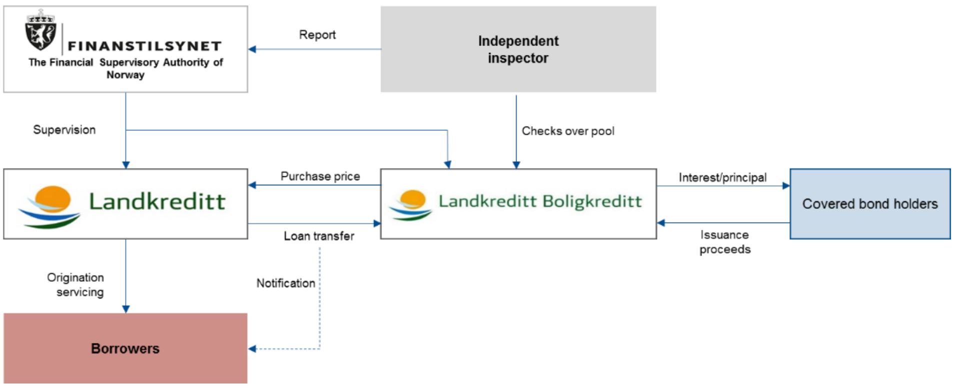
Programme structure

Specialised mortgage bank issuing covered bonds

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the country's Financial Institutions Act (Lov om finansforetak og finanskonsern) and related regulation on mortgage credit institutions, both introduced in 2007. The act was last amended to transpose the European Covered Bond Directive. Such amendments came into force on 8 July 2022, in parallel with their application in the EU. The act itself provides the general structure of the main framework and references regulations provided by Norway's ministry of finance (Finanstilsynet). As such, Norway's regulation on capital requirements and its adoption of EU banking regulation CRR/CRD IV provide further details on the requirements for Norwegian covered bonds and issuers.

Under this framework, issuance is permitted through specialist covered bond issuers. Like LKBol, 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

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

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.

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 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 LKBol as a covered bond issuer.

We generally classify Norwegian mortgage covered bonds as a systemic refinancing product, particularly for residential mortgages. Outstanding covered bonds accounted for 34% of Norwegian GDP in 2022. Globally, Norway was the seventh largest issuer in 2022 and the 10th largest by outstanding issuances.

LKBol's covered bond activities and market share suggest a low to moderate systemic importance. LKBol only issues domestically, 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 2023	Sep 2022
Balance (NOK bn)	4.6	4.45
Residential (%)	100.0	100.0
Substitute (%)	0.0	0.0

Property type (%)

Reporting date	Sep 2023	Sep 2022
Single-family house	68.8%	68.1
Apartment	23.9%	24.8
Others	7.4%	7.1

General information

Reporting date	Sep 2023	Sep 2022
No. of loans	2,936	2,938
No. of obligors	2,903	2,912
Avg. size (NOK m) *	1.6	1.5
Top 10 (%)	2.4	2.5
Remaining life (y)	15.7	16.2
LTV (%)	40.1	40.8

*Per Scope aggregated borrower

Interest rate type (%)

Reporting date	Sep 2023	Sep 2022
Floating	100.0	100.0
Fixed	0.0	0.0

Repayment type (%)

Reporting date	Sep 2023	Sep 2022
Annuity	59.8	57.4
Flexible loan	23.5	24.8
Interest-only	16.7	17.8

Cover pool analysis

LKBol's mortgage-covered bond rating is cover pool-supported, which provides 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 credit quality. Our assessment on the interplay between complexity and transparency translates into a CPC category of 'low', which allows the maximum three-notch uplift on top of the governance uplift.

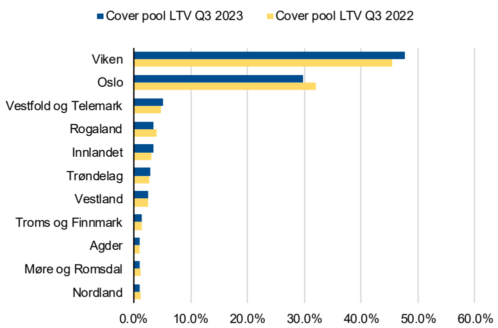
The minimum supporting OC needed to achieve the highest rating remains unchanged at 5%, supported by the sound credit metrics of the cover pool and low market risks. Market risks arise from maturity mismatches, which are partially mitigated by the bonds' soft-bullet structure.

Cover pool composition

The cover pool comprises granular, first-lien Norwegian residential mortgage loans denominated in Norwegian krone. As of September 2023, the loans were granted to 2,903 obligor groups, down from 2,912 in the last annual review. The average loan size slightly increased to NOK 1.6m from NOK 1.5m. The 10 largest obligors account for 2.4%, down from 2.5%.

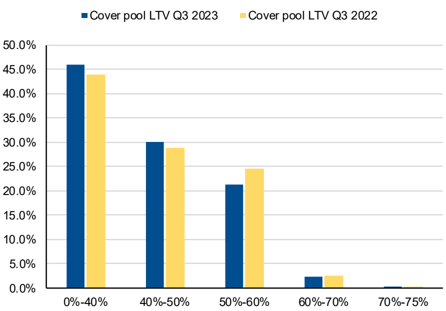
The weighted average whole LTV is 40.1%, down from 40.8%, calculated based on the maximum drawable amount for re-drawable loans (flexible loans). Such loans make up 25% of the cover pool. Flexible loans have an embedded credit line that can be redrawn without new credit approval. These loans will only be granted if the loan's LTV does not exceed 60%. Existing flexible loans may only be drawn up to 60%. Another 17% 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 the Oslo and Viken regions, together accounting for around 77.5%. The rest of the portfolio is spread across Norway, supported by LKBol's online distribution channel. Norway's oil regions (Rogaland and Agder) are less represented.

Two-thirds of the portfolio are made up of single-family houses and one-quarter of flats. Holiday homes account for only 0.1% and agricultural properties for 0.4%.

Asset risk analysis

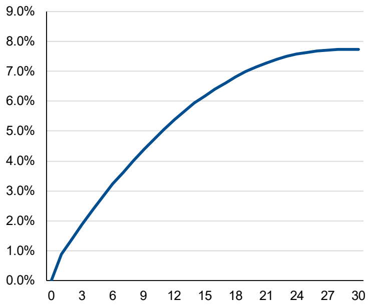
Strong credit quality translates into low credit risk

The cover pool's credit quality remains strong. We assume an annual average default probability of 83 bps, which provides a comfortable cushion against a level of defaults as observed in the previous benign economic phase. We made this assumption based on the issuer's risk scoring and our probability-of-default mapping benchmarked to those of other Norwegian residential mortgage lenders. We found that the average borrower's probability of default is commensurate with a bb+ rating.

Taking into account the term structure of the mortgage loans, we have derived a cumulative term default rate of 7.7%, down from 8.8% in the last review. The lower term default mainly reflects a higher share of low-risk loans. We calculated the legal amortisation profile assuming all flexible loans have an initial term of 30 years, do not amortise through their remaining life and are fully drawn.

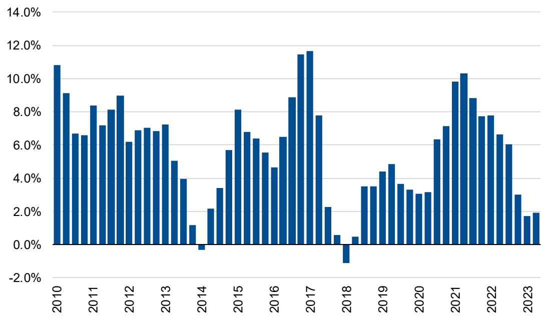
Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on credit performance data provided. We have further maintained our assumption of a coefficient of variation of 50% for the mortgage loans.

Figure 3: Expected term defaults, cumulative



Source: Scope Ratings, LKBol

Figure 4: House price growth in Norway, annualised



Source: Scope Ratings, statOECD

Stressed recovery rates have improved to 96.8% from 84.8%. This reflects i) a decrease in the portfolio's average LTV; and ii) a reduction in value haircuts to reflect the correction of property values during the last year; and iii) updated indexation. We have maintained the 5% base market value decline (MVD) to account for imminent value corrections.

Figure 5: Norwegian security value haircuts (SVH)

Region	Base MVD	Stressed MVD	Fire-sale discount	Stressed SVH
Oslo	5%	47.5%	20%	57.5%
South-western Norway	5%	40.0%	20%	52.5%
Rest of Norway	5%	40.0%	20%	52.5%

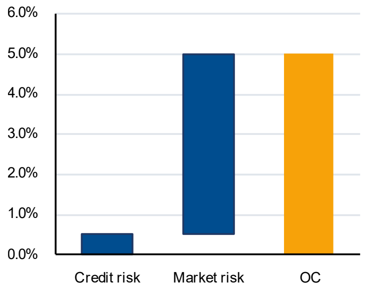
The fire-sale discount is unchanged at 20%, supported by benchmarking. Our recovery analysis also includes 2.5% of variable costs and NOK 70,000 of fixed costs.

Cash flow risk analysis

The unchanged rating-supporting OC of 5.0% mainly reflects the programme's asset-liability maturity mismatch risk arising from the slow scheduled amortisation of the cover assets against the faster redemption of the covered bonds. This mismatch makes the programme sensitive to low prepayments. Market risk accounts for 4.5 pp of the 5% rating-supporting OC, up from 3.0 pp.

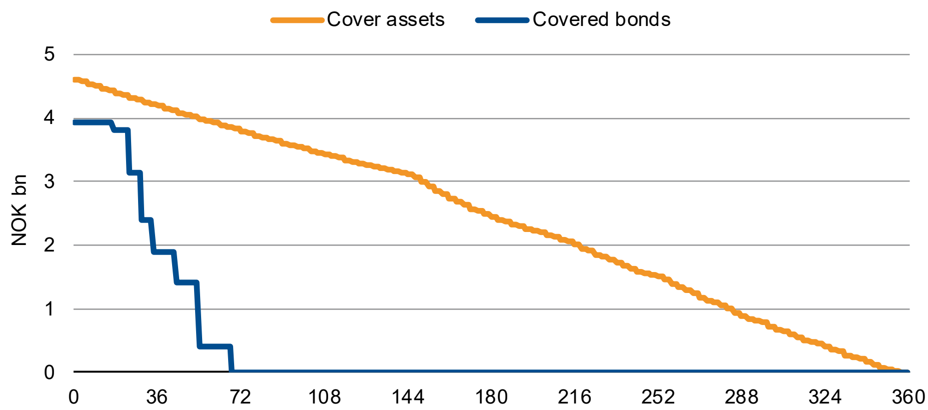
As of Q3 2023, the weighted average life of the outstanding covered bonds is 3.5 years when accounting for their soft-bullet structure, down from 3.6 years in the previous analysis. In comparison, the (scheduled) weighted average life of the cover pool is 15.7 years, which assumes a 30-year tenor on 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 150bps 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 contain short-term substitute assets.

Asset-liability mismatches

	Assets	Liabilities
NOK	100%	100%
Fixed	0.0%	0.0%
Floating	100%	100%
WAL (years)	**15.7**	**3.5**

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, and we do not expect foreign currency-denominated issuances at this stage.

Credit risk accounts for 0.5 pp of the rating-supporting OC, down from 2.0 pp. This reflects a lifetime mean default rate of 7.7% (down from 8.8%), a coefficient of variation of 50% (unchanged) and a stressed recovery rate of 96.8% (up from 84.8%).

We have assumed a recovery lag of 18 months, reflecting Norway's lean and digital sale procedures as well as the portfolio's concentration in two of Norway's most liquid areas, Oslo and Viken. A house in Norway needs around eight weeks to be sold on average; in Oslo, the average is three weeks, though we have observed a slowdown recently.

For asset amortisation, we conservatively assumed all flexible lines to be fully drawn. Our calculation of bond amortisation assumed that the one-year maturity extensions were executed.

We have tested the programme's resilience against high (15%) and low (1%) prepayments and against a set of rising and declining interest rate scenarios. The covered bonds are most sensitive to a scenario of low prepayments and low interest rates. We therefore assume assets will be sold at a discount to meet bond payments.

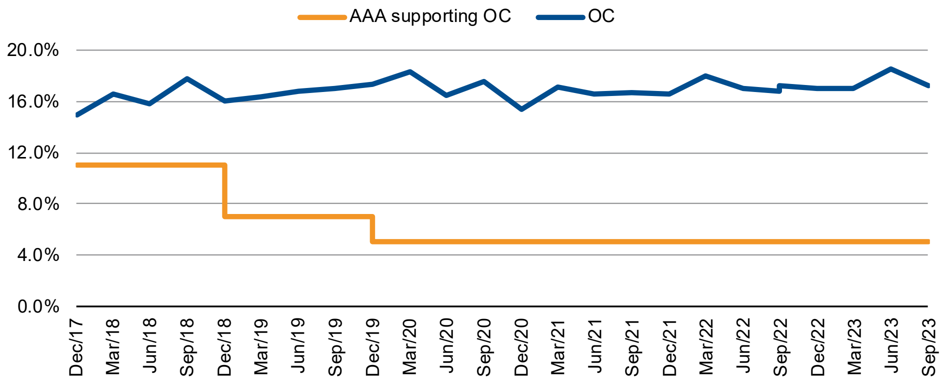
Further, we tested the sensitivity to margin compression, frontloaded defaults, a 25% prepayment rate and a liquidity premium of up to 200bps.

Availability of overcollateralisation

Overcollateralisation fully taken into account

The current rating of LKBol allows us to fully account for the provided OC of 17.3%, which is above the 5% overcollateralisation (unchanged since the last review) 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 overcollateralisation 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 and 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, we believe the strong alignment of interests between the bank and the covered bond holders would prevent any negative impact. Also credit-positive is the fact that collections are generally made via direct debit, allowing a relatively swift redirection of payments if necessary.

Sovereign risk does not affect the ratings

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

No impact from ESG

We have not directly included ESG aspects into the covered bond rating. We recognise the issuer's introduction of a 'Green Mortgage' product that offers favourable interest rates for the purchase of energy-efficient homes, but these have a limited share in the cover pool.

Like others in the banking industry, Landkreditt Bank generally does not record environmental aspects in its main underwriting database, particularly on Norwegian energy-efficiency standards. Therefore, we were 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 because 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 2023	30 Sep 2022
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 CPC category	3	3
Maximum achievable covered bond uplift	8	8
Potential covered bond rating buffer	2	2
Cover pool (NOK bn)	4.6	4.45
thereof, substitute assets (NOK bn)	0.0	0.0
Covered bonds (NOK bn)	3.9	3.8
Overcollateralisation: current / legal minimum	17.3% / 5.0%	16.9% / 5.0%
Overcollateralisation to support current rating	5.0%	5.0%
Overcollateralisation upon a one-notch issuer downgrade	7.0%	7.0%
Weighted average life of assets	15.7 years	16.2 years
Weighted average life of liabilities [1]	3.5 years	3.6 years
Number of loans	2,936	2,938
Average loan size (NOK m)	1.6	1.5
Top 10 residential	2.4%	2.5%
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)	40.1%	40.8%
Geographic split (top 3)	Viken: 47.8%	Viken: 45.5%
	Oslo: 29.7%	Oslo: 32.1%
	Vestfold og Telemark: 5.1%	Vestfold og Telemark: 4.9%
Default measure	Inverse Gaussian	Inverse Gaussian
Weighted average default rate (mortgage/substitute)	7.7% / -	8.8% / -
Weighted average coefficient of variation (mortgage/substitute)	50%	50%
Weighted average recovery assumption (D0/D8) [2]	99.9% / 96.8%	99.9% / 84.8%
Share of loans > three months in arrears (NPL)	0.0%	0.0%
Interest rate stresses (max./min.; currency-dependent)	-1 to 10%	-1 to 10%
FX stresses (max./min.; currency-dependent)	n/a	n/a
Max liquidity premium	150bps	150bps
Average servicing fee	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.

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