Verd Boligkreditt AS
Norwegian Mortgage-Covered Bonds

The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued out of Verd Boligkreditt AS (Verd) is based on the bank's private issuer rating, enhanced by seven notches of cover pool support. Four notches thereof reflect our assessment of the strong fundamental credit support provided by the Norwegian legal covered bond and resolution frameworks.

Rating rationale (summary)

Cut-off date	Cover pool	Cover asset type	Covered bonds*	Rating/Outlook
31 Mar 2019	NOK 9.40bn	Mortgage loans	NOK 7.87bn	AAA/Stable

* Obligasjoner med fortrinnsrett (Norwegian mortgage-covered bonds) [1]

The covered bonds are rated AAA. The programme does not benefit from a buffer against an issuer downgrade as it takes into account the maximum cover pool uplift granted for the programme. The covered bond rating incorporates fundamental credit support of four notches above our credit view on the issuer which also provides a backstop against a deterioration in the credit quality of the cover pool. See **here** for the rating release press release.

Fundamental credit support	Rating distance	Cover pool analysis
	D7 (AAA)	Cover pool support +7
	D6	Cover pool support +6
	D5	Cover pool support +5
Resolution regime +2	D4 (AA-)	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	D0	Issuer rating

Low LTV cover pool originated by nine banks

The covered bonds are secured by a portfolio of private residential first lien mortgage loans with low loan-to-value (LTV)/credit risk. The fully domestic cover pool comprises predominantly owner-occupied properties in the southern and western parts of Norway. The loans are originated by nine savings banks all of which are owners of Verd and part of De Samarbeidende Sparebankene (DSS). The alliance uses Verd as a joint covered bond funding platform.

Adequate overcollateralisation supporting the rating

The programme's AAA rating is cover pool supported. 4.0% of overcollateralisation (oc) is sufficient to mitigate credit and market risks, supporting a seven-notch uplift. The supporting oc is well below the current level of available oc which stands at 19.5%. Maturity mismatches are the main contributor accounting for 2 pp of the supporting oc. Credit risk contributes only 1.8 pp and remains a secondary risk driver for the programme. Market risk is minimal accounting for the remaining 0.2 pp.

Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectations that: i) the credit performance of Verd and its member banks will continue to be stable; ii) the issuer will maintain its covered bond programme's prudent risk profile; and iii) both Verd's member banks and direct issuer will remain willing and able to provide sufficient oc to support the covered bonds' very high credit quality.

[1] 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.

Ratings & Outlook

Issuer rating	**Not disclosed**
Issuer Outlook	Not disclosed
Covered bond rating	**AAA**
Outlook	Stable
Rating action	New
Last rating action date	15.05.19

Rating team (covered bonds)

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

Karlo Fuchs
+49 69 6677389 78
k.fuchs@scoperatings.com

Lead analyst (banks)

Pauline Lambert
p.lambert@scoperatings.com

Scope Ratings GmbH

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

Phone +49 69 66 77 389 0

Headquarters

Lennéstraße 5
10785 Berlin

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

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Rating / credit view drivers and mitigants (summary)

Positive rating / credit view drivers

The issuer. Verd pursues a focused and low risk business. The 10-plus year relationship between Verd and its owner banks has been highly cooperative and successful. The owner banks are well established in their local markets and maintain reassuring prudential metrics.

Covered bond legal framework in Norway (+2 notches). Norway's mortgage bank act provides a very strong framework, ensuring that the covered bond structure can fully support and enforce recourse to the cover pool.

Resolution regime assessment (up to +2 notches). Norwegian covered bonds are excluded from bail-in and a cohesive external stakeholder group supports the market's ongoing development.

Cover pool support (up to +3 notches). Asset quality is sound, supported by the stable performance of Norwegian residential mortgage loans and available overcollateralisation is robust. High margins provide a buffer against risks.

Negative rating / credit view drivers and mitigants

The issuer. The banks operate in southern and western Norway, regions more exposed to the cyclical oil and gas industry. A deterioration in the credit fundamentals of Verd's owner banks could impact the quality of the assets available for transfer and the banks' ability to meet obligations under the servicing and shareholder agreements.

Covered bond legal framework.

Principles-based mitigants to market risks are less well defined by Norwegian legislation than in an international context.

Resolution regime assessment. Should the bank cease operations, a transfer or orderly wind down of the bank and its programme is the most likely scenario in our view. Support from member banks is available but investors have no legal recourse to documented or public commitments regarding an ongoing minimum level of liquidity and oc.

Cover pool support. Asset-liability mismatch risk driven by the programme's vulnerability to high prepayments reducing available excess spread.

Positive rating / credit view -change drivers

Issuer/group. Verd provides an open funding platform which other savings banks could decide to join. This could provide additional diversification of mortgage assets to be transferred to Verd. For example, one of the current owners, Voss Sparebank, joined in 2017. Further, Flekkefjord Sparebank may merge with Kvinesdal Sparebank according to the latest news.

Further clarity and documentation of the owner banks' duties and obligations to support the credit fundamentals of Verd in situations of need could support our credit view on the bank.

Covered bond legal framework. The full potential uplift is utilised.

Resolution regime assessment. Higher visibility as a covered bond issuer as well as clear and binding documentation of support from member banks regarding liquidity, oc and operations could increase fundamental credit support.

Cover pool support. Full potential cover pool uplift is utilised.

Negative rating / credit view -change drivers

Issuer/group. A decline in the operating environment which substantially impacts profitability and/or a change in strategic direction which increases the bank's risk profile. This could be reinforced by the member banks being unable or unwilling to provide the necessary capital and liquidity support for Verd to maintain sound prudential metrics.

Legal covered bond framework. No deterioration is expected. EU covered bond harmonisation is not expected to negatively impact the existing legal framework if translated into national law.

Resolution regime assessment. No deterioration is expected.

Cover pool support. A further increase in asset-liability mismatch or a material change in the interest rate and foreign exchange risks profile, not mitigated by overcollateralisation, could reduce cover pool support and result in a downgrade.

Table of Contents

1. The issuer

Verd Boligkreditt (Verd) is a specialised residential mortgage institution with the right to issue covered bonds. In Norway, only specialised credit institutions can issue covered bonds and are subject to a specific supervisory regime involving an independent inspector as well as the Norwegian financial supervisory authority. They are also subject to the same regulations as other Norwegian financial institutions, including capital adequacy and liquidity management requirements.

Unlike most covered bond issuers, Verd is not a subsidiary of a single parent bank. Established in 2009, Verd is owned and used by nine independent savings banks in southern and western Norway. Sparebanken Vest, a former shareholder, now operates Verd on behalf of the owner banks.

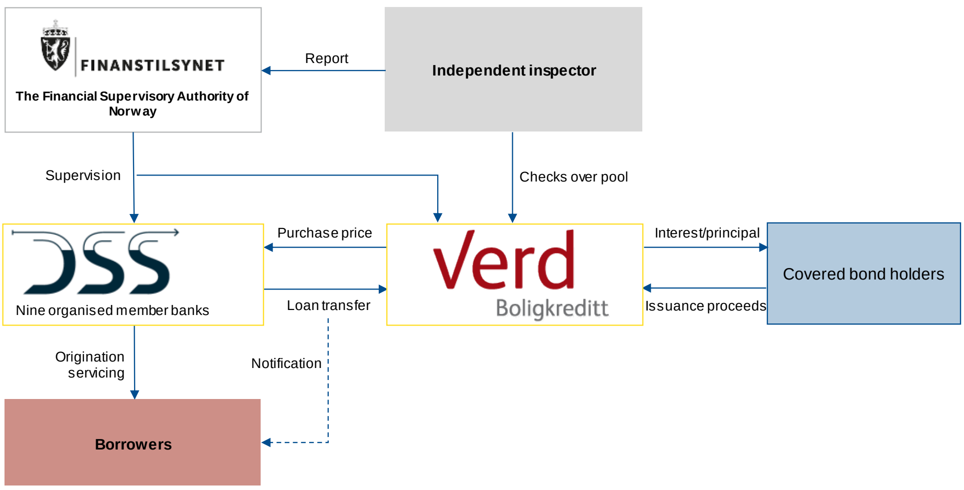
The nine savings banks are part of De Samarbeidende Sparebankene (DSS), an alliance which enhances negotiating power with suppliers, operational efficiencies and enables expertise sharing. The banks had combined total assets of NOK 63bn (including assets transferred to Verd) at year-end 2018. As seen throughout Norway, alliances are important for sustaining the business franchises of individual banks. This includes shared ownership of companies offering a range of financial products, such as insurance, leasing and securities services.

Active in their local markets for over 150 years on average, the owner savings banks have well established positions in their local markets and are important contributors to their communities via the regular distribution of profits. Typical of Norwegian savings banks, their boards include customer and employee representatives and often representatives from the local community. With the exception of the two largest banks, they do not have equity capital certificates outstanding.

Verd's credit profile is sustained by service and support agreements with the owner banks and depends on close cooperation among all involved parties. In addition, Verd's board which includes representatives from four of the owner banks as well as Sparebanken Vest, is responsible for setting strategy and limits to manage credit, market, liquidity and funding risks.

2. Covered bond structure

Figure 1: On-balance sheet issuance structure



Source: Verd and Scope

For further details of our bank credit analysis see **Appendix: Verd Boligkreditt Credit Considerations**.

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the Financial Institutions Act together with a related regulation on mortgage credit institutions, both introduced in 2007. Under this framework, issuance is permitted only through specialist covered bond issuers. Most issuers of covered bonds (called Boligkreditt, or specialised residential mortgage institutions) are subsidiaries that rely on loans originated by their respective parent banks. In contrast, Verd is a funding platform jointly owned by its owner banks.

A Boligkreditt issues covered bonds whose proceeds are used to purchase mortgage assets from its parent bank(s), thereby financing the latter's lending business.

The Boligkreditt's status as a non-deposit-taking institution protects the covered bonds from set-off risk.

3. Fundamental credit support

Fundamental credit support factors enhance Verd's covered bond rating by four notches above our credit view on the issuer. This is based on our view of: i) Norway's covered bond legal framework (two notches); and ii) the resolution regime and systemic importance of Verd and its covered bonds (two notches).

Fundamental credit support provides a rating floor for the covered bonds of four notches above our credit view on the issuer. This mitigates any impact from potential adverse management of the cover pool.

3.1. Legal framework analysis

We view the Norwegian covered bond framework as one of Europe's strongest, meeting our criteria for protecting investors. We therefore assign the full credit differentiation of two notches.

Norway is not a member of the EU but participates in the EU's internal market under the European Economic Area Agreement. According to this agreement Norway is obliged to implement all EU directives and regulations that relate to financial institutions and markets, such as the CRR/CRD IV, MiFID, Prospectus Directive and Solvency II. This gives financial institutions in Norway the same rights and obligations as those in the EU.

Legal framework reflects strong investor protection and alignment with European best practice

We do not expect the upcoming transposition of the European covered bond harmonisation directive to introduce credit-negative factors into the Norwegian legal covered bond framework, nor are the changes expected to be material.

Segregation of cover pool upon insolvency

The act[2] gives bondholders a preferential claim over the cover pool if the issuer is placed under public administration. Norway's term for covered bonds, obligasjoner med fortrinnsrett, or 'OMF' is protected by law. While the assets in the pool remain with the estate if the issuer is placed under public administration, bondholders and derivative counterparties have an exclusive, equal, proportionate and preferential claim over the cover pool, and the administrator is obliged to ensure timely payment provided the pool gives full cover to the respective claims.

Ability to continue payments after issuer insolvency

Under the act, covered bond issuers cannot be declared bankrupt, but must be placed under public administration if they face solvency or liquidity problems. This gives authorities more flexibility to deal with covered bond companies while maintaining the

[2] Act on Financing Activity and Financial Institutions (Financial Institutions Act) & Regulations on mortgage credit institutions which issue bonds conferring a preferential claim over a cover pool consisting of public sector loans and loans secured on residential property or other real property (covered bonds)

rights of covered bond holders. The liquidator ensures that the cover pool is properly managed and that covered bond holders and derivative counterparties receive agreed and timely payments. Public administration or insolvency does not in itself give covered bond holders and derivative counterparties the right to accelerate their claims. If contractual payments cannot be made when claims fall due, and an imminent change is unlikely, the liquidator halts payments.

Programme enhancements remain available

OMF have a mandatory minimum oc requirement of 2% (nominal). All voluntary oc is part of the cover pool.

Key eligibility criteria

The definition of eligible assets follows European standards. There is a maximum LTV ratio of 75% for the main collateral type (residential mortgages) and 60% for commercial, holiday and leisure properties. The share of commercial or residential mortgage loans is not restricted. Further, the act permits the inclusion of substitute assets (maximum 20% of the cover pool). Generally, cover assets can be domiciled in the European Economic Area or certain OECD countries. The regulation adds rating requirements for the national government of the country in which the mortgaged property or borrower is located.

By law, non-performing loans remain in the cover pool. However, the act specifies that non-performing loans are only partly accounted for in cover pool tests, with the share dependent on the LTV of the respective collateral. This requirement would still apply upon the borrower's non-performance because covered bond investors remain entitled to foreclosure proceeds.

Liquidity and other risk management guidelines

The act does not stipulate specific market and liquidity risk constraints. At the same time, covered bond issuers must implement strict internal regulations to reduce the impact of stresses on capital. Issuers are allowed to use derivatives to mitigate market risks. Further, most Norwegian covered bonds are issued with soft-bullet structures with a one-year extension. This mitigates liquidity risk and provides buffers to facilitate redemption at the due date.

Soft bullet with one-year extension protects against maturity mismatches

Overcollateralisation generally remains available in the event of an administration or a default of a parent bank and does not trigger a cross default for the issuer.

Covered bond oversight

Verd is supervised by both an independent inspector and the Financial Supervisory Authority of Norway (Finanstilsynet). Upon solvency or liquidity problems for the issuer, a public administrator would ensure timely payment to the covered bond holders. There is also ongoing regulatory oversight for Norwegian covered bonds which complies with UCITS and the CRR.

3.2. Resolution regime and systemic importance

Verd's covered bonds benefit from an additional two-notch uplift reflecting a bail-in exemption and support from a strong external stakeholder community. The uplift is constraint by a combination of: i) the low likelihood that the covered bond issuer will be maintained in a resolution scenario; ii) the low visibility of Verd as a covered bond issuer; and iii) the support of the owner banks which provides investors with limited documented or public commitments as regards a minimum level of liquidity or oc.

In general, Norwegian covered bonds of resolvable and very visible issuers with a supportive shareholder (or parent) can benefit from four additional notches of support.

Exclusion from bail-in

Norwegian covered bonds are exempt from bail-in…

Norwegian covered bonds benefit from a bail-in exemption. Norway is in the European Economic Area, and the EU's Bank Recovery and Resolution Directive (2014/58/EU – BRRD) which took effect on 1 January 2019 exempts covered bonds and related derivatives from write-downs affecting an issuer's other debt instruments accordingly.

Going concern and resolution

…with transfer or wind-down the most likely scenario

We believe that the current capital structure would, in theory, allow regulators to restructure the bank using available resolution tools should the need arise. However, the most likely scenario would be a transfer or take-over by another bank. An orderly wind-down is a also a plausible scenario. The bank's size and setup as a joint issuance vehicle makes resolution less likely compared to a 100% owned subsidiary should it or its shareholder fail. As a result, investors might not benefit from an issuer structure that might not be maintained as a going concern.

Systemic relevance of covered bonds in Norway

Norwegian covered bonds are a systemically important refinancing instrument…

We generally classify Norwegian covered bonds as a systemic refinancing product, particularly for residential mortgages. The combined outstanding volume of covered bonds has averaged more than 25% of GDP since 2011 and stood at 32% at the end of 2017. Annual issuance hovers at around EUR 20bn and reached EUR 21.7bn in 2017. In Norway, 25 institutions currently issue covered bonds, with collateral including residential, commercial and public-sector assets.

Globally, Norway was the sixth largest issuer in 2017 and the seventh largest by total outstanding size. This is remarkable given that the market has only existed for 10 years.

Relevance of covered bond funding for Verd Boligkreditt

…although Verd's systemic importance is low to moderate…

In our view, Verd's covered bond issuing activities and market share only result in a low to moderate systemic importance. The bank only issues into the domestic market which should reduce negative repercussions on other issuers in the event of a failure. However, we also have taken into account that most of Norway's 25 covered bond issuers are subsidiaries of similarly small to midsize banks. Even a failure of a covered bond issuer with the size and setup of Verd could thus result in contagion, effectively creating systemic problems for other issuers reliant on this refinancing channel for their core product, residential mortgage lending. This risk is reinforced within the DSS association because all member banks have a strong interest in maintaining this mutual funding platform.

Proactive stakeholder community

Stakeholders supporting the programme are not only limited to external stakeholders such as the Norwegian Covered Bond Council, investors and regulators. Verd also has the support of its member banks acting as the main stake/shareholders in the company.

Support from its shareholders is less documented compared to Norwegian peers with regard to liquidity, oc and operations (servicing in regard to the treatment of non-performing loans).

In the current framework, there is no credit facility that provides short-term liquidity or similar mitigants to short-term liquidity shocks. The member banks have not committed to purchase obligations issued by Verd, while Verd (as a special mortgage bank) is not allowed to regularly repo its own bonds with the national bank. However, we understand that the member banks are strongly committed to the programme and willing to agree to any measure deemed necessary to strengthen and support Verd in its function as their funding vehicle.

…and documented support from its member banks is limited

Generally, the member banks do not provide any guarantees to Verd. Accordingly, non-performing or defaulted mortgage loans are bought back voluntarily. Only loans that were not eligible and transferred erroneously have to be retransferred according to the service and transfer agreement. However, there are strong incentives to member banks to purchase the loans back if they become non-performing. First, any claim from such loans will be deducted from the commission Verd pays out to its member banks (but the reduction is limited to 1% of the average volume of loans transferred from a respective bank per year). Second, if a loan is repurchased, the cure/restructuring or collection process can be accelerated and processed more efficiently.

Verd does not benefit from any documented commitment to support oc beyond the initial 10%. If market values decline significantly, loans may exceed the legal limit of 75% LTV. This does not make a loan ineligible but the portion above the legal limit must not be used to issue covered bonds. Hence, it may be necessary to add new assets to support at least the legal minimum oc of 2%.

Loan services are performed by the member banks (on behalf of Verd). These include day-to-day loan services and also non-performing loan handling (special services). This arrangement works well as long as the member banks repurchase their non-performing loans. However, if there is a significant increase in loan defaults in Norway, the member banks may be burdened with their own loans and refuse to buy back loans from Verd. Verd does not have the resources to perform servicing on its own but may mandate a third party.

A cohesive and supportive external stakeholder group supports the product

The country’s covered bond issuers actively cooperate under the umbrella of the Norwegian Covered Bond Council to promote their product and initiate any changes to the framework. An example is the March 2017 increase in minimum oc to 2%, aimed at avoiding potential challenges for cover pool derivatives arising from the European Market Infrastructure Regulation. Norway’s covered bond investors, which include banks and insurers, actively use covered bonds not only as a substitute for long-dated, NOK-denominated government debt, but also to manage liquidity. Moreover, Norway’s central bank has demonstrated its support for covered bonds by using them in its repo operations and running a covered bond to government debt ‘swap programme’ in 2008-14. Norway’s financial supervisory authority also has an active interest given the bonds’ widespread use to refinance residential mortgage lending.

4. Asset and cash flow analysis (cover pool support)

Cover pool provides additional rating uplift to protect the highest achievable rating

Verd's cover pool provides the maximum seven-notch uplift to our credit view on the issuer. Cover pool support warrants three notches of additional credit uplift on top of fundamental credit support factors.

The cover pool exhibits a sound credit quality and limited residual risks, all of which can be mitigated with available oc. Planned issuances are not expected to impact this assessment.

As of 31 March 2019, the cover pool has provided the covered bonds with oc of 19.5%. If we apply stresses commensurate with the rating assigned, 4% can support the current three-notch cover pool uplift.

Based on discussions with the issuer, we expect sufficient oc to remain available to support the maximum cover pool rating uplift.

Figure 2: Key cover pool characteristics

Reporting date	31.03.2019
Total cover pool (NOK m)	9,403
Covered bonds outstanding (NOK m)	7,866
Current overcollateralisation	19.5%
Minimum regulatory overcollateralisation	2.0%
Duration/WAM (cover pool) (years)	11.0/11.9
Duration/WAM (covered bonds) (years)[1]	4.0/4.0
Duration/WAM mismatch (years)	7.0/7.9
Overcollateralisation to support current rating	4.0%
Overcollateralisation to support current rating upon a one-notch issuer downgrade	Downgrade to AA+
Main cover pool asset type	Residential mortgage loans
Number of mortgage obligors[2]	5,804
Average mortgage loan size (NOK '000s)	1,518
Average loan-to-value	53.1%
Top 10 exposure share	0.7%
Top 20 exposure share	1.2%

[1] Including the 12-month extension
[2] Multiple borrowers with reference to the same loan/property were grouped as one borrower

Source: VERD and Scope

4.1. Cover pool composition

Granular Norwegian mortgage loans…

The cover pool is predominantly secured by Norwegian residential mortgage loans denominated in Norwegian kroner. The cover pool also comprises substitute assets which can be split into NOK 256.3m in bank deposits and NOK 336m in highly rated bonds of which most are exposed to other Norwegian mortgage-covered bonds.

The cover pool is very granular. As of March 2019, the cover pool comprised 5,804 obligors with an average loan size of NOK 1,518,000 (around EUR 152,000). The largest obligor only accounts for 0.08%. Together, 80% of the obligors have loan amounts below NOK 3m.

Figure 3: Cover pool by loan size (NOK m)

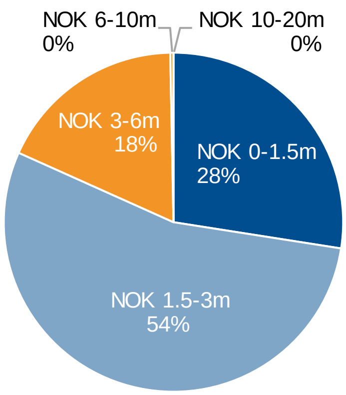
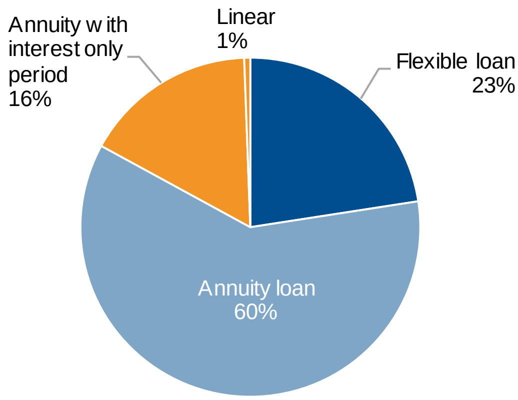


Figure 4: Loan type (by max. drawable balance)



Source: Verd and Scope

23% (weighted average by maximum drawable amount) of the loans are flexible loans that allow borrowers to redraw the loan up to a certain maximum amount. New flexible loans or redraws will only be granted for loans not exceeding an LTV of 60%. This is a consequence of the macroprudential measures introduced in Norway that require amortisation for loans exceeding this limit (see Table 1). The remaining 77% of the loans are amortising loans. Some of the annuity loans (16% of the total) are interest-only loans which start to amortise once the 'out-of-cover' loan part (which stays with the originating banks) is fully amortised.

…characterised by regulations limiting risky credit growth and leverage

Macroprudential measures have started to have a positive impact on the credit quality of the cover pool. In addition to the LTV limits on interest-only (flexible) loans, Norwegian regulators have introduced further measures to prevent credit risk from increased borrower leverage. The measures address elevated house prices in Norway and the affordability of mortgage debt.

Table 1 – Macroprudential measures in Norway

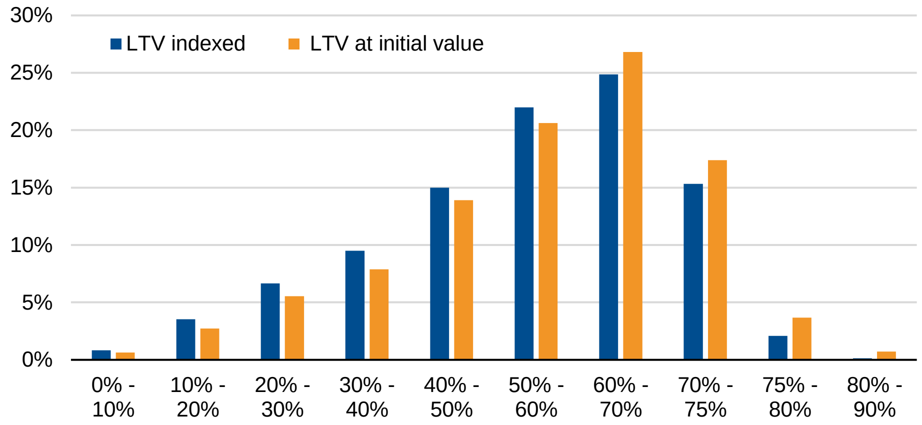
Effective since	Measure	Authority
Dec 2011	Amortisation requirement for residential mortgage loans exceeding an LTV of 70%	Finanstilsynet
	Affordability test assuming 5 pp increase in interest rates at origination	Finanstilsynet
Jan 2014	CRR implementation effectively leading to higher loss given default for residential real estate and higher risk weights for commercial real estate	Finansdepartementet, Finanstilsynet
Jan 2015	CRR and CRD implementation effectively tightening requirements for residential mortgage lending models; liquidity coverage ratio of at least 100%	Finansdepartementet, Finanstilsynet
Jul 2018	Amortisation requirement of at least 2.5% p.a. or equivalent to 30-year term for residential mortgage loans exceeding an LTV of 60%	Norges Bank
	Affordability test assuming 5 pp increase in interest rate with exception for 10% (8% in Oslo) of mortgage volume which fails the test	Norges Bank
	Total debt may not exceed five times gross annual income – same exception as affordability test	Norges Bank
	LTV capped at 85% for residential mortgage loans, and 60% for second homes in Oslo – same exception as affordability test	Norges Bank

Source: European Systemic Risk Board (ESRB); national measures of macroprudential interest in the EU/EEA

LTV of 53% reflecting moderate price increase since loan origination

As of March 2019, the cover pool has a low average LTV of 53%. This conservatively calculated LTV assumes that all flexible loans are drawn to their maximum amount. At the same time, the low LTV also reflects the increase in property prices in Norway since origination. The collateral is generally valued (initial and monitoring) using an automated valuation system, 'Eiendomsverdi', which is used throughout Norway and by most banks. The automated valuation is compared against the purchase price and assessed during the underwriting process. In individual cases the bank may request independent and full appraisals, including an on-site inspection. The indexed LTV compares to a value of 55%. The difference reflects a moderate increase in values since the loans were granted. We observe a significantly lower price appreciation in the regions related to the cover pool compared to Oslo.

Figure 5: Cover pool by LTV



Source: Verd and Scope

Regional focus on southern and western Norway – the Norwegian oil region

Verd's cover pool is regionally concentrated in the Norwegian oil regions but are also home to diversified, export oriented businesses and sectors, like fisheries, ship building, tourism and hydro power. Exposures in Rogaland, Hordaland and Vest/Aust-Adger and Sogn og Fjordane account for 91% of the cover pool. Exposures outside the core region are driven by the bank's provision of financing to local customers. These are exceptions and are only granted to borrowers with above-average credit quality.

Figure 6: Regional distribution by county

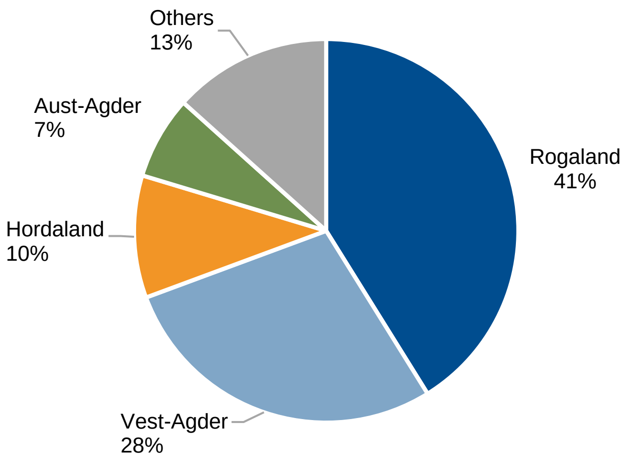
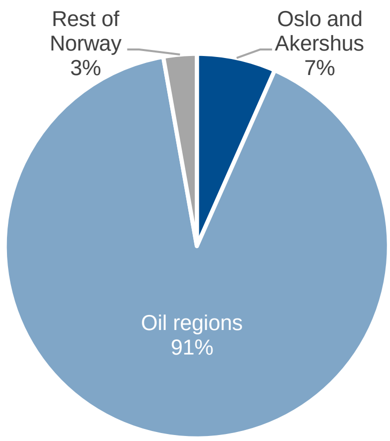
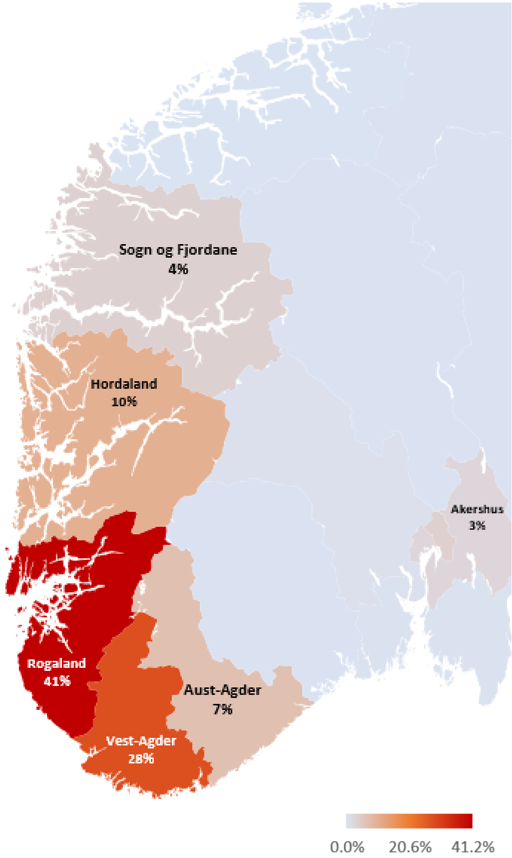


Figure 7: Regional distribution by risk type



Source: Verd and Scope

Figure 8: Regional distribution map



91% of financings are exposed to Norwegian oil or oil related regions which are located in the western and southern part of Norway – the region along the Atlantic coast of southern Norway. Those regions are also home to diversified, export oriented businesses and sectors, like fisheries, ship building, tourism and hydro power It consists of the counties Rogaland, Hordaland, Sogn og Fjordane, and Møre og Romsdal as well as Vest and Aust Agder. Another 7% account for Oslo and Akershus. The remaining 3% are spread across Norway.

Skudnenes & Aakra Sparebank and Haugesund Sparebank are the largest contributors to mortgage loans into Verd. Hence, the area around Haugesund is strongly represented in the cover pool. The third largest contributor is Sparekillingsbanken Kristiansand which drives the portfolio's exposure to the area around Kristiansand in the south-eastern part of Norway.

Transferred loan portfolios are homogenous…

The portfolios transferred by the banks are relatively homogenous. Each respective bank's LTVs are within a range of 50%-57% and the share of flexible loans does not exceed 30%. The loans' remaining term is around 20 years with a seasoning of around four years.

Table 2 – Key characteristics of member banks

Verd member banks	Cover pool contribution (NOK m)	in %	# of Financings	Avg. LTV	Max Financing (NOK m)	Flexible loans[3]	Amortising loans	Remaining term (y)	Seasoning (y)
Skudenes & Aakra Sparebank	1,742	20%	1,226	54.2%	5.0	26%	74%	20	4
Haugesund Sparebank	1,635	19%	1,245	52.6%	6.1	30%	70%	19	5
Spareskillingsbanken Kristiansand	1,564	18%	1,104	50.8%	6.4	25%	75%	18	4
Flekkefjord Sparebank	870	10%	347	56.8%	4.9	4%	96%	21	3
Etne Sparebank	781	9%	491	56.6%	5.8	30%	70%	19	4
Søgne & Greipstad Sparebank	715	8%	384	55.4%	5.5	14%	86%	21	4
Lillesands Sparebank	672	8%	361	52.5%	7.6	17%	83%	19	4
Luster Sparebank	612	7%	441	50.2%	6.6	24%	76%	19	4
Voss Sparebank	220	3%	119	50.2%	7.4	3%	97%	19	3
Cover pool	**8,810**	**100%**	**5,718**	**53.3%**	**7.6**	**23%**	**77%**	**19**	**4**

[3] weighted average by maximum drawable amount

Origination and underwriting processes are relatively comparable amongst the member banks. They are even similar to Norwegian peers because the criteria for granting mortgage loans is largely determined by regulation and most banks use a common IT platform. The system used for credit underwriting is developed by Evry AS, the largest provider of IT services to the Norwegian financial industry. The focus is on debt servicing capability, with the banks having good access to information about potential clients (e.g. tax records) and properties (e.g. central land register, market prices).

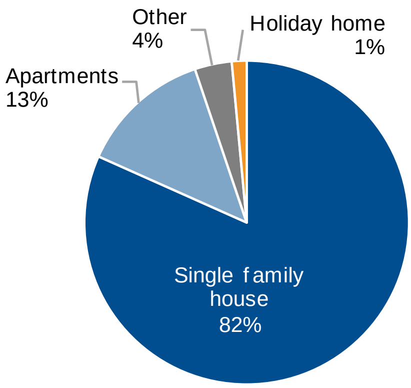
… driven by similar systems and processes

Most of Verd's cover pool is backed by mortgage loans secured by single-family or terraced houses (82%). 13% of property types in the pool are apartments.

3.7% account for exposures to other properties and 1.5% to holiday homes (against which no bonds will be issued). Others account for farming or land-related mortgage claims.

Verd does not have any mortgages with common housing debt in the cover pool.

Figure 9: Property type



Source: Verd and Scope

As of March 2019, there are no non-performing loans (over 90 days past due) in the cover pool. Loans in arrears are generally repurchased by the parent bank, albeit on a voluntary basis.

4.2. Credit risk assessment

Low credit risk…

We assess the credit risk of Verd's residential cover pool as low. However, the oil region around Norway's southern and western counties is economically volatile which also impacts unemployment rates. The 2014-15 plunge in oil prices, which affected Norway's economy more than the global financial crisis of 2008, lifted the unemployment rate in this area higher than in the rest of Norway, also contributing to higher credit losses.

Our projections of mortgage loan default use an inverse Gaussian distribution. Based on credit performance data provided by Verd, the originating banks (IFRS9 reporting and background documentation, static delinquency history and loan-level probabilities of default) and benchmarking, we derived an effective average annual term default probability, based on a 90 days past due definition, of 55 bps (or a 10.5% cumulative probability of default over the lifetime of the loan). The volatility of default (weighted average coefficient of variation) was assumed to be 55%. This factors in the higher sensitivity to economic shocks in the western regions of Norway but also considers the diversification within these areas compared to more concentrated peers. In addition, we considered an average cure base rate of 55% which effectively reduces the annual default probability to 25 bps.

…with mean loss at 1.1% in a stressed scenario…

For the mortgage loans in the cover pool we estimate a weighted average recovery rate of 97.3% under a base case scenario (D0) and 76.6% under the most stressful scenario (D7). The high base case recovery rate is supported by the portfolio's relatively low average LTV of 53%. The stressed rate is driven by the haircuts applicable to the region and a fire sale discount of 30%.

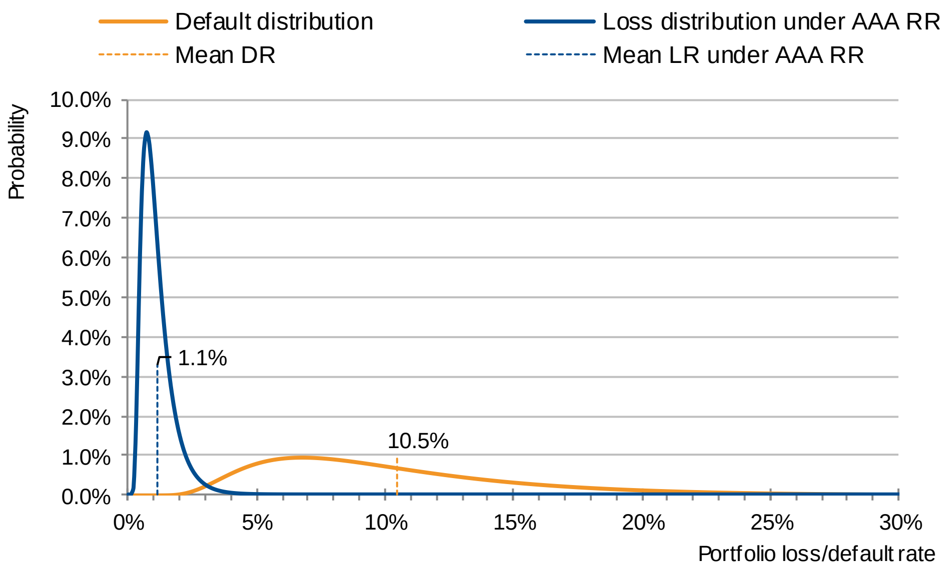
…and loss in a base case scenario of 13 bps supported by low LTV

The mean lifetime default rate together with the stressed recovery rate translates into a mean loss rate of 1.1% for the mortgage loans, compared with a 13 bps mean loss rate under our base case recovery assumptions.

For more details see

Appendix: Quantitative covered bond analysis

Figure 10: Default and loss distribution



Source: Scope

As of March 2019, the cover pool also includes 6.3% of substitute assets. They mainly comprise highly rated bonds (NOK 336m) and bank deposits (NOK 256m) with a highly rated bank. According to internal guidelines, the bank only invests in Norwegian fixed income securities, Swedish municipalities or 0%-weight SSAs with a minimum Aa rating.

We estimated the sub-portfolio's default characteristics using a portfolio analysis framework. The respective non-parametric distributions can be described with a mean default rate of 0.1% and a coefficient of variation of 1,030%. The low default rate and high coefficient of variation reflect the high individual credit quality but also the high obligor concentration in the respective sub-portfolio. We applied a stressed recovery of 67% and a base case recovery of 98.3% for the substitute assets.

4.3. Market risks

Asset-liability mismatch risk remains main risk contributor

We consider Verd's market risks, in particular asset-liability mismatches, to be the main driver of supporting oc. Interest rate and foreign currency risks are immaterial because assets and liabilities are both floating rate and fully denominated in Norwegian kroner.

4.3.1. Asset-liability mismatch risk

The asset-liability mismatch is moderate to high. It is driven by the weighted average maturity gap (weighted average life) of 8.0 years between the legal maturity of the mortgage loans (12 years) and outstanding covered bonds (4 years). Measured by duration, the gap is 7.1 years.

As of 31 March 2019, Verd had seven covered bonds outstanding amounting to NOK 200m-2.5bn. The bonds are issued as public placements with initial maturities of 2-8 years. The weighted average life for the outstanding covered bonds is 4.0 years[4].

[4] Our cash flow analysis reflects the scheduled maturity of the covered bonds plus the one-year extension (legal maturity).

Table 3: Cash flow characteristics

Currency	Total assets	Net present value	WAM (principal)	Duration	Floating-rate assets	Fixed-rate assets
	NOK	NOK	Years	Years	%	%
NOK	9,402.6	10,723.2	11.9	11.0	100.00	0.00

Currency	Total liabilities	Net present value	WAM (principal)	Duration	Floating-rate assets	Fixed-rate assets
	NOK	NOK	Years	Years	%	%
NOK	7,866.0	8,009.7	4.0	4.0	94.4	5.6

Nominal OC	19.5%
NPV OC	33.9%

WAM gap	7.9
Duration gap	7.0

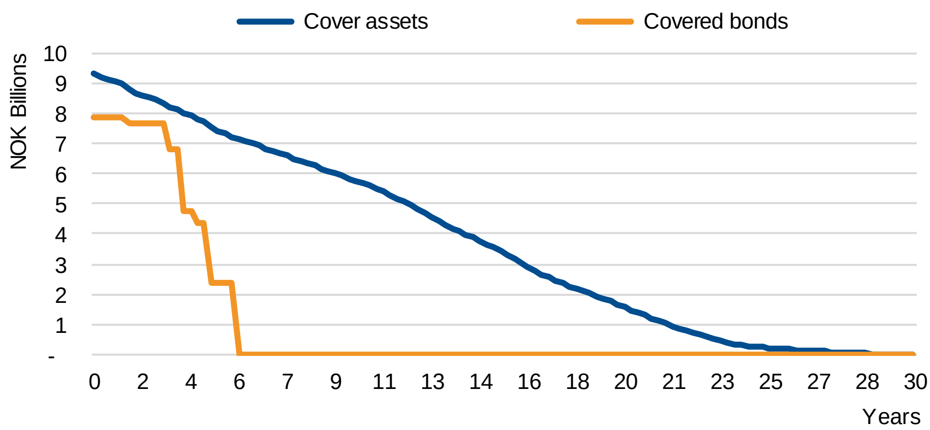
Source: Verd and Scope

NOK 7,866m in covered bonds are predominantly issued at a floating rate, with Verd hedging the 5.6% of fixed coupon bonds into floating until the bonds' scheduled maturity date. During the extension period the fixed bonds pay a floating coupon according to the respective terms and conditions.

Our analysis does not take hedging into account, mainly because the termination events in the swap agreements are not excluded for Verd. We understand that Verd will amend its hedge documents in due course. Given the moderate size of the fixed liabilities, this open position is not material to the oc supporting the rating.

Verd's mortgage assets have a relatively long redemption profile which is common for Norwegian residential mortgage loans. Amortisation is also driven by the 23% (weighted average by maximum drawable amount) of flexible loans which we have assumed are fully drawn and only pay interest until their maturity. The latter was assumed to be in line with amortising loans. Further, another 17% of the mortgage loans have an interest-only period. These loans are split into a cover- and out-of-cover portion. The out-of-cover portion amortises first. The cover portion starts amortising once the 'out-of-cover' loan has been repaid in full.

Figure 11: Cash flow characteristics



Source: Verd and Scope

In a stand-alone and run-down scenario, current oc does not provide sufficient scheduled inflows for the bonds' full repayment at the scheduled or legal final maturity date. This implies the need to sell assets to ensure the full and timely payment of maturing covered bonds and interest due, exposing the programme to risks driven by the assets' disposal.

Stressed disposal proceeds were calculated by discounting the cover pool's remaining cash flows with a liquidity premium.

We also tested the impact of high prepayment rates which according to the issuer range between 20%-30% per year. This reflects the fact that the economic life of the loans is generally much lower compared to the scheduled maturities. Prepayments will reduce the available excess spread during the transaction's life while proceeds from repaid loans are assumed to be interest-bearing.

Norwegian borrowers tend to prepay a loan opportunistically before its legal maturity to improve financing conditions, generally by entering into a new contract with a lower interest rate with either the same or a different bank. Unlike fixed-rate markets there are generally no prepayment fees in Norway which would discourage borrowers from repaying a loan prior to its scheduled maturity.

4.3.2. Interest rate risk

Limited interest rate risks

Interest rate risk is limited because, even if the interest rate hedge is not considered, the open position is small. The programme is exposed to limited basis risk as borrowers must be notified six weeks in advance of a change in interest rates.

The programme benefits from excess spread. The mortgage assets have a weighted average spread of 136 bps and compare to short-dated covered bonds with a weighted average spread of 46 bps (including extension) over the term of the transaction.

4.3.3. Foreign exchange risk

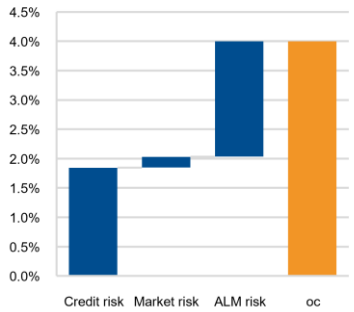
No foreign exchange risk

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

4.3.4. Overcollateralisation

Verd's covered bond ratings are supported by the cover pool and therefore hinge on the issuer's ability and willingness of its member banks to provide oc above the legal minimum.

Figure 12: oc components



Source: Verd and Scope

Our credit view on Verd allows us to consider the full available oc in our analysis. Applying all credit and market risk stresses, we established that an oc of 4% can mitigate identified stresses and support the uplift under our rating methodology, giving the programme the highest rating.

Maturity mismatches (asset-liability mismatch risk), accounting for 2 pp of the 4% supporting oc, are the main risk contributors. We have applied a 25% prepayment assumption that creates a large amount of cash and reduces the transaction's excess spread. Accordingly, the worst-case scenario would be a scenario with ongoing high prepayments. In contrast, a scenario in which assets needed to be sold at a discount as a consequence of maturity mismatches with the long-dated assets would produce lower levels of oc supported by the high asset margins.

Credit risk remains relatively low which is reflected by an annual average term default probability of 25 bps (including cures), a stressed recovery rate of 76.6% and a coefficient of variation of 55% for the mortgage loans. Credit risk accounts for 1.8 pp and is not a major driver for the supporting oc. Market risk is minimal because most bonds and all assets are floating. Both assets and liabilities are denominated in NOK.

The programme's supporting oc is most vulnerable to high prepayments (25%) in combination with rising interest rates (rising after two years non-converting).

The supporting oc reflects the results of further sensitivity tests including a margin compression down to 80 bps, effectively reducing the excess spread and a negative spread on interest paid on the cash account. In addition, we tested sensitivity to higher refinancing spreads, additional covered bonds issued and frontloaded defaults.

No downgrade buffer should the issuer be downgraded

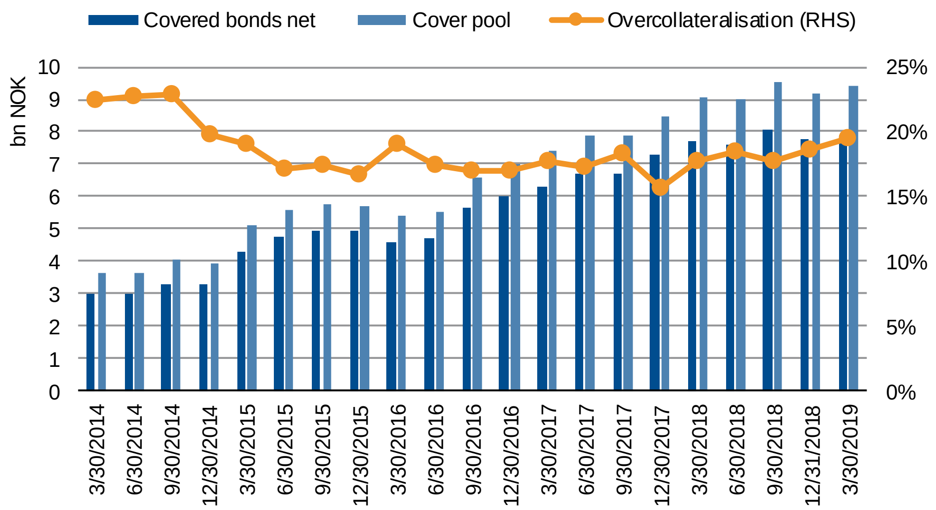
If our credit view on the issuer was downgraded by one notch, the covered bond rating would be downgraded in tandem because there is currently no buffer from the fundamental uplift. In this case, the oc supporting a AA+ rating is likely to be maintained at the current level, provided the covered bond programme's credit and cash flow profiles remain the same.

We are not aware of plans involving a significant change to the risk profile or available oc that could negatively impact the current rating uplift.

Oc is at 19.5% as of March 2019 and has remained above the level of 4% (the level supporting the rating) since the inception of the programme, supported by the minimum level of 10% and the additional cover assets financed with CT1 and CT2 capital.

The issuer actively manages liquidity by frequently buying back upcoming maturities in order to replace them with new, longer dated maturities. The bonds which are bought back and retained are registered in the cover pool and accordingly become an asset for the benefit of other covered bond investors. As a consequence, we calculated oc based on outstanding issued covered bonds net of retained bonds.

Figure 13: Overcollateralisation levels



Source: Verd and Scope

4.1. Counterparty risk

The rated covered bonds have counterparty exposure to the issuer and to the issuer's member banks as loan originator and servicer. Further, there is exposure to Sparebank Vest as bank and deposit account as well as paying agent. In respect to most of Vest's responsibilities there are replacement mechanisms in place that would shield the covered bonds from a credit deterioration of Vest, while no such mechanism is in place for the issuer's member banks. However, we believe the strong alignment of interests between the issuer, its member banks and covered bond holders would prevent any negative impact from such risks before regulatory intervention became necessary. We also take a positive view of the use of direct debit for the collections which ensures payments on accounts and in the name of the issuer from day one.

Verd issues both fixed and floating covered bonds. The latter are swapped into floating coupons until the bonds' maturity but are not taken into account in our analysis. Hence, the swap counterparty and its materiality to the rating is not relevant to the rating of the covered bonds.

5. Rating stability

We checked rating stability based on the current oc, the issuer's credit migration and planned issuances.

5.1. Changes to the issuer assessment

Negative changes in our assessment of the bank will impact the covered bond ratings

Verd's AAA covered bond ratings are vulnerable to a downgrade of the issuer because the programme does not benefit from unused notches from either the fundamental or cover pool uplift. Should the issuer be upgraded, Verd's covered bonds would still be rated AAA but would benefit from additional notch(es) of downgrade buffer.

5.2. Changes to overcollateralisation

A downgrade of the issuer by one notch would lead to a downgrade of the covered bond ratings, accordingly. In this scenario, we would – ceteris paribus – not be likely to change the supporting oc of 4%. Should the issuer be upgraded by one notch and assuming an unchanged risk profile, the oc would likely be reduced by 50 bps.

6. Sovereign risk

Sovereign risks (particularly macroeconomic risks) do not limit the mortgage-covered bond ratings. We believe the risks of an institutional framework meltdown or legal insecurity problems are currently very remote in Norway (rated AAA, Stable Outlook by Scope[5]).

7. Data adequacy

We consider the detailed cover pool and performance data provided by the bank to be good quality

We consider the quality of the data provided to be good, considering the cover pool's granularity.

Scope analysts visited Verd and interviewed key personnel of the issuer and selected member banks to gain a deeper understanding of the banks' origination, monitoring and workout processes. We also discussed key trends relevant for the development of the cash flow profile, including issuance plans.

Verd provided both public and confidential information on pool composition, including asset performance data. We reconciled the aggregated cash flow profiles provided by the bank based on detailed asset and liability composition information. This includes detailed loan-level data with the relevant credit characteristics of the mortgage segment.

If detailed information on some credit aspects was unavailable, we benchmarked the bank's information with market data and made conservative assumptions. We have ensured as far as possible that sources were reliable before drawing upon them but did not verify each item of information independently.

8. Monitoring

We will monitor this 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.

9. Applied methodology

The primary methodology is the Covered Bond Rating Methodology. The secondary methodologies are General Structured Finance Rating Methodology for the application of Scope's idealised expected loss tables and the Methodology for Counterparty Risk in Structured Finance. For the issuer's credit view we have used the principles of the Bank rating methodology. All rating methodologies are available on our website, www.scoperatings.com

[5] The sovereign report on Norway can be found here.

I. Appendix: Quantitative covered bond analysis and key assumptions

Credit risk analysis

Verd's mortgage cover pool is granular and allows us to apply an inverse Gaussian distribution in order to assess the likelihood of defaults. To establish lifetime default rate assumptions, we analysed the bank's static performance data (static arrears) and considered the one-year probabilities of default (through the cycle) assigned by the bank to each loan. We further took the final legal maturity of the loans into account, while for flexible loans we assumed that the loan term equals the term of the amortising loans. We also analysed the risk parameters described in the bank's IFRS9 reporting and took some of the parameters into account, which includes cure rates. We compared default rates and coefficients of variation observed for granular pools of mortgage loans in Norway and other jurisdictions including Denmark, Germany and Austria.

We analysed the substitute asset defaults with a non-parametric distribution by performing a Monte Carlo analysis. We assumed a correlation factor of 25% on the covered bonds and 100% on the sovereign/municipal exposure as well as the deposits with Vest. Conservatively, the issuer's credit assessments were used for all exposures to derive a default expectation.

In our loss given default analysis, we assumed that the credit lines for flexible loans are fully drawn and pay interest only until their expected maturity.

We calculated the recovery rate on the mortgages by analysing movements in the collateral's market value[6]. The recovery analysis considers the distance to a long-run or sustainable price for the underlying asset, as well as fire-sale discounts, for instance during a property's foreclosure. We relied on fundamental recovery analysis because the security represents first-lien claims on the underlying real estate properties. Our legal analysis established that the security cannot be challenged from a legal standpoint.

Norwegian (Verd) residential total security value haircuts

For the analysis of the mortgage collateral, we applied distance-conditional recovery rates as a function of the seven-notch distance between the covered bond rating of AAA and our credit view on the issuer. The stress levels are divided into seven levels because fundamental support provides a four-notch uplift and the cover pool support can provide a maximum additional three-notch uplift – hence seven stress levels, D0 (base case) to D7 (stressed) with D7 stresses anchored at the highest achievable rating of AAA.

We analysed the current Norwegian property market to derive total security value haircut assumptions specific to the three regions which exhibit different trends and risk characteristics: i) Oslo and Akershus; ii) the oil regions (Rogaland, Hordaland, Møre og Romsdal, Aust/Vest Agder and Sogn og Fjordane); and iii) the rest of Norway.

We analysed the house price indices provided by Statistics Norway to derive market value declines. Using the nominal house price index, indices were reduced with region-specific, sustainable deflation factors which range between 2.5% and 3.5%. We then used these to measure current over/undervaluation from the sustainable average in the different regions.

At the stress level, we capture long-term observed volatility levels in addition to current over/undervaluation based on regional indices. We derived a stressed-level of observed volatility ranging from 38% for Oslo and Akershus, 31% for the oil regions to 29% for the rest of Norway. This was based on the average index minus three standard deviations. The three standard deviations are supported by the moderate economic stresses within the 2009-recession compared to some other European countries for which we applied only two standard deviations. From this we calculated market value declines for stressed and base levels as follows:

- Market value decline (stressed) = 1 – (1 – stressed volatility adjustments) * (regional over/undervaluation)
- Market value decline (base) = regional over/undervaluation

[6] We applied our covered bond analysis framework but also used our General Structured Finance Methodology to establish market value haircuts and rating-distance conditional recovery assumptions.

To derive our final total security haircut, fire-sale discount assumptions was derived by taking into consideration market value haircuts reported in the issuer's IFSR9 reporting used to derive its loss given default expectations. From this we derived a flat fire-sale discount of 30%. Fire-sale discounts reflect our view that the properties are expected to be sold under non-standard market or distressed conditions due to several factors such as asset deterioration or insufficient competition in the auction process. Total security value haircut (SVH) assumptions were derived based on the following equation:

- Total security value haircut = 1 – (1 –market value decline) * (1 – fire-sale discount)

We derived intermediate rating stresses through a linear interpolation between the base and the stressed scenarios.

Table 4: Total security value haircuts for Norway / Verd

Regions	Stressed SVH	Base SVH
Oslo and Akershus	62.5%	40.0%
Oil regions	52.5%	30.0%
Rest of Norway	55.0%	37.5%

Other parameters

The highest stress assumptions only apply in the scenarios which, if passed, allow our maximum credit differentiation between the issuer and its covered bonds.[7]

Liquidity premium. We applied 150 bps as an additional and most stressful liquidity premium to discount Norwegian residential mortgage loans and 150 bps for the substitute assets (mostly Norwegian covered bonds). The liquidity premium was determined by analysing the historical trading spreads of Norwegian mortgage-covered bonds and by benchmarking against other core covered bond countries' trading spreads.

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

Interest rate analysis. We tested the rated OMF against several scenarios with rising and falling interest rates. The programme is most sensitive to a scenario in which interest rates rise after two years and plateau at 10%. For further details see our Covered Bond Rating Methodology.

Recovery timing. We assumed a recovery lag of 24 months for residential loans originated by the member banks and the substitute assets (mainly covered bonds). Recovery timing for the mortgage loans was based on an analysis of Norwegian enforcement processes and the potentially less fungible mortgage market in the more rural and south-west regions.

Prepayment rate assumptions. We tested constant prepayment rate assumptions of 0% and up to 25% for all cover assets. Sensitivities towards 30% were also tested. We assumed that the cash account pays interest equal to the respective reference rate (no spread). This limits the programme's sensitivity to negative carry in a high prepayment scenario which constitutes the worst-case scenario.

Servicing fee. We applied country- and asset-type-specific servicing fees to be paid by the cover pool annually. We assumed a servicing fee of 25 bps for the residential mortgage loans, and 10 bps for the substitute assets.

Default timing. Different default timings were considered. Back-loaded default scenarios are not as severe for OMF because of their relatively short lives.

[7] The maximum credit differentiation between the rating of the issuer and its covered bonds is typically determined by our fundamental assessment of the legal and resolution framework. Our methodology states that the maximum credit differentiation can only be three notches higher than this fundamental uplift. We determined fundamental support of four notches for the issuing bank. According to our methodology, the maximum uplift is seven notches (4+3).

II. Appendix: Summary of covered bond characteristics

Reporting date	31.03.2019
Issuer name	Verd Boligkreditt AS
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 mortgages loans
Issuer rating	Not disclosed
Covered bond rating	AAA / Stable
Covered bond maturity type	Soft bullets (one-year extension)
Cover pool currency	NOK (100%)
Covered bonds currency	NOK (100%)
Fundamental cover pool support (notches)	4
Max. achievable covered bond uplift (notches)	7
Potential covered bond rating buffer	0
Cover pool assets (NOK m)	9,403
Thereof substitute assets (NOK m)	592
Covered bonds (NOK m)	7,866
Current overcollateralisation/ legal minimum overcollateralisation	19.5% / 2.0%
Overcollateralisation to support current uplift	4.0%
Overcollateralisation to support rating upon a one-notch issuer downgrade	Downgrade to AA+
Weighted average seasoning of mortgage loans (years)	4.1
Duration/weighted average maturity of assets (years)	11.0 / 11.9
Duration/weighted average maturity of liabilities (years) [1]	4.0 / 4.0
Duration gap/weighted average maturity gap (years)	7.0 / 7.9
Number of obligors[3]	5,718
Average loan size (NOK '000s)	1,518.0
Top 10 exposures	0.7%
Top 20 exposures	1.2%
Interest rate type – cover pool	100% floating
Interest rate type – covered bonds	100% floating
Weighted average loan-to-value	53.1%
Geographic split (top 3)	Rogaland (41%); Vest Agder (28%); Hordaland (10%)
Default measure	Inverse Gaussian
Cumulative weighted average default rate (mortgage loans) / annualised	10.5% / 0.55%
Coefficient of variation (mortgage loans)	55%
Weighted average recovery assumption (D0/D7)[2] (mortgage loans)	97.3% / 76.6%
Current share of loans > 3 month in arrears	0%
Interest rate stresses (min./max.; currency-dependent)	-1% / 20%; no
Foreign exchange stresses (min./max.; currency-dependent)	n/a
D7 liquidity premium[2] (mortgage loans/substitute assets)	150 bps / 150 bps
Servicing fee (mortgage loans/substitute assets)	25 bps / 10 bps

[1] Including the 12-month extension
[2] D0 and D7 denote the stresses commensurate with the rating distance between our credit view on the issuer and the covered bond ratings
[3] Multiple borrowers with reference to the same loan/property were grouped as one borrower

III. Appendix: Verd Boligkreditt Credit Considerations

Credit drivers (summary)

The drivers, in decreasing order of importance in the credit assessment, are:

- As dictated by its legislative status and strategic purpose, Verd pursues a restricted and low risk business. Verd issues covered bonds whose proceeds are used to selectively purchase residential mortgage assets from its owner banks, thereby financing the latter's lending business.
- The investment-grade credit profiles of the owner banks form the basis for our credit view on the Verd. The owner banks are well established in their local markets and maintain reassuring prudential metrics. The focus on retail customers and mortgage lending underpin strong levels of capitalisation and good asset quality. However, the banks operate in southern and western Norway which are regions more exposed to the cyclical oil and gas industry.
- The 10-plus year relationship between Verd and its owner banks has been highly cooperative and successful. This has ensured that Verd suffers no credit losses and maintains a sound financial profile. The alliance and the various support mechanisms, however, have yet to be tested under more difficult conditions.

Credit change drivers

Further clarity and documentation of the owner banks' duties and obligations to support the credit fundamentals of Verd in situations of need. We note that the relationship between Verd and its owner banks is based on a high degree of mutual understanding and cohesion. More explicit details regarding support mechanisms (e.g. liquidity support) would be viewed positively.

Change in composition of owner banks. As it is an open platform, other savings banks could join Verd and further diversify the mortgage assets available for transfer. For example, one of the current owners, Voss Sparebank, joined in 2017. On the other hand, the geographic diversification of mortgage assets could suffer if the composition of the owner banks changed.

Material deterioration in the credit fundamentals of owner banks. This could impact the quality of the assets available for transfer as well as the banks' ability to meet obligations under the servicing and shareholder agreements.

Credit view drivers (details)

As dictated by its legislative status and strategic purpose, Verd pursues a restricted and low risk business. Verd issues covered bonds whose proceeds are used to selectively purchase residential mortgage assets from its owner banks, thereby financing the latter's lending business.

Established in 2009, nine independent savings banks own and use Verd for their funding needs. Verd aims to support the lending growth of its owners in a cost-efficient and prudent manner. About 25% of the banks' mortgages are transferred to Verd, which is a low level compared to other covered bond issuers in Norway.

All the mortgages which may be purchased by Verd are originated by the banks. The banks use a common credit underwriting system from Evry AS, the largest provider of IT services to the Norwegian financial industry. The focus is on debt servicing capability, with the banks having good access to information about potential clients (e.g. tax records, individual register) as well properties (e.g. central land register, market prices).

In addition, mortgage regulations have been in place for several years to manage the development of household debt. These include a maximum 85% LTV, a stress test on ability to repay assuming a 5% increase in mortgage rates and a maximum debt-to-income requirement of five times gross annual income.

Verd purchases only mortgages which meet its criteria. These include the following:

- Customer types: employed or self-employed, resident in Norway, Norwegian citizens
- Credit criteria: not in arrears, not delinquent (> 14 days or loss write-down)
- Collateral: max LTV of 75%, first lien only, recent valuations, documented quarterly valuation from independent 3rd party
- Property types: primary residences only, no cooperative housing loans

Verd relies on the parent banks to service the loans which have been sold. For example, payment reminders and communications with customers is handled by the parent banks.

Under the Norwegian Act on Financial Institutions which entered into force 1 January 2016, covered bond companies cannot be declared bankrupt and are placed under public administration if they face solvency or liquidity problems.

The investment-grade credit profiles of the owner banks form the basis of our credit view on the Verd. The owner banks are well established in their local markets and maintain reassuring prudential metrics. The focus on retail customers and mortgage lending underpin strong levels of capitalisation and good asset quality. However, the banks operate in southern and western Norway which are regions more exposed to the cyclical oil and gas industry.

Norway's banking system is characterised by around 100 savings banks, with most of them having less than NOK 10bn in assets. Due to their size, the owner banks find it beneficial to issue covered bonds collectively through Verd. At the same time, we note that each bank issues senior unsecured debt in its own name, with some also issuing subordinated debt and capital instruments.

The savings bank business model is characterised by a focus on lending to retail customers and mortgages. The banks have good knowledge of their customers and generally do not lend to customers outside of their respective market area. They may lend to an existing retail client buying a property outside their home market.

All the Verd banks are part of the DSS cooperation which brings economies of scale in important areas such as IT, digital channel strategies and administration. DSS has an agreement until end-2020 with Evry AS. As well, the joint ownership in various product companies enables the banks to offer a full range of products and services to their clients. Sparebanken Vest typically holds the largest stake in these product companies.

Table 5: Selected characteristics of Verd banks

	Year established	Stake in Verd YE 2018	Assets (NOK bn) YE 2018	% retail lending YE 2018	Main market region
Skudenes & Aakra Sparebank	1876	19.7%	9.0	82%	Rogaland
Haugesund Sparebank	1928	19.5%	11.1	66%	Rogaland
Spareskillingsbanken	1877	18.2%	9.2	84%	Agder
Flekkefjord Sparebank	1837	10.8%	6.8	79%	Agder
Etne Sparebank	1860	7.8%	2.0	76%	Hordaland
Sogne & Greipstad Sparebank	1863	7.7%	4.3	73%	Agder
Luster Sparebank	1848	7.1%	3.7	73%	Sogn og Fjordane
Lillesands Sparebank	1852	6.8%	3.4	73%	Agder
Voss Sparebank	1843	2.4%	4.5	73%	Hordaland

Note: Asset figures exclude loans transferred to Verd.
Source: Banks, Scope Ratings

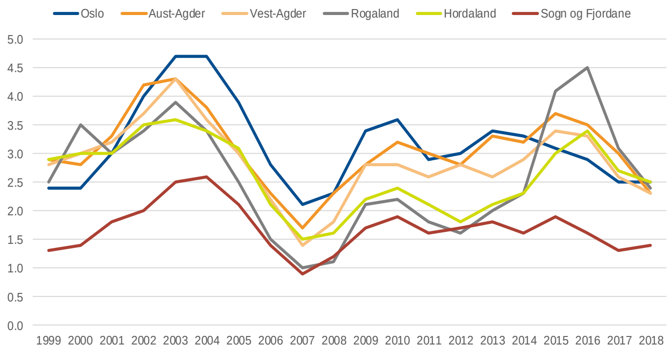
The Verd banks are situated in southern and western Norway, regions which are important for the oil and gas industry – in particular, Rogaland, Hordaland and Vest-Agder. The regions are also home to diversified, export-oriented businesses and sectors such as fisheries, ship building, hydro power and tourism.

Meanwhile, these regions have not experienced the same degree of price appreciation in home prices as seen in Oslo. Unemployment in these regions is now also in line with the national level (3.8%).[8]

The Norwegian economy continues to recover from the impact of the 2014-2016 decline in oil prices. After falling for several years, petroleum investment increased by 3% in 2018 and is expected to increase by 12.5% in 2019 and 1% in 2020. Investments are then expected to decline as development projects are completed.[9]

Since last year, the policy rate has been raised twice and now stands at 1%. The latest monetary policy report (1Q 2019) foresees the policy rate increasing further this year and eventually reaching 1.75% at the end of 2022.

Figure 14: Unemployment rates by region (%)



Source: Statistics Norway

Table 6: House price developments by region

Region	Avg price (NOK m)	Avg sqm price (NOK 000)	Price change last 10 years
Oslo	5.0	72.3	111%
Bergen	3.5	42.8	66%
Stavanger	3.7	34.8	34%
Kristiansand	3.0	29.5	28%
Norway	3.7	42.4	77%

Notes: Bergen is the major city in Hordaland, Stavanger is the major city in Rogaland, and Kristiansand is the major city in Agder.

Source: Eiendomsverdi, March 2019

Due to their focus on retail clients, the Verd banks have less exposure to commercial customers, although the proportion varies by bank. Commercial clients are often in the following sectors: real estate, industrials, construction, transport and primary industries (including agriculture and fishing). Normally, the banks do not provide loans on a joint basis which limits the size of the commercial customers they can serve.

The Verd banks are solidly capitalised, driven in part by regulatory requirements. Banks of all sizes in Norway are subject to a minimum CET1 requirement of 12.5.% - comprised of the minimum Pillar 1 requirement of 4.5%, the 2.5% capital conservation buffer, a 3% systemic risk buffer and a 2.5% counter-cyclical buffer.[10] In addition, the Verd banks have Pillar 2 requirements ranging from 2.3% to 3.3%[11] which must also be met with CET1 capital.

From January 2017, the banks have been required to consolidate their ownership stakes in Verd and other product companies. Consequently, there was a small decline in the overall capital levels of the banks from 2016 to 2017. The average CET1 capital ratio of the banks declined to 19.9% from 21.3%. Meanwhile, the banks continue to maintain comfortable buffers above requirements. We also note that the banks use the standardised approach for credit risk exposures.

For information on how key financial metrics of the owner banks compare to other Norwegian banks and international peers, please see Appendix: Peer comparison.

The 10-plus year relationship between Verd and its owner banks has been highly cooperative and successful. This has ensured that Verd suffers no credit losses and maintains solid prudential metrics. However, the alliance and the various support mechanisms have yet to be tested under more difficult conditions.

As planned, Sparebanken Vest fully divested its ownership stake in Verd in 2018. Meanwhile, Sparebanken Vest Boligkreditt (Sparebanken Vest's fully owned covered bond company) continues to manage Verd on behalf of the banks. After leaving the Sparebank 1 alliance in 2003, Sparebanken Vest has strategically formed several new financial services and products companies.

[8] Statistics Norway, data for Feb 2019
[9] Monetary Policy Report, 1Q 2019
[10] Current countercyclical buffer rate is 2% but is increasing to 2.5% at end-2019.
[11] Three of the Verd banks have not yet been given Pillar 2 requirements by the Norwegian FSA.

Verd was established in 2009 and became fully operational in 2010. As of year-end 2018, Sparebanken Vest is one of the largest savings banks in Norway with NOK 189bn in assets.

Under the shareholder agreements, each bank is obliged to contribute capital according to its shareholding to maintain Verd's CET1 capital at a minimum level (equal to regulatory minimum plus management buffer). The owner banks' shareholding in Verd is determined annually, based on the amount of mortgage loans transferred. Except for some rebalancing due to Sparebanken Vest's divestiture, the ownership stakes have been relatively stable.

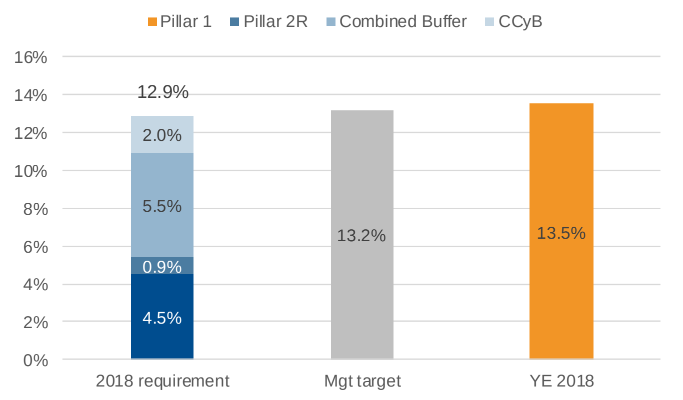
Under the servicing agreements, the banks have a strong incentive to take back loans which are at risk of being non-performing as their commission will be reduced if there is a customer default. To date, the owner banks have bought back at-risk loans. Consequently, Verd has not experienced any losses on its loan portfolio. Loans which no longer meet the criteria are repurchased by the bank or are replaced by a qualifying loan. If a bank for some reason suddenly cannot service the transferred loans, Verd believes that it would be relatively easy to transfer this responsibility to another bank – as many banks use systems from Evry AS.

If a bank is not fulfilling its obligations under the shareholder or servicing agreements, Verd may terminate the relationship with six months notice or with 30 days notice in the case of a serious breach.

The banks or Verd may terminate the relationship with 12 months notice. If this happens, the bank's transferred loans will be returned in a manner not to inconvenience customers and not to disrupt outstanding covered bonds backed by these loans.

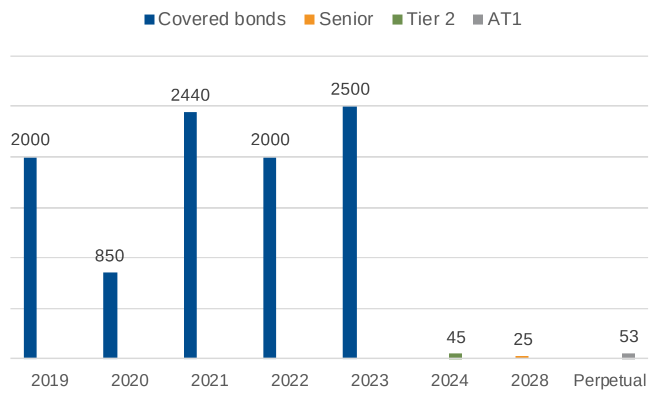
Verd is subject to the same regulations as banks. For example, by end-2019, Verd must meet a minimum CET1 requirement of 12.5% and a Pillar 2 requirement of 0.9%. As well, Verd has decided to maintain a management buffer of 0.3%.

Figure 15: CET1 capital vs requirements



Source: Company data, Scope Ratings

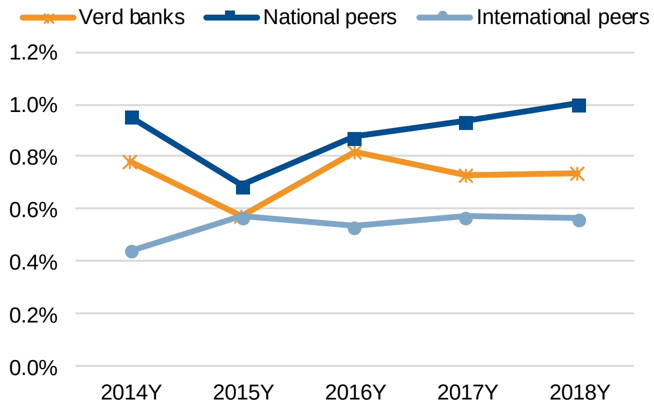
Figure 16: Debt distribution profile



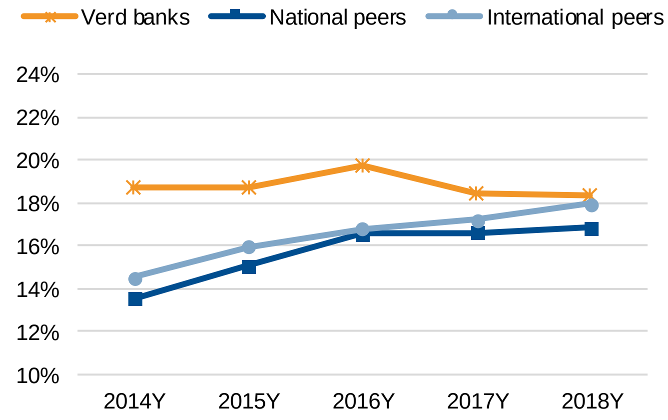
Source: Company data, Scope Ratings

IV. Appendix: Peer comparison

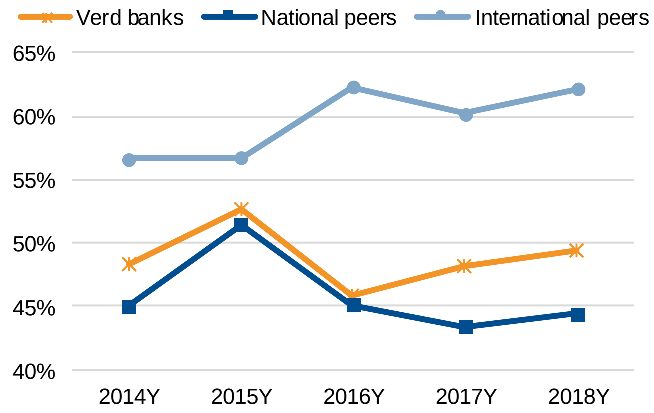
Return on average assets (%)



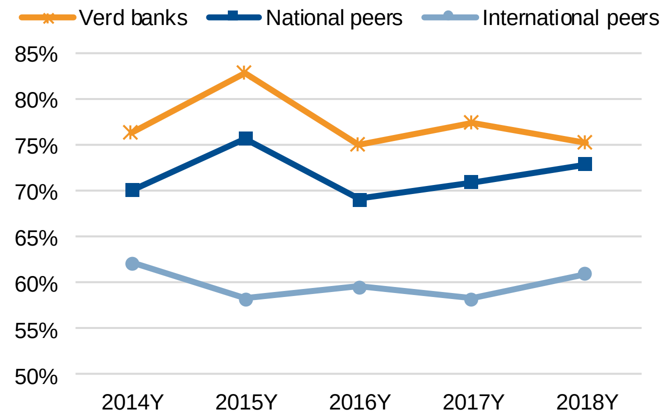
CET1 ratio (%, transitional basis)



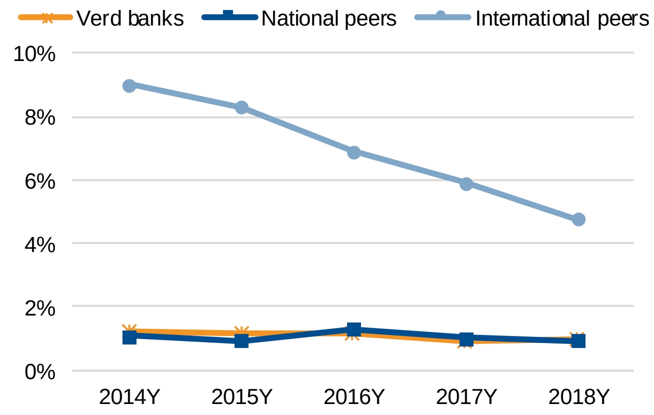
Costs % Income (%)



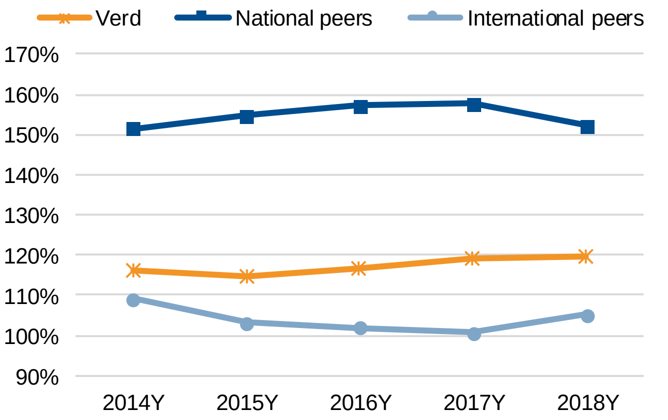
Net interest income % Operating income



NPLs % Net loans



Amortised loans % Deposits



National peers: Verd banks, DNB, Sparebank 1 SR-Bank, Sparebank 1 SMN, Sparebanken Vest, Landkreditt Bank, Sandes Sparebank, Totens Sparebank
International peers: Verd banks, Hypo-Bank Burgenland, Bausparkasse Wustenrot, Banca Popolare di Sondrio, Credito Emiliano, Kutxabank, Unicaja, Coventry Building Society
Notes: Figures for the Verd banks are weighted averages based on each bank's ownership interest in Verd.

Source: SNL, Scope Ratings

V. Appendix: Selected Financial Information – Verd Boligkreditt AS

	2014Y	2015Y	2016Y	2017Y	2018Y
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	146	7	125	109	163
Total securities	797	346	398	387	282
of which, derivatives	48	43	26	13	3
Net loans to customers	4,881	5,218	6,928	7,982	8,772
Other assets	0	1	0	0	0
Total assets	**5,824**	**5,572**	**7,451**	**8,478**	**9,216**
Liabilities					
Interbank liabilities	491	466	695	656	838
Senior debt	4,974	4,764	6,316	7,317	7,764
Derivatives	0	0	2	0	2
Deposits from customers	0	0	0	0	0
Subordinated debt	80	45	45	45	70
Other liabilities	NA	NA	NA	NA	NA
Total liabilities	**5,571**	**5,293**	**7,070**	**8,039**	**8,693**
Ordinary equity	254	244	346	404	470
Equity hybrids	0	35	35	35	53
Minority interests	0	0	0	0	0
Total liabilities and equity	**5,824**	**5,572**	**7,451**	**8,478**	**9,216**
Core tier 1/Common equity tier 1 capital	226	226	326	375	445
Income statement summary (NOK m)					
Net interest income	82	68	56	80	91
Net fee & commission income	-35	-30	-23	-34	-39
Net trading income	-2	-8	2	-1	-11
Other income	0	0	0	0	0
Operating income	**45**	**30**	**35**	**45**	**41**
Operating expense	7	5	7	7	7
Pre-provision income	**38**	**25**	**28**	**39**	**34**
Credit and other financial impairments	0	0	0	0	0
Other impairments	0	0	0	0	0
Non-recurring items	NA	NA	NA	NA	NA
Pre-tax profit	**38**	**25**	**28**	**39**	**34**
Discontinued operations	0	0	0	0	0
Other after-tax Items	0	0	0	0	0
Income tax expense	10	7	7	9	8
Net profit attributable to minority interests	0	0	0	0	0
Net profit attributable to parent	**28**	**18**	**21**	**29**	**26**

Source: SNL

	2014Y	2015Y	2016Y	2017Y	2018Y
Funding and liquidity					
Net loans/deposits (%)	NA	NA	NA	NA	NA
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 (%)	83.8%	93.6%	93.0%	94.2%	95.2%
NPLs/net loans (%)	0.1%	0.2%	0.0%	0.1%	0.0%
Loan-loss reserves/NPLs (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Net loan growth (%)	6.9%	6.9%	32.8%	15.2%	9.9%
NPLs/tangible equity and reserves (%)	2.0%	4.2%	0.2%	1.9%	0.0%
Asset growth (%)	14.1%	-4.3%	33.7%	13.8%	8.7%
Earnings and profitability					
Net interest margin (%)	1.4%	1.2%	0.8%	1.0%	1.0%
Net interest income/average RWAs (%)	4.3%	3.5%	2.4%	2.9%	2.9%
Net interest income/operating income (%)	181.9%	228.2%	159.2%	177.4%	220.3%
Net fees & commissions/operating income (%)	-77.3%	-100.7%	-64.8%	-75.4%	-93.7%
Cost/income ratio (%)	15.5%	17.0%	19.9%	14.5%	18.1%
Operating expenses/average RWAs (%)	0.4%	0.3%	0.3%	0.2%	0.2%
Pre-impairment operating profit/average RWAs (%)	2.0%	1.3%	1.2%	1.4%	1.1%
Impairment on financial assets /pre-impairment income (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Loan-loss provision charges/net loans (%)	0.0%	0.0%	0.0%	0.0%	0.0%
Pre-tax profit/average RWAs (%)	2.0%	1.3%	1.2%	1.4%	1.1%
Return on average assets (%)	0.5%	0.3%	0.3%	0.4%	0.3%
Return on average RWAs (%)	1.5%	0.9%	0.9%	1.1%	0.8%
Return on average equity (%)	11.3%	7.2%	6.2%	6.9%	5.1%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	11.4%	11.1%	12.3%	12.5%	13.5%
Tier 1 capital ratio (%, transitional)	13.2%	12.8%	13.6%	13.7%	15.2%
Total capital ratio (%, transitional)	15.5%	15.1%	15.3%	15.2%	17.3%
Leverage ratio (%)	NA	4.4%	4.8%	4.8%	5.3%
Asset risk intensity (RWAs/total assets, %)	33.9%	36.4%	35.5%	35.4%	35.7%

Source: SNL

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
1 Cour du Havre
F-75008 Paris

Phone +33 1 8288 5557

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com