

# Landkreditt Boligkreditt AS

## Norwegian Covered Bonds – Performance Update



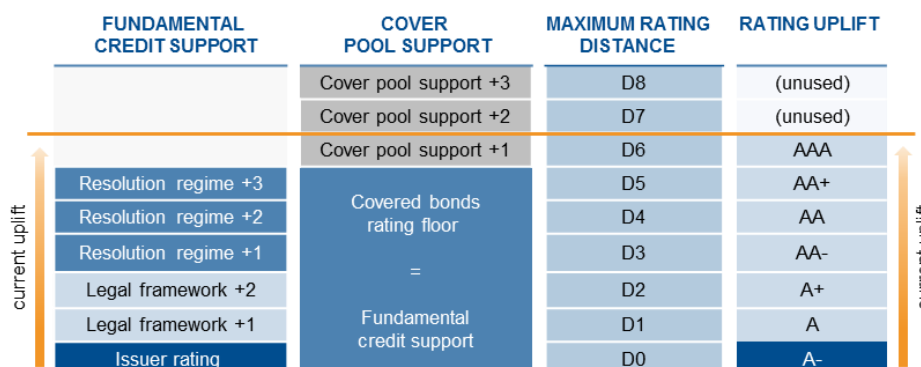
The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued out of Landkreditt Boligkreditt AS (LKBol) is based on the bank's A- issuer rating, enhanced by six notches of cover pool support. Five notches thereof reflect our assessment of the strong fundamental credit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

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
31 December 2019	NOK 4.4bn	Residential mortgage loans	NOK <sup>1</sup> 3.7bn	AAA/Stable

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

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

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



### Stable Outlook

The Stable Outlook on the covered bond rating reflects our expectations that: i) the credit performance of 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 December 2018 the cover pool has increased to NOK 4.4bn (+10%). Relevant risk metrics such as the loan-to-value (LTV) ratio and the remaining term have remained stable. In 2019, LKBol issued longer dated covered bonds which increased the weighted average life (WAL) of liabilities to 4.0 years, up from 3.7 years previously. Although this has reduced asset-liability maturity mismatch risk (which has also led to a lower OC needed to support the AAA covered bond rating), it remains elevated because the WAL of the assets is stable at 11 years.

### Ratings & Outlook

Issuer rating	A-
Outlook	Stable
Last rating action	New
Last rating action date	04.04.18
Covered bond rating	AAA
Outlook	Stable
Rating action	Affirmation
Last rating action date	20.03.20

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### Related Research

Scope affirms Landkreditt Boligkreditt AS mortgage-covered bonds at AAA/Stable March 2020

Norway first out of the blocks to align with EU covered bond directive January 2020

New analysis on Landkreditt Bank AS May 2019

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Bloomberg: SCOP

<sup>1</sup> The currency was changed on 25 March 2020. In the initial publication the text made reference to EUR.

### The issuer

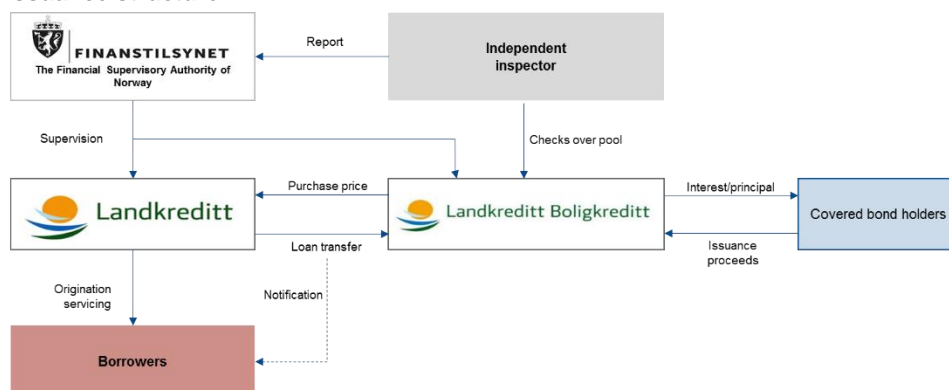
LKBol's ratings reflect those of its parent bank, LKB. LKB is a leader in financial services for agricultural customers in Norway. The bank also focuses on retail customers as part of its strategy to achieve greater scale and business diversification. LKB aims to establish a customer base balanced equally on the agricultural and retail sectors. As an online bank, LKB has an efficient structure and continues to invest further in digitalisation and improving customer service.

For further details on our bank credit analysis see the full bank rating report available on [www.scooperatings.com](http://www.scooperatings.com).

### Programme structure

The Norwegian legal covered bond framework is mainly based on the relevant section on covered bonds in the Financial Institutions Act and a related regulation on mortgage credit institutions, both introduced in 2007. Under this framework, issuance is permitted only through specialist covered bond issuers. Like 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

### Fundamental credit support analysis

Fundamental credit 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.

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.

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. Generally, we provide four additional notches of support for Norwegian covered bonds issued by resolvable and very visible entities. For more information, see our [related research](#).

Two notches of uplift based on legal framework analysis...

... on top three notches of uplift reflecting resolution regime

### Cover pool characteristics

Reporting date	Dec 2019	Dec 2018
Balance (NOK bn)	4.4	4.0
Residential (%)	100	100
Substitute (%)	0.0	0.0

### Property type (%)

Reporting date	Dec 2019	Dec 2018
Single-family house	68.7	69.5
Apartment	25.3	24.8
Others	6.0	5.7

### General information

Reporting date	Dec 2019	Dec 2018
No. of obligors	2,803	2,607
Avg. size (NOK m)*	1.6	1.5
Top 10 (%)	2.2	2.7
Remaining life (y)	15	15
LTV (%)	44.6	45.4

\*per Scope aggregated borrower

### Interest rate type (%)

Reporting date	Dec 2019	Dec 2018
Floating	100	100
Fixed	0.0	0.0

### Repayment type (%)

Reporting date	Dec 2019	Dec 2018
Annuity	50.9	51.3
Flexible loan	32.2	32.1
Interest-only	16.9	16.6

### Cover pool analysis

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

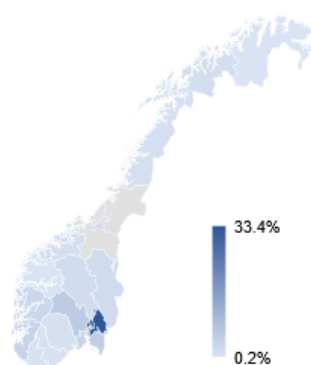
Since our last review in 2019, the minimum supporting OC needed to achieve the highest rating has decreased to 5.0% from 7.0%, mainly reflecting the reduction in maturity mismatches, which lowers the likelihood of forced asset sales.

### Cover pool composition

The cover pool comprises Norwegian granular, first-lien residential mortgage loans denominated in Norwegian kroner. As of December 2019, the loans were granted to 2,803 obligor groups. The average loan size remains small at NOK 1.6m (around EUR 140,000). The top 10 largest obligors account for 2.2%.

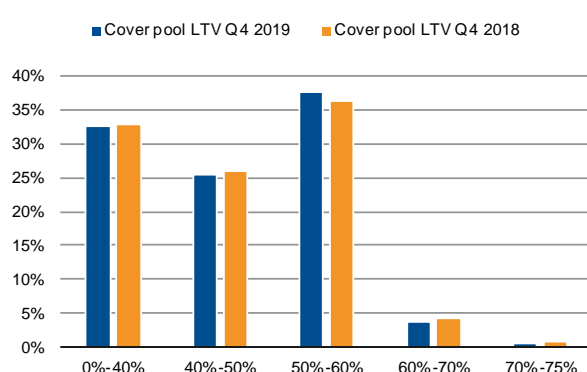
The weighted average whole LTV is 45%. This LTV is calculated based on the maximum drawable amount for re-drawable loans (flexible loans) which make up 32% of the cover pool. These loans have an embedded credit line which can be redrawn without new credit approval. Flexible loans will only be granted if the loan's LTV does not exceed 60%. Existing flexible loans may only draw up to a level of 60%. Another 17% of the mortgage loans have an interest-only period. The remaining loans are normal amortising loans.

### Regional distribution



Source: Scope Ratings, Landkreditt.

### LTV distribution



Source: Scope Ratings, Landkreditt.

The collateral is primarily located in the Oslo and Akershus regions, together accounting for around 62%. The rest of the portfolio is spread across Norway, supported by LKB's online distribution channel. Norway's oil regions (Rogaland, Hordaland and Agder) are less well represented, accounting for 9.4% compared to a share in the country's population of around 25%.

Around two-thirds of the portfolio is made up of single-family houses and another quarter of flats or apartments. Holiday homes account for only 0.5% and agricultural property for another 0.3%.

### Strong credit quality translates into low credit risk

### Asset risk analysis

The credit quality of the cover pool remains strong. We assume an unchanged annual average default probability of 60bps, which provides a comfortable cushion against actual defaults observed in the previous benign economic situation. Our projection of default on mortgage loans uses an inverse Gaussian distribution, based on available credit performance data provided by the bank (in particular, historical delinquencies, portfolio loss rate) and benchmarking. In addition to the stable default probability we also maintained our assumption of a coefficient of variation of 50% for the mortgage assets.

Recovery rates have also remained stable, reflecting the stable portfolio LTV together with unchanged assumptions regarding market value declines for residential properties in Norway. Reflecting the low average LTV, we estimate a weighted average recovery rate of 100% under a base case scenario and 88.5% under the most stressful scenario.

### Cash flow risk analysis

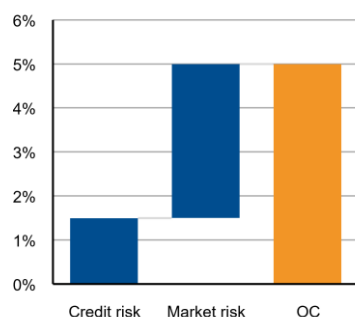
The rating-supporting OC of 5.0% mainly reflects the programme's asset-liability maturity mismatch risk from the slow scheduled amortisation of cover assets compared to a relatively fast redemption profile for the covered bonds and a corresponding sensitivity to low prepayments. Market risk in total accounts for 3.5pp of the supporting OC of 5.0%, down from 5.5pp in the previous analysis.

As of Q4 2019, the WAL of the outstanding covered bonds is 4.0 years when accounting for the bonds' soft-bullet structure, up from 3.7 years in the previous analysis. In comparison, the (scheduled) WAL of the cover pool is 11.0 years. In the event of recourse to the cover pool, we assume that assets will be sold at a discount if the cash accumulated from cover pool amortisation is insufficient to pay timely interest and principle on the covered bonds. Currently, the cover pool does not include short-term, substitute assets.

Other market risks are limited as cover assets and covered bonds are both floating rate. Also, there is no foreign exchange risk as assets and liabilities are denominated in Norwegian kroner. At this stage we do not expect any foreign currency-denominated issuances.

Credit risk only accounts for an (unchanged) 1.5pp of the supporting OC. This is low, reflecting the lifetime mean default rate of 10%, a coefficient of variation of 50% and a stressed recovery rate of 88.5%.

### Supporting OC breakdown

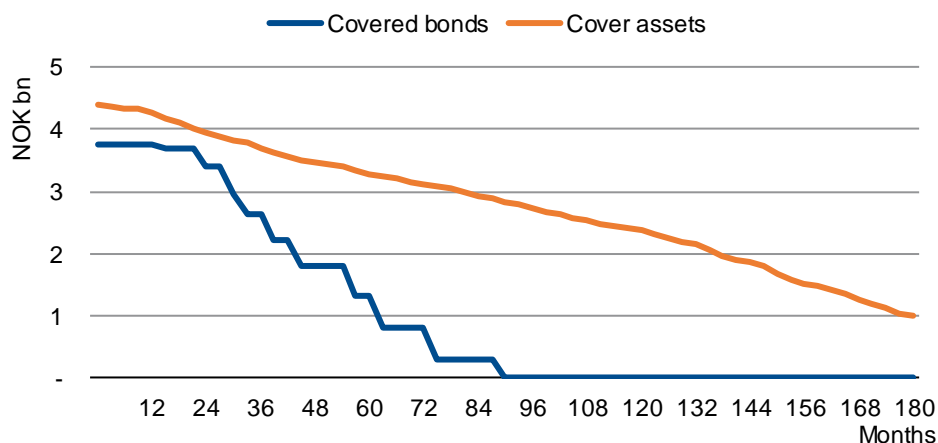


Source: Scope Ratings

### Asset-liability mismatches

	Assets	Liabilities
<b>NOK</b>	100%	100%
<b>Fixed</b>	0.0%	0.0%
<b>Floating</b>	100%	100%
<b>WAL (years)</b>	11.0	4.0

Figure 1: Amortisation profile



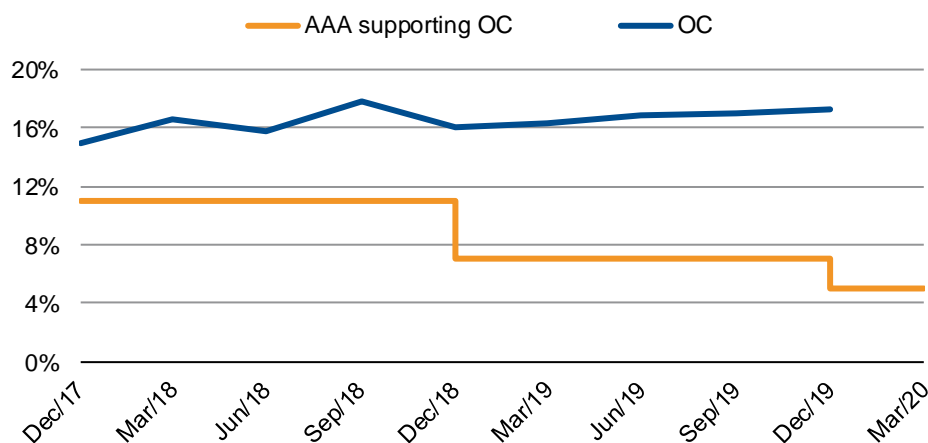
Source: Scope Ratings, Landkreditt

### Overcollateralisation fully taken into account

### Availability of overcollateralisation

The current rating of LKBol allows us to fully account for the provided OC. 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 2: Available overcollateralisation versus current rating-supporting level**



Source: Scope Ratings, Landkreditt

### Counterparty risk mitigated by alignment of interests

### Other risk considerations

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

### Sovereign risk does not affect the ratings

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

### No impact from ESG

We have not directly included ESG aspects into the rating of covered bonds issued by LKBol. The issuer has only recently introduced a 'Green Mortgage' product, offering favorable interest rates for the purchase of energy-efficient homes. The share of such loans in the cover pool is still limited.

Environmental aspects, in particular Norwegian energy efficiency standards, have often not been recorded in the bank's main underwriting databases – which is typical for most banks. We were therefore unable to perform a specific analysis of environmental or social factors and their impact on the cover assets' probability of default or their recovery proceeds. At the same time, we have indirectly included environmental aspects 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 6.0%.



# Landkreditt Boligkreditt AS

## Norwegian Covered Bonds – Performance Update

Reporting date	31 Dec 2019	31 Dec 2018
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% Substitute = 0%	Residential = 100% 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%)
Fundamental cover pool support	5	5
Maximum achievable covered bond uplift	8	8
Potential covered bond rating buffer	2	2
Cover pool (NOK bn)	4.4	4.0
thereof, substitute assets and deposits (NOK bn)	0.0	0.0
Covered bonds (NOK bn)	3.7	3.5
Overcollateralisation: current / legal minimum	17.4% / 2.0%	16.1% / 2.0%
Overcollateralisation to support current rating	5.0%	7.0%
Overcollateralisation upon a one-notch issuer downgrade	6.0%	8.0%
Weighted average life of assets	11.0 years	11.0 years
Weighted average life of liabilities <sup>1</sup>	4.0 years	3.7 years
Weighted average life gap	7.0 years	7.3 years
Number of borrowers	2,803	2,606
Average loan size per borrower (NOK m)	1.6	1.5
Top 10 residential	2.2%	2.7%
Interest rate type – assets	Floating 100% Fixed 0%	Floating 100% Fixed 0%
Interest rate type – liabilities	Floating 100% Fixed 0%	Floating 100% Fixed 0%
Weighted average LTV (indexed)	44.6%	45.4%
Geographic split (top 3)	Akershus = 33.4% Oslo = 29.2% Buskerud = 6.1%	Akershus = 32.8% Oslo = 30.0% Buskerud = 6.2%
Default measure	Inverse Gaussian	Inverse Gaussian
Weighted average default rate (mortgage) (annualized/cumulative)	60bps / 10%	60bps / 10%
Coefficient of variation (mortgage)	50%	50%
Weighted average recovery assumption (D0/D8) <sup>2</sup> (mortgage)	100% / 88.5%	100% / 88.5%
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

<sup>1</sup> Including the 12-month extension

<sup>2</sup> D0 and D8 denote the stresses commensurate with the rating distance from the minimum and maximum achievable covered bond uplift



# Landkreditt Boligkreditt AS

## Norwegian Covered Bonds – Performance Update

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