Landkreditt Boligkreditt AS
Norwegian Covered Bonds – Performance Update

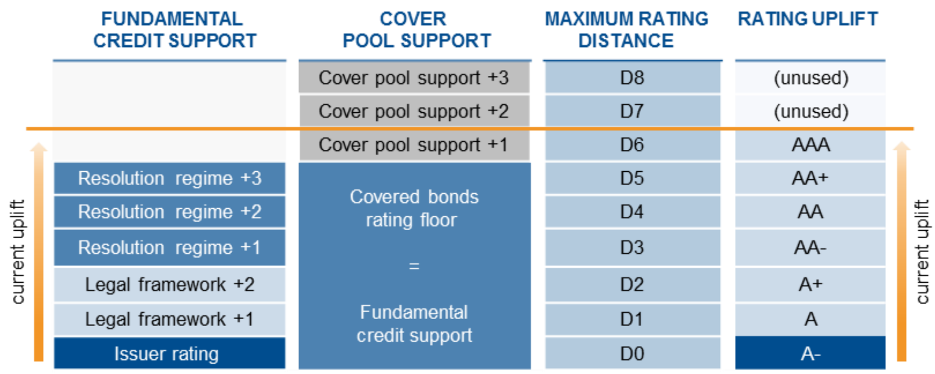
The AAA rating with a Stable Outlook assigned to the Norwegian mortgage-covered bonds issued by Landkreditt Boligkreditt AS (LKBol) is based on the bank's A- issuer rating enhanced by six notches of cover pool support. Five notches thereof reflect our assessment of the strong fundamental credit support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

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
31 Dec. 2020	NOK 4.96bn	Residential mortgage loans	NOK 4.29bn	AAA/Stable

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

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 2019, the cover pool has increased to NOK 4.96bn (+13%). At the same time, the Scope-calculated loan-to-value (LTV) ratio decreased by 1pp to 43.6% and the remaining term to maturity increased to 17.2 years (from 16.4).

In 2020, LKBol started issuing larger bonds with an outstanding balance of up to NOK 750m, up from the previous maximum of NOK 500m. This does not negatively impact the programme's market risks as the cover pool balance was also increased. Supporting overcollateralisation remains unchanged at 5%.

Ratings & Outlook

Issuer rating	**A-**
Outlook	Stable
Last rating action	New
Last rating action	04.04.18
Covered bond	**AAA**
Outlook	Stable
Rating action	Affirmation
Last rating action	12.03.2021

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Related Research

Scope affirms Landkreditt Boligkreditt AS mortgage-covered bonds at AAA/Stable
March 2021

New analysis on Landkreditt Bank AS
April 2020

Earnings outlook for Norwegian banks more nuanced than zero interest rates suggest
Oct 2020

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

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The issuer

LKBol's ratings reflect those of its parent bank, LKB. LKB is a leader in financial services provided to agricultural customers in Norway. The bank also focuses on retail customers in order to expand its scale and business diversification. LKB's customer base is balanced equally between agricultural and retail sectors. As an online bank, LKB has an efficient structure and continues to invest in digitalisation and improving customer service. LKB is currently opening more branches in Norway to strengthen visibility, but will maintain its digital focus.

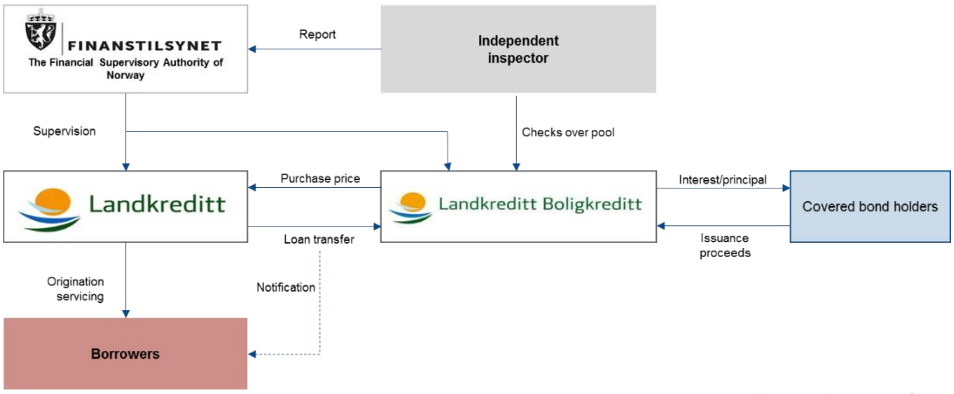
For further details on our bank credit analysis see the full bank rating report available on www.scoperatings.com.

Programme structure

Specialised mortgage bank issuing covered bonds

The Norwegian legal covered bond framework is mainly based on the 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.

Two notches of uplift based on legal framework analysis…

We consider the Norwegian covered bond framework to be one of Europe's strongest, meeting our criteria for protecting investors. Therefore, we assign the highest credit differentiation of two notches.

… on top of three notches of uplift reflecting resolution regime

LKBol's covered bonds benefit from an additional three-notch uplift that reflects their exemption from bail-in and the support from a strong stakeholder community. This is based on: i) a moderate to high likelihood that the covered bond issuer will be maintained in a resolution scenario; and ii) the high systemic importance of covered bonds in Norway. However, we also recognise the low visibility and importance of LKBol as a covered bond issuer. 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.

Cover pool characteristics

Reporting date	Dec 2020	Dec 2019
Balance (NOK bn)	5.0	4.4
Residential (%)	100	100
Substitute (%)	0.0	0.0

Property type (%)

Reporting date	Dec 2020	Dec 2019
Single-family house	69.9	68.7
Apartment	24.3	25.3
Others	5.8	6.0

General information

Reporting date	Dec 2020	Dec 2019
No. of obligors	3,020	2,803
Avg. size (NOK m)*	1.6	1.6
Top 10 (%)	2.2	2.2
Remaining life (y)	17.0	16.4
LTV (%)	43.6	44.6

*per Scope aggregated borrower

Interest rate type (%)

Reporting date	Dec 2020	Dec 2018
Floating	100	100
Fixed	0.0	0.0

Repayment type (%)

Reporting date	Dec 2020	Dec 2019
Annuity	54.2	50.9
Flexible loan	25.4	32.2
Interest-only	20.4	16.9

Cover pool analysis

LKBol'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.

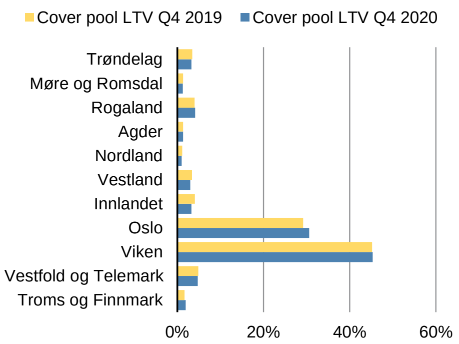
The minimum supporting OC needed to achieve the highest rating remains unchanged at 5%, supported by the sound credit metrics of the cover pool and low (unchanged) market risks. The latter arise from maturity mismatches that benefit from the bonds' soft-bullet structure.

Cover pool composition

The cover pool comprises granular, first-lien Norwegian residential mortgage loans denominated in Norwegian krone. As of December 2020, the loans were granted to 3,018 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%.

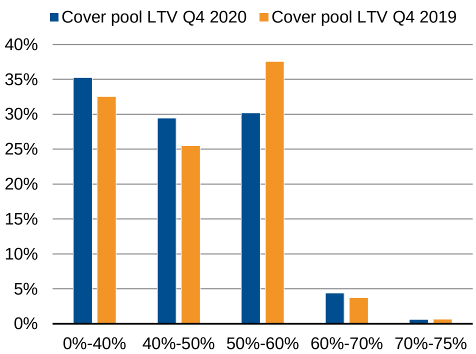
The weighted average whole LTV is 44%, calculated based on the maximum drawable amount for re-drawable loans (flexible loans), which make up 25% (down from 32%) of the cover pool. These loans have an embedded credit line that can be redrawn without new credit approval. Flexible loans will only be granted if the loan's LTV does not exceed 60%. Existing flexible loans may only be drawn up to 60%. Another 20% (up from 17%) of the loans have an interest-only period. The remaining loans are normal amortising loans.

Regional distribution



Source: Scope Ratings, LKBol.

LTV distribution



Source: Scope Ratings, LKBol.

The collateral is primarily located in the Oslo and Viken regions, together accounting for around 76%. The rest of the portfolio is spread across Norway, supported by LKB's online distribution channel. Norway's oil regions (Rogaland and Agder) are less represented, accounting for 5.5%.

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 0.1% and agricultural property for another 0.4%.

Asset risk analysis

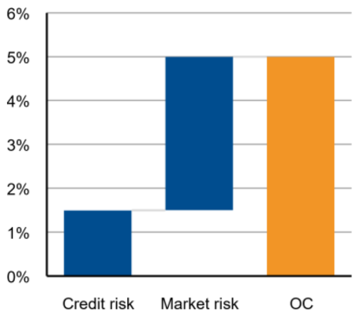
Strong credit quality translates into low credit risk

The cover pool's credit quality remains strong. We assume an annual average default probability of 61bps, 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. We have further maintained our assumption of a coefficient of variation of 50% for the mortgage assets.

Recovery rates have remained stable, reflecting the low portfolio LTV together with our assumptions regarding market value declines for residential properties in Norway. We estimate a weighted average recovery rate of 99.9% under a base case scenario and 88.5% under the most stressful scenario.

Cash flow risk analysis

Supporting OC breakdown



Source: Scope Ratings

Asset-liability mismatches

	Assets	Liabilities
NOK	100%	100%
Fixed	0.0%	0.0%
Floating	100%	100%
WAL (years)	11.1	4.2

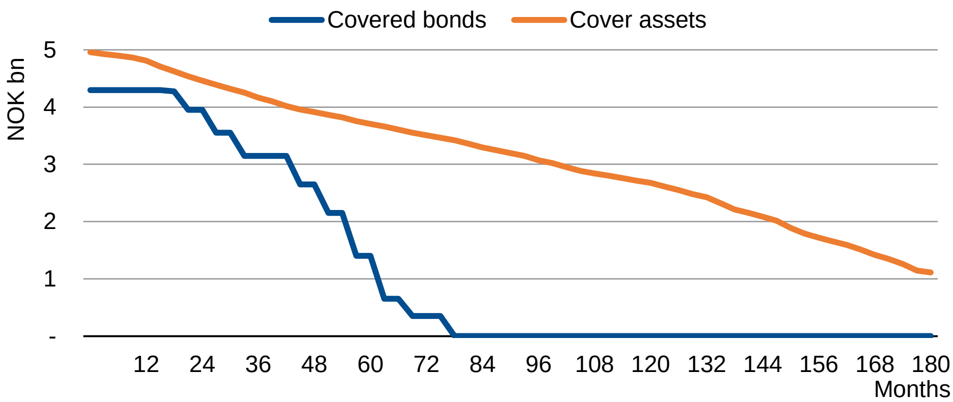
The unchanged rating-supporting OC of 5.0% mainly reflects the programme's asset-liability maturity mismatch risk from the slow scheduled amortisation of the cover assets against the faster redemption of the covered bonds, which creates a sensitivity to low prepayments. Market risk accounts for 3.5pp of the 5% rating-supporting OC.

As of Q4 2020, the weighted average life of the outstanding covered bonds is 4.2 years when accounting for their soft-bullet structure, up from 4.0 years in the previous analysis. In comparison, the (scheduled) weighted average life of the cover pool is 11.1 years. In the event of recourse to the cover pool, we assume assets will be sold at a discount if the cash accumulated from cover pool amortisation is insufficient to pay timely interest and principal 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 both assets and liabilities are denominated in Norwegian krone. At this stage, we do not expect foreign currency-denominated issuances.

Credit risk only accounts for an (unchanged) 1.5pp of the rating-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%.

Figure 1: Amortisation profile



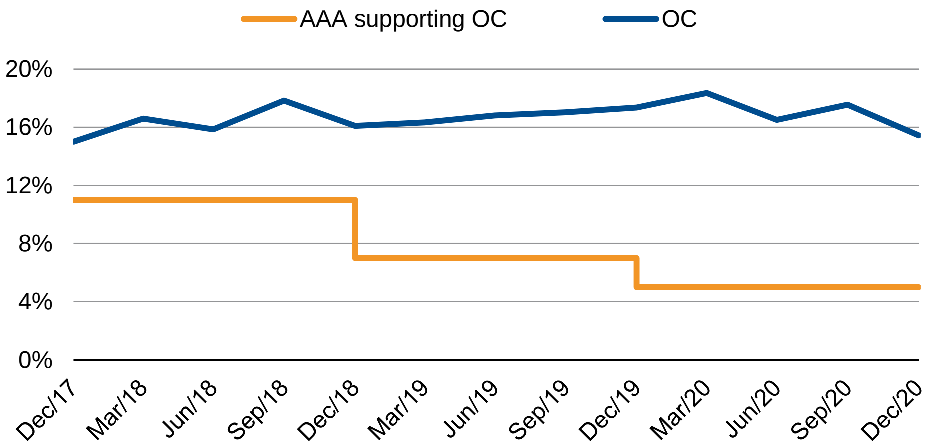
Source: Scope Ratings, Landkreditt

Availability of overcollateralisation

Overcollateralisation fully taken into account

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

Other risk considerations

Counterparty risk mitigated by alignment of interests

The rated covered bonds have counterparty exposures to the issuer, as well as to the issuer's parent 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 the covered bonds issued by LKBol. The issuer has only recently introduced a 'Green Mortgage' product that offers favourable interest rates for the purchase of energy-efficient homes. The share of such loans in the cover pool remains limited.

Environmental aspects, in particular Norwegian energy efficiency standards, have often not been recorded in the bank's main underwriting databases – which is typical among 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 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%.

Reporting date	31 Dec 2020	31 Dec 2019
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)	5.0	4.4
thereof, substitute assets and deposits (NOK bn)	0.0	0.0
Covered bonds (NOK bn)	4.3	3.7
Overcollateralisation: current / legal minimum	15.4% / 2.0%	17.4% / 2.0%
Overcollateralisation to support current rating	5.0%	5.0%
Overcollateralisation upon a one-notch issuer downgrade	6.0%	6.0%
Weighted average life of assets	11.1 years	11.0 years
Weighted average life of liabilities[1]	4.2 years	4.0 years
Weighted average life gap	6.9 years	7.0 years
Number of borrowers	3,020	2,803
Average loan size per borrower (NOK m)	1.6	1.6
Top 10 residential	2.2%	2.2%
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)	44.0%	44.6%
Geographic split (top 3)	Viken = 45.3% Oslo = 30.6% Vestfold og Telemark = 4.8%	Akershus = 33.4% Oslo = 29.2% Buskerud = 6.1%
Default measure	Inverse Gaussian	Inverse Gaussian
Weighted average default rate (mortgage) (annualised/cumulative)	61bps / 10%	60bps / 10%
Coefficient of variation (mortgage)	50%	50%
Weighted average recovery assumption (D0/D8)[2] (mortgage)	99.9% / 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%
Foreign exchange stresses (max./min.; currency-dependent)	n/a	n/a
Maximum liquidity premium	150bps	150bps
Average servicing fee	25bps	25bps

[1] Including the 12-month extension

[2] D0 and D8 denote the stresses commensurate with the rating distance from the minimum and maximum achievable covered bond uplift

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