FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Realkredit Danmark's CC S and CC T Covered Bonds at 'AAA'

Fri 18 Nov, 2022 - 9:49 AM ET

Fitch Ratings - Frankfurt am Main - 18 Nov 2022: Fitch Ratings has affirmed Realkredit Danmark A/S's (A/Stable/F1/a) mortgage covered bonds issued out of Capital Centre (CC) S and CC T at 'AAA'. The Outlooks are Stable.

KEY RATING DRIVERS

The covered bonds' ratings for both programmes are based on Realkredit's Long-Term Issuer Default Rating (IDR) of 'A' and the various uplifts above the IDR granted to the programmes. The ratings also consider overcollateralisation (OC) protection for covered bond holders.

The covered bond programmes are rated five notches above the bank's IDR. This is out of a maximum achievable uplift of eight notches, consisting of a resolution uplift of zero notches, a payment continuity uplift (PCU) of six notches and a recovery uplift of two notches.

The Stable Outlook on both programmes is driven by that on Realkredit's IDR and the three-notch cushion against an IDR downgrade.

For the CC S cover pool, which consists of Danish fixed-rate residential and commercial mortgages, Fitch gives credit to 5.3% OC. This is the lowest nominal OC observed in the past 12 months and provides more protection than the 3% 'AAA' breakeven OC for the programme.

For the CC T cover pool, which consists of Danish floating- and adjustable-rate residential and commercial mortgages, Fitch gives credit to 6.8% OC. This is also the lowest nominal OC observed in the past 12 months and provides more protection than the 3.5% 'AAA' breakeven OC for the programme.

Uplifts

Fitch does not assign a resolution uplift to Realkredit's covered bonds as the issuer is a specialised mortgage lender not operationally integrated into a parent bank and the bail-in tool is not applicable to specialised mortgage banks in Denmark.

The six-notch PCU for both programmes reflects the liquidity protection in place for at least 12 months. The outstanding bonds in CC S have a pass-through amortisation profile and more than 99% of the CC T bonds have extendible maturity. The remaining CC T bonds are hard-bullet and their redemptions are covered by liquid assets for at least 12 months. The six notches also reflect interest payment protection of at least three months in both programmes. The PCU is capped at six notches (instead of eight) as the liquid assets are made up of highly rated bonds and therefore subject to market value risk.

Both programmes are eligible for a recovery uplift of two notches. The combination of a 'AA+' timely payment rating level and a one-notch recovery uplift results in the lowest breakeven OC supporting the 'AAA' ratings.

OC Protection

For CC S, the Fitch 'AAA' breakeven OC is unchanged at 3%. For CC T, the Fitch 'AAA' breakeven OC has increased to 3.5% from 3% since the last review.

The increase in Fitch's 'AAA' breakeven OC for CC T is driven by a lower administrative margin modelled on the assets leading to a lower excess spread in the analysis increasing the ALM loss component from -1.3% to -0.8%.

The breakeven OC for both programmes remains driven by the credit risk of each pool as Fitch does not model a sale of assets in its cash flow analysis, but considers the possibility of bond refinancing post insolvency or models the pass-through or maturity extension of bonds with these features. The 'AA+' credit loss component of the breakeven OC remains at 3.3% for CC S, which is the portfolio loss floor under Fitch's criteria, and is applied to address the idiosyncratic risks of low-risk portfolios. For CC T, the 'AA+' credit loss component has decreased only slightly to 4.4% from 4.5% driven by lower loan-to-value ratios improving recovery prospects for especially the commercial assets.

For the residential assets, Fitch has derived foreclosure frequency (FF) assumptions based on the analysis of vintage cumulative default data, as described under its originator-specific residential mortgage analysis rating criteria. The expected FF is unchanged at 1.00% for the residential assets in CC S and has decreased slightly to 1.51% from 1.53% for CC T, to which Fitch applied the 'high' rating scenario multiples to derive FF in each rating scenario. This is due to the mild economic environment in Denmark and low cumulative defaults.

For recovery prospects, we give full credit to the automated property valuation model used for regulatory purposes, to which we applied the updated market value decline assumptions for each rating scenario, as detailed under the criteria.

Fitch analysed the commercial sub-portfolios under the Appendix 10 of its Covered Bonds Rating Criteria (Commercial Real Estate Loans Securing Covered Bonds Analysis), which references Fitch's SME Balance Sheet Securitisation Rating Criteria. To derive stressed losses for these assets the agency uses its Portfolio Credit Model.

Fitch applied different probability of default (PD) assumptions for each asset according to the bank's internal rating score, with a one-year PD floor at 0.5% and expected average annual default rate at 1.0%. For the social and cooperative housing segment, the expected average annual default rate was unchanged at 0.5% (floored at 0.25% for each loan), given its good historical performance.

We also applied low and high stressed prepayment rates of 0% and 20%, respectively (lower than for residential loans based on historical data), cure rates of 50% in a 'B' scenario and a three-year recovery timing assumption for these loans. The 'AAA' collateral haircuts are 75% for industrial properties and 65% for other commercial properties. For the social and cooperative housing segments, we applied the residential market value declines that are set out in the Originator-Specific Residential Mortgage Analysis Rating Criteria.

For the commercial sub-pool analysis, Fitch tested high and low prepayment assumptions in both its portfolio credit and cash-flow models. The worst-case scenario in our cash flow model was high prepayments for both CC S and CC T. The resulting ALM loss component was -0.3% for CC S and -0.8% for CC T, reflecting the excess spread in the programmes coming from the administrative margins charged to borrowers.

In Fitch's cash flow modelling, the interest payments on both the assets and liabilities is floored at zero when the spread plus index component goes negative, which occurs in Fitch's low interest rate scenarios. However, for these programmes the excess spread is not exposed to market rates and Realkredit can charge the investor negative coupons. To reflect this feature, Fitch increased the margin on both the assets and the bonds so that the excess spread is maintained in the modelled decreasing interest rate scenarios.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The covered bonds are rated 'AAA', which is the highest level on Fitch's scale and cannot be upgraded.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

CC S

The 'AAA' rating of Realkredit's CC S mortgage covered bonds would be vulnerable to a downgrade if Realkredit's Long-Term IDR was downgraded by four notches to 'BBB-' or below, or the level of OC Fitch gives credit to in its analysis falls below the 'AAA' breakeven OC of 3%. If the relied-upon OC decreased to the legal minimum of 8% (of risk-weighted assets), we would downgrade the covered bonds to 'A+', one notch above the bank's IDR.

CC T

The 'AAA' rating of Realkredit's CC T mortgage covered bonds would be vulnerable to a downgrade if Realkredit's Long-Term IDR was downgraded by four notches to 'BBB-' or below, or the level of OC Fitch gives credit to in its analysis falls below the 'AAA' breakeven OC of 3.5%. If the relied-upon OC decreased to the legal minimum of 8% (of risk-weighted assets), we would downgrade the covered bonds to 'A+', one notch above the bank's IDR.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The covered bonds' ratings are driven by the credit risk of the issuing financial institution as measured by its Long-Term IDR.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT		RATING		PRIOR
Realkredit Danmark A/S				
senior secured, Mortgage Covered Bonds, S	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable
senior secured, Mortgage Covered Bonds, T	LT	AAA Rating Outlook Stable	Affirmed	AAA Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

EMEA CMBS and CRE Loan Rating Criteria (pub. 03 Jun 2021) (including rating assumption sensitivity)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 20 Sep 2021)

SME Balance Sheet Securitisation Rating Criteria (pub. 19 Oct 2021) (including rating assumption sensitivity)

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 15 Jul 2022)

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 29 Jul 2022)

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (pub. 01 Aug 2022)

Covered Bonds Rating Criteria (pub. 08 Aug 2022) (including rating assumption sensitivity)

Bank Rating Criteria (pub. 07 Sep 2022) (including rating assumption sensitivity)

CLOs and Corporate CDOs Rating Criteria (pub. 08 Sep 2022) (including rating assumption sensitivity)

Originator-Specific Residential Mortgage Analysis Rating Criteria – Supplementary Data File (pub. 28 Oct 2022)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

ABS Loss Forecaster Model, v1.2.0 (1)

Covered Bonds Cash Flow Model, v2.1.1 (1)

Portfolio Credit Model, v2.15.1 (08 Sep 2022, 19 Oct 2021)

ResiGlobal Model: Europe, v1.8.2 (11 Nov 2022, 11 Nov 2022)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Realkredit Danmark A/S	EU Issued, UK Endorsed

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Structured Finance: Covered Bonds Banks Structured Finance Europe Denmark