FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Frankfurt am Main - 15 Nov 2023: Fitch Ratings has affirmed Realkredit Danmark A/S's (A+/Stable/F1) mortgage bonds issued out of Capital Centre (CC) S and CC T at 'AAA' with Stable Outlooks, following the periodic review of the programmes.

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 the overcollateralisation (OC) protection for covered bond holders. The Stable Outlook on both programmes is driven by that on Realkredit's IDR and a four-notch cushion against an IDR downgrade.

The covered bond programmes are rated four 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.

For the CC S cover pool, which consists of Danish fixed-rate residential and commercial mortgages, Fitch gives credit to 6.2% OC. This is the lowest nominal OC observed in the past 12 months and provides more protection than the 3% 'AAA' break-even 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 6.4% OC. This is also the lowest nominal OC observed in the past 12 months and provides more protection than the 4.0% 'AAA' break-even 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 each programme.

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 break-even OC supporting the 'AAA' ratings.

OC Protection

For CC S, the 'AAA' break-even OC remains unchanged at 3% and for CC T the 'AAA' break-even OC has increased to 4.0% from 3.5% since the last review.

The increase in Fitch's 'AAA' break-even OC for CC T is mainly driven by a larger credit loss due to lower recovery given default, as the loan-to-value ratio of the pool has increased since the last analysis, in addition to a slight increase of the proportion of commercial mortgage loans within the pool.

The break-even 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 break-even 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 worsened slightly to 4.7% from 4.4% driven by higher loan-to-value ratios within the pool.

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 1.0% and 1.5% for the residential assets in CC S and in CC T, respectively. Fitch applied the 'high' rating multiples to derive FF in each rating scenario. This is due to the mild economic environment in Denmark and low historical cumulative defaults.

For recovery prospects, we give 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 11 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 assets/liabilities mismatch (ALM) loss component increased to -0.1% from -0.3% for CC S and to -0.7% from -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:

The 'AAA' ratings of Realkredit's CC S and CC T mortgage covered bonds would be vulnerable to a downgrade if Realkredit's Long-Term IDR is downgraded by five notches to 'BBB-' or below; or if the level of OC Fitch gives credit to in its analysis falls below the 'AAA' break-even OC of 3% and 4.0%, respectively. If the OC of each pool falls to the legal minimum of 8% (of risk-weighted assets), both covered bonds would be downgraded to 'AA-', one notch above the bank's IDR.

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 bank's Long-Term IDR.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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

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

Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum — Effective from August 1, 2022 to November 28, 2023 (pub. 01 Aug 2022)

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 28 Dec 2022)

Structured Finance and Covered Bonds Counterparty Rating Criteria — Effective from March 14, 2023 to November 28, 2023 (pub. 14 Mar 2023)

EMEA CMBS and CRE Loan Rating Criteria (pub. 09 Jun 2023) (including rating assumption sensitivity)

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 07 Jul 2023)

APPLICABLE MODELS

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

ABS Loss Forecaster Model, v1.2.1 (1)

Covered Bonds Cash Flow Model, v2.1.4 (1)

Portfolio Credit Model, v2.16.2 (21 Jul 2023, 19 Oct 2021)

ResiGlobal Model: Europe, v1.8.9 (1)

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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