FitchRatings

Fitch Affirms Realkredit Danmark's Capital Centres S & T Covered Bonds at 'AAA'/'AA+'

Fitch Ratings-Frankfurt/London-01 February 2019: Fitch Ratings has affirmed Realkredit Danmark A/S's (Realkredit, A/Stable/F1/a) mortgage covered bonds issued out of Capital Centre (CC) S at 'AAA', and out of CC T at 'AA+'. The Outlook is Stable. The affirmation follows the implementation of the Originator-Specific Residential Mortgage Analysis Rating Criteria on 11 January, replacing the Denmark Residential Mortgage Rating Criteria Addendum.

KEY RATING DRIVERS
CC S covered bonds' rating is based on Realkredit's Long-Term Issuer Default Rating (IDR) of 'A', a payment continuity uplift (PCU) of six notches, a two-notch recovery uplift and the 5.9% overcollateralisation (OC) that Fitch takes into account in its analysis, which provides more protection than the revised 3.5% 'AAA' breakeven OC. This level supports a 'AA+' tested rating on a probability of default (PD) basis and a one-notch recovery uplift to 'AAA'. The Stable Outlook is driven by the Stable Outlook on Realkredit's IDR and the three-notch cushion against an IDR downgrade.

CC T covered bonds' rating is based on Realkredit's Long-Term IDR of 'A', a PCU of six notches, a two-notch recovery uplift and the 7.1% OC that Fitch takes into account in its analysis, which provides more protection than the unchanged 6.5% 'AA+' breakeven OC. This level supports a 'AA' tested rating on a PD basis and a one-notch recovery uplift to 'AA+'. The Stable Outlook is driven by the Stable Outlook on Realkredit's IDR and the four-notch cushion against an IDR downgrade. The rating is currently constrained by the relied-upon OC.

Fitch currently does not assign an IDR 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 CC S reflects the liquidity protection in place for at least 12 months. 99% of the outstanding bonds have a pass-through amortisation profile while the remaining 1% are hard bullet, whose redemptions are covered by liquid assets for at least 12 months. The six notches also reflect the interest payment protection for at least three months.

The six-notch PCU for CC T reflects the extendible maturity feature of the bonds issued since 2014 and the liquidity protection for the hard-bullet bonds (8%), as their redemptions are covered by eligible liquid assets on a 12-month rolling basis. The six notches also reflect the interest payment protection for at least three months.

Following the implementation of the new Originator-Specific Residential Mortgage Analysis Rating Criteria, we reviewed the approach for modelling the credit losses for Realkredit's residential loans to private borrowers. Expected foreclosure frequency (FF) assumptions for each cover pool are now derived based on the analysis of vintage cumulative default data, which are then multiplied by standardised sets of rating scenario multipliers to determine FF assumptions at stressed rating levels. The expected FF is 1% for the residential assets in CC S and 1.55% for CC T. Fitch applied the high rating scenario multiples. On the recovery side, we now give full credit to automated valuation model used for regulatory purposes (versus 50% credit to upward house price indexation in the old criteria). This results in lower expected losses for both residential sub-pools, to 1.6% for CC S (in a 'AAA' scenario) and 2.3% for CC T (in a 'AA+' scenario). The lower credit loss is the main driver for CC S 'AAA' breakeven OC improvement (to 3.5% from 4.0%) given the high share of residential loans in that pool.

Fitch has analysed the commercial sub-portfolios under the appendix 7 of its Covered Bonds Rating Criteria (Commercial Real Estate Loans Securing Covered Bonds Analysis), which references Fitch's SME Balance Sheet Securitisation Rating Criteria. There were no material changes in Fitch's assumptions for these assets. Fitch uses its Portfolio Credit Model to derive stressed losses for this segment. The expected average annual default rate (90 days' past due) for the performing commercial mortgage portfolio was set at 1.5%. It was set at 0.5% (floored at 0.25% for each loan) for the social and cooperative housing segment, given its very good historical performance. We have taken into account that this segment may gradually reduce over time in both capital centres. 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' market value decline assumptions are 75% for industrial properties, 65% for the other commercial properties. For the social and cooperative housing segments, we applied the residential MVDs set out in the Originator-Specific Residential Mortgage Analysis Rating Criteria.

On the commercial sub-pool analysis, Fitch tested high and low prepayment assumptions in both its portfolio credit model and cash-flows model. For both pools, the worst case scenario was a high prepayment one, resulting in shorter life of assets and thus lower excess spread modelled (resulting ALM loss component of -0.2% for CC S and 0% for CC T), but lower combined credit loss of each pool (3.7% for CC S and 6.7% for CC T). The breakeven OC for both covered bond 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 such features.

RATING SENSITIVITIES
Realkredit Capital Centre (CC) S Covered Bonds
The rating would be vulnerable to a downgrade if any of the following occurs: (i) Realkredit's Long-Term IDR is downgraded by four notches to 'BBB-' or below; (ii) the PCU is lowered to two notches; or (iii) the relied-upon OC decreases below Fitch's 'AAA' breakeven OC of 3.5%. Should the relied-upon OC decrease to the legal minimum of 8% of risk-weighted assets, the covered bonds would be downgraded to 'A+'.

Realkredit CC T Covered Bonds
The rating would be vulnerable to a downgrade if any of the following occurs: (i) Realkredit's Long-Term IDR is downgraded by five notches to 'BB+' or below; (ii) the PCU is lowered to one notch; or (iii) the relied-upon OC decreases below Fitch's 'AA+' breakeven OC of 6.5%. The rating of CC T could be upgraded to 'AAA' should the relied-upon OC increase to 8%. Should the relied-upon OC decrease to the legal minimum, the covered bonds would be downgraded to 'A+'.

Fitch's breakeven OC for a given covered bond rating will be affected by, among other factors, the profile of the cover assets relative to outstanding covered bonds, which can change over time even in the absence of new issuance. Therefore, the breakeven OC for the covered bond rating cannot be assumed to remain stable over time.

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Additional information is available on www.fitchratings.com
Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
CLOs and Corporate CDOs Rating Criteria (pub. 19 Jul 2018)
Covered Bonds Rating Criteria (pub. 11 Jan 2019)
European RMBS Rating Criteria (pub. 21 Dec 2018)
Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds - Excel File (pub. 02 Feb 2018)
Fitch’s Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File (pub. 30 Oct 2017)
Originator-Specific Residential Mortgage Analysis Rating Criteria (pub. 11 Jan 2019)
SME Balance Sheet Securitisation Rating Criteria (pub. 23 Feb 2018)
Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 01 Aug 2018)
Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum (pub. 01 Aug 2018)
Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 23 Oct 2018)
Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 02 Feb 2018)

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