FitchRatings

Banks
Retail & Consumer Banks
Denmark

Realkredit Danmark A/S

Key Rating Drivers

Strong Credit Profile: Realkredit Danmark A/S's ratings reflect its low risk appetite and strong asset quality metrics, which balance its monoline business model and undiversified, though stable, earnings. They also consider Realkredit's well-entrenched mortgage lending franchise in Denmark, strong capitalisation and well-managed reliance on wholesale funding. The bank's IDRs are also underpinned by potential parental support from Danske Bank A/S (A/Stable/a).

Capital Fungibility Constraints VR: Realkredit's Viability Rating (VR) is rated in line with that of its parent as Fitch Ratings believes there is a high correlation between the two VRs because of a high level of capital fungibility. Consequently, we are likely to retain Realkredit's VR within one notch of that of its parent, unless the fungibility of capital decreases.

Strong Asset Quality: Realkredit's asset quality is a rating strength. Credit risk exposure solely comprises mortgage lending, the tight underwriting of which is underpinned by conservative Danish covered-bond and mortgage-lending legislation. Realkredit's loan book is geographically concentrated in Denmark and strongly linked to the performance of the Danish economy. We expect asset quality to hold up, despite the economic slowdown and the impaired loans ratio should not increase materially above 2%.

Undiversified but Stable Earnings: Realkredit's profitability is weaker than that of similarly rated peers as its income is solely reliant on its lending activity. Realkredit's lack of revenue diversification is offset by low credit losses and robust cost efficiency.

Strong Capitalisation: Realkredit's capitalisation is underpinned by its low-risk business model and solid capital surplus over regulatory minimums, giving the bank a sufficient cushion to absorb potential credit losses and risk-weighted assets (RWAs) inflation. Realkredit is subject to standalone capital requirements, which underpins our view of its capitalisation.

Solely Wholesale Funded: Realkredit relies extensively on wholesale funding because mortgage lending is, by law, entirely funded by covered bonds in Denmark. We believe the risk of Realkredit not being able to access the covered bond market is low due to strong demand for these bonds from Danish financial institutions, insurance companies and pension funds. Refinancing risk is also mitigated by the bank's good liquidity buffer and potential ordinary support from Danske if needed.

Rating Sensitivities

Revised Support Assessment: Realkredit's IDR could be upgraded if Danske's IDRs are upgraded, assuming it retains its core role within the group. In addition, a downgrade of its parent's VR by more than one notch could lead to a downgrade of Realkredit's ratings, given the high correlation we believe exists between the two ratings.

Eroded Capitalisation: We would downgrade Realkredit's VR if we expect it will not be able to maintain its common equity Tier (CET1) ratio above 14% or restore it to that level within a short time. This could be due to significantly higher-than-expected loan impairment charges (LICs) driven by a prolonged recession, high unemployment and a material property price correction.

Constrained Funding Access: An adverse change in investor sentiment requiring extraordinary support from the parent, due to a material weakening of Realkredit's ability to access competitively priced covered bond funding, would be negative for the bank's VR. An increased reliance on international debt investors who could prove less stable during financial stress would also put pressure on ratings.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Support Rating	1
Sovereign Risk	
Long-Term Foreign- and Local-Currency IDRs	AAA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign- and Local-Currency IDRs	Stable

Applicable Criteria

Bank Rating Criteria (November 2021)

Related Research

Danske Bank A/S (July 2022)

Large European Banks Quarterly Credit Tracker (June 2022)

Global Economic Outlook (June 2022)

Potential Material AML Fine for Danske Is Rating Neutral (April 2022)

Fitch Affirms Denmark at 'AAA'; Outlook Stable (February 2022)

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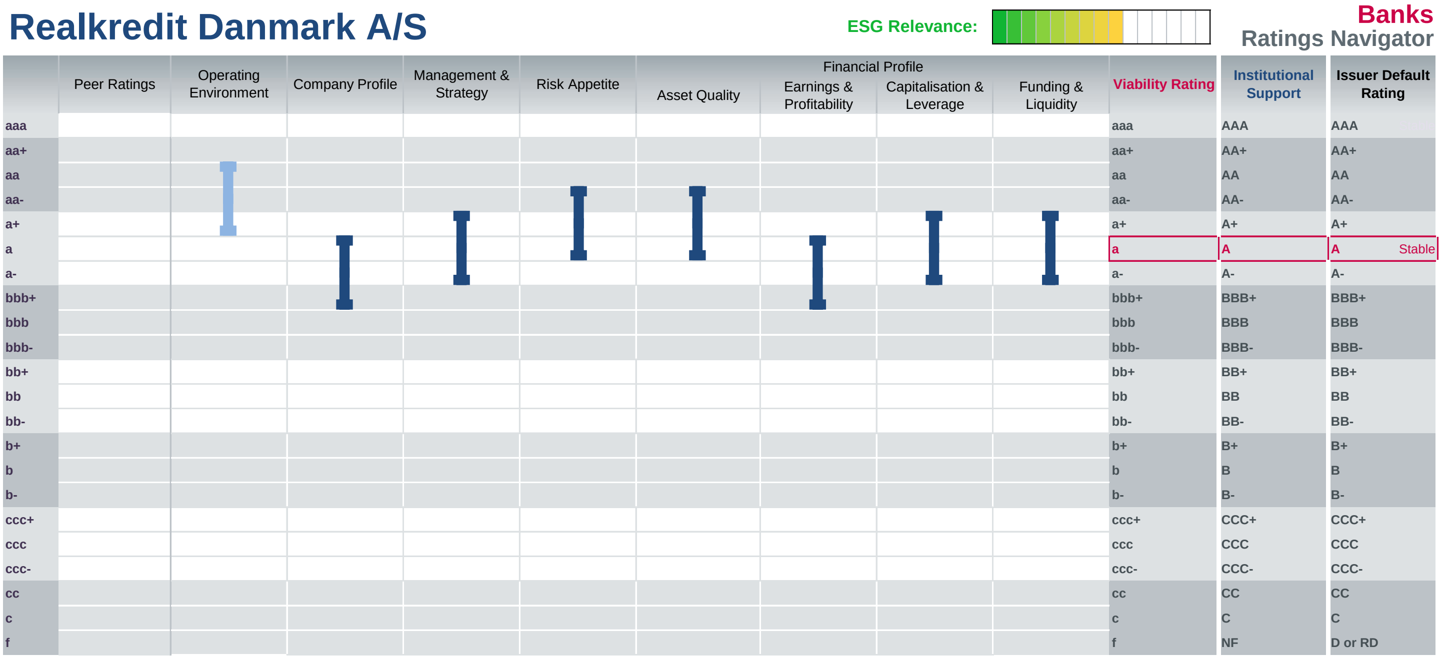


Significant Changes

Resilient Danish Operating Environment

Realkredit's operations are concentrated in Denmark, which presents very good opportunities for banks to be consistently profitable. The economic environment and sovereign credit profile are strong and structural weaknesses are very limited, underpinned by strong levels of employment and a healthy sovereign fiscal position. We expect real GDP growth of 2.4% in 2022, down from our 3.1% expectation at the beginning of the year, which is in line with Denmark's pre-pandemic five-year average growth rate. The economy will decelerate after a recent post-pandemic cyclical upswing driven by high levels of domestic and foreign demand, expansionary fiscal and financial conditions and a pronounced recovery of the labour market.

Danish household indebtedness is high in an international context, due to high house ownership, financed by mortgage loans. The high inflation, rise in long-term interest rates and the projected monetary tightening will dampen real spending power, but should be manageable for Nordic households, which have accumulated sizeable savings during the pandemic.

We expect a moderate rise in bankruptcies largely coming from financially weaker SMEs in the sectors worst-hit by the pandemic, as well as from those vulnerable to higher commodity and energy prices and the interest rate hike cycle. This should also increase appetite for bank credit, which has been dampened during the pandemic by government liquidity support measures and loan schemes. Banks in Denmark have sufficient liquidity to meet higher corporate loan demand.

Institutional Support Assessment

Institutional Support			Value
Parent IDR			A
Total Adjustments (notches)			+0
Institutional Support:			**A**
Support Factors (negative)	Equalised	1 Notch	2+ Notches
Parent ability to support and subsidiary ability to use support			
Parent/group regulation	✓		
Relative size		✓	
Country risks	✓		
Parent Propensity to Support			
Role in group	✓		
Potential for disposal	✓		
Implication of subsidiary default	✓		
Integration	✓		
Size of ownership stake	✓		
Support track record	✓		
Subsidiary performance and prospects	✓		
Branding		✓	
Legal commitments			✓
Cross-default clauses			✓

We believe there is extremely high probability that Realkredit would be supported, if ever required, by its parent. Danske has strong incentives to provide extraordinary support as we consider Realkredit a core and integral part of the group. Danske originates all mortgage loans in Denmark via Realkredit and overall mortgage lending represents the majority of all domestic lending. Any required support for Realkredit would likely be manageable relative to the ability of Danske to provide it.

Realkredit's management and corporate culture are highly integrated into Danske's and Realkredit shares some central functions and distribution channels with its parent bank, which we regard as ordinary support. Realkredit also benefits from shared risk management practices within the group.

Brief Company Summary

Second-Largest Mortgage Bank in Denmark

Realkredit is a wholly-owned mortgage bank subsidiary of Danske (the largest financial institution in Denmark) and the second-largest specialist mortgage bank in Denmark, with a market share of about 25%. Realkredit serves all customer segments in Denmark (where the vast majority of credit exposure resides), while the strategy in Sweden and Norway is to serve large commercial and residential real estate companies.

Realkredit's business model is monoline, but it balances low-risk appetite and stable income. Realkredit has been less vulnerable to negative interest rates than commercial banks because of the mortgage financing pass-through model in Denmark. Mortgage lending is, by law, financed through covered bonds and Realkredit is a large issuer of these securities internationally.

Mortgage loans for private individuals and SMEs are distributed through Realkredit's own real estate agency chain and Danske's branch network. The largest customers in Denmark, Norway and Sweden are served by a dedicated unit specialised in property mortgage advisory.

Low Risk Appetite

Realkredit observes tight underwriting standards for mortgage loans. These are underpinned by the conservative Danish covered bond legislation and regulatory constraints set by the Danish FSA. Realkredit applies a loan/value (LTV) regulatory cap of 80% for most mortgage loans and 60% for riskier lending, such as financing agricultural, office or retail properties.

At end-March 2022, the average LTV ratio was 51% compared with 60% at end-2020. Since 2H12 average LTVs have gradually declined across all customer segments, driven partly by conservative underwriting standards and partly by increasing property prices. We expect a moderate fall in residential property prices from 2H22, which we view as a natural cool-off after the pandemic-driven surge in prices in 2020-2021. Between March 2020 and May 2022 the prices of single-family homes and apartments grew by 23% and 30%, respectively, and we expect prices to remain above the pre-pandemic levels.

Realkredit's principal segment is residential mortgage loans (owner-occupied housing and holiday homes). The remaining segments are residential and commercial real estate and agriculture. We do not expect the bank's segment mix to change in the foreseeable future.

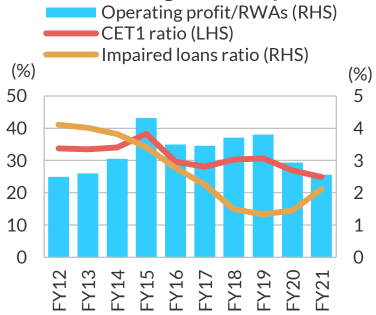
The share of fixed-rate residential mortgage loans increased materially in 2019 and 2020, driven by low rates and high re-mortgaging activity. This trend abruptly reversed in 1H22 as customers switched to variable-rate loans (which will likely to continue), due to a sharply steepened yield curve. The lower fair value of fixed-rate mortgage debt due to higher interest rates incentivises borrowers to refinance their loans, using a new variable rate loan.

At end-March 2022, the back book was evenly split between fixed-rate (10–30 years) and variable-rate mortgage loans. During the underwriting of long-term loans with an interest rate fixed for a short period (such as five years), the bank stress tests borrowers' repayment capacities. It assumes there will be a 30-year amortising loan with a materially inflated interest rate of at least 4%.

Realkredit's recent lending growth has been modest. The contraction in the loan portfolio in 1H22 reflects fair-value adjustment, while the underlying growth was broadly stable. We expect annual credit expansion to remain below 2%.

Realkredit's market risk exposure is low. The structural interest rate risk in the banking book is insignificant because there is no interest rate mismatch between mortgage loans and covered bonds, and both are carried at fair value.

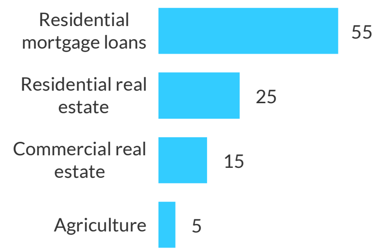
Results Through-The-Cycle



Source: Fitch Ratings, banks

Loans by Segments (%)

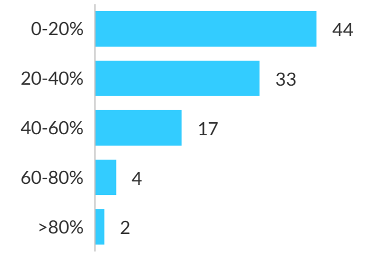
End-2021



Source: Fitch Ratings, Realkredit

LTV Split (%)

End-2021



Source: Fitch Ratings, Realkredit

Summary Financials and Key Ratios

	31 Dec 21		31 Dec 20	31 Dec 19	31 Dec 18
	Year end	Year end	Year end	Year end	Year end
	(USDm)	(DKKm)	(DKKm)	(DKKm)	(DKKm)
	Audited - unqualified	Audited - Unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	956	6,285	6,496	6,905	7,008
Net fees and commissions	-19	-127	-21	-528	-617
Other operating income	-29	-191	-296	336	58
Total operating income	908	5,967	6,179	6,713	6,449
Operating costs	151	995	864	812	703
Pre-impairment operating profit	756	4,972	5,315	5,901	5,746
Loan and other impairment charges	41	269	335	265	196
Operating profit	715	4,703	4,980	5,636	5,550
Tax	157	1,034	1,097	1,240	1,213
Net income	558	3,669	3,883	4,396	4,337
Other comprehensive income	2	13	14	-18	-13
Fitch comprehensive income	560	3,682	3,897	4,378	4,324
Summary balance sheet					
Assets					
Gross loans	123,725	813,477	819,827	805,858	799,386
- Of which impaired	2,607	17,139	11,925	10,732	11,879
Loan loss allowances	446	2,930	2,801	2,736	2,792
Net loans	123,279	810,547	817,026	803,122	796,594
Interbank	2,277	14,969	24,993	53,772	21,285
Derivatives	6	40	39	128	66
Other securities and earning assets	7,062	46,435	47,187	52,363	51,158
Total earning assets	132,624	871,991	889,245	909,385	869,103
Cash and due from banks	559	3,674	52	54	161
Other assets	203	1,334	1,971	3,109	1,953
Total assets	133,386	876,999	891,268	912,548	871,217
Liabilities					
Interbank and other short-term funding	304	2,000	2,000	4,003	778
Other long-term funding	124,861	820,950	835,217	853,479	815,043
Trading liabilities and derivatives	2	16	17	5	68
Total funding and derivatives	125,168	822,966	837,234	857,487	815,889
Other liabilities	694	4,561	4,444	5,068	5,413
Total equity	7,524	49,472	49,590	49,993	49,915
Total liabilities and equity	133,386	876,999	891,268	912,548	871,217
Exchange rate		USD1 = DKK6.5749	USD1 = DKK6.1138	USD1 = DKK6.6759	USD1 = DKK6.5194

Source: Fitch Ratings, Fitch Solutions, Realkredit

Summary Financials and Key Ratios

	31 Dec 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.6	2.9	3.8	3.7
Net interest income/average earning assets	0.7	0.7	0.8	0.8
Non-interest expense/gross revenue	16.7	14.0	12.1	10.9
Net income/average equity	7.6	8.0	9.0	8.9
Asset quality				
Impaired loans ratio	2.1	1.5	1.3	1.5
Growth in gross loans	-0.8	1.7	0.8	0.9
Loan loss allowances/impaired loans	17.1	23.5	25.5	23.5
Loan impairment charges/average gross loans	0.03	0.04	0.03	0.02
Capitalisation				
Common equity Tier 1 ratio	24.9	26.9	30.7	30.3
Tangible common equity/tangible assets	5.6	5.6	5.5	5.7
Basel leverage ratio	5.1	5.0	4.9	5.1
Net impaired loans/common equity Tier 1	31.1	20.0	17.6	20.0

Source: Fitch Ratings, Fitch Solutions, Realkredit

Key Financial Metrics – Latest Developments

Prudent Underwriting Mitigates Credit Losses

Asset quality metrics have been resilient in the past two years due to limited direct exposure to industries that are vulnerable to the pandemic, prudent collateralisation and underwriting standards, no excessive growth and the strong property market. The higher impaired loans ratio of 2021 reflects the alignment of customer staging within the Danske group, which had no impact on credit losses due to sufficient collateralisation.

Realkredit's low coverage of impaired loans by specific loan loss allowances (6% at end-2021) is appropriate given generally low LTVs and a long record of low credit losses. LICs had a decade-high of about 20bp of gross loans in 2013 and equalled about 3bp in 2017–2021. Danish legislative framework enforces creditor rights and incentivises mortgage repayment.

Potential asset quality pressure in Danish mortgage loans is low as only 11% of loans must be refinanced in 2021. The actual volumes are likely to be higher due to prepayment incentives brought about by higher interest rates for borrowers with long-term fixed-rate loans.

Stable, but Low, Profitability

The bank's overall profitability is moderate, mainly due to thin margins, but it should be viewed in light of its low-risk business model, its healthy and recurring revenue, tight cost control and historically contained credit losses. The interest rate hike cycle will be broadly neutral for the bank's profitability because the income from mortgage lending is not directly linked to market interest rates. Mortgage loans in Denmark are funded by covered bonds, the cost of which is directly passed on to borrowers, while Realkredit charges administrative margins, which have been under moderate pressure recently.

We expect Realkredit's operating profit/RWAs to remain in line with an 'a' category score, but most likely to remain below 3%. The bank's superior cost efficiency reflects low burden from overheads that are centralised at the parent level, which we regard as ordinary support due to Realkredit's important role in the group.

Robust Capitalisation

Realkredit's CET1 ratio of 24.9% at end-2021 benefits from low risk-weights on mortgage loans, but its leverage ratio of 5.1% is adequate in a European context. At end-2021, Realkredit's total regulatory capital ratio (almost solely comprising equity) was almost 10pp above the requirement. This level is sufficient to absorb the expected material inflation in RWAs in the coming years as a result of EBA guidelines and Basel IV. In our assessment we also consider Realkredit's high product concentration and potential ordinary capital support from the parent.

Danish mortgage banks are exempt from the minimum requirements for own funds and eligible liabilities, but must maintain a bail-in-able debt buffer corresponding to 2% of loans. For now, Realkredit observes this buffer using its capital surplus. The expected RWA increase will reduce the capital surplus and, as a result, Realkredit will use bail-in-able loans from Danske to meet the buffer in the future, which will be easily manageable by the parent.

Low Refinancing Risk

Realkredit issues covered bonds on an ongoing basis and loan origination is not dependent on available liquidity. The bank's refinancing risk is mitigated by the efficiently-functioning Danish covered bond market (including numerous stress periods), distributed quarterly refinancing auctions, and loan pricing promoting loans with less frequent refinancing periods.

The covered bond law transfers the refinancing risk to the investor (in the event of a failed auction), but this has not been tested yet. Consequently, it is important for Realkredit to maintain a significant liquidity portfolio to maintain investor confidence. This may be particularly important in the case of foreign investors (about 25% of all covered bond investors).

High asset encumbrance is mitigated by robust asset quality of loans, large overcollateralisation and no other outstanding senior obligations to a third-party creditor. At end-2021 Realkredit's liquidity buffer equalled 190% of the regulatory requirement (corresponding to at least 2.5% of mortgage loans). The requirement is additional to the liquidity coverage ratio, which was comfortably above 100%.

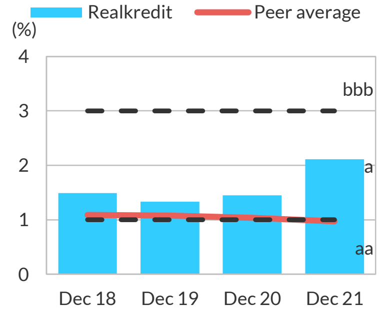
Note on Charts

Black dashed lines represent indicative quantitative ranges and implied scores for Fitch's core financial metrics for banks operating in the environments that Fitch scores in the 'aa' category. Light-blue columns represent Fitch's forecasts.

Peer average includes Landshypotek Bank AB (VR: a), Nykredit Realkredit A/S (a), Nationwide Building Society (a), Svenska Handelsbanken AB (aa), Swedbank AB (aa-), Yorkshire Building Society (a-), de Volksbank N.V. (a-).

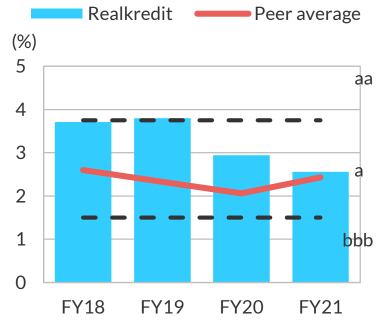
Financial year-end for Nationwide Building Society is 4 April.

Impaired Loans/Gross Loans



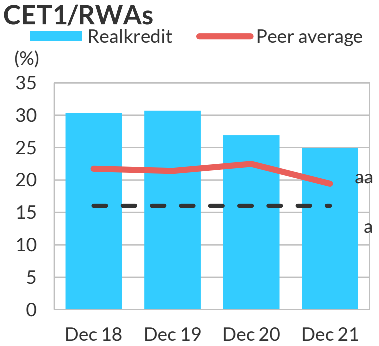
Source: Fitch Ratings, banks

Operating Profit/RWAs



Source: Fitch Ratings, banks

CET1/RWAs



Source: Fitch Ratings, banks

Environmental, Social and Governance Considerations

FitchRatings **Realkredit Danmark A/S**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Realkredit Danmark A/S has 5 ESG potential rating drivers

- Realkredit Danmark A/S has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have a minimal credit impact on Realkredit, either due to their nature or to the way in which they are being managed by the bank. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.