Credit Rating Announcement

30 June 2022

Scope affirms at AAA/Stable the covered bonds issued out of Realkredit's capital centres S and T

The issuer rating of A+ combined with governance support results in the highest achievable ratings for the mortgage covered bonds. The cover pool provides additional rating stability.

The latest information on the rating, including rating reports and related methodologies, is available on this LINK.

Rating action

Scope Ratings GmbH (Scope) has today affirmed the AAA rating assigned to the Danish mortgage covered bonds (særligt dækkede realobligationer) issued by Realkredit Danmark A/S (Realkredit) out of capital centre S and capital centre T. All ratings have a Stable Outlook.

Key rating drivers

Solid issuer rating (positive)[1]. Realkredit has a solid issuer rating of A+. It is a core and closely integrated subsidiary of Danske Bank A/S, which itself has a solid market position. As the second largest mortgage lender in Denmark, Realkredit has reassuring profitability and prudential capital metrics.

Governance support (positive)[2]. Governance support is the primary rating driver for both capital centres. It provides the covered bonds with six notches of uplift above the issuer rating. As such, only four notches are needed to raise the covered bonds ratings to the highest achievable level. The analysis takes into account the transposition of the European covered bonds directive into Danish law, which is neutral for Scope's assessment of governance support regarding the rated covered bonds. (ESG factor)

Cover pool support (positive)[3]. The capital centre-specific cover pool analyses support additional rating stability. This is reflected by:

1. **Cover pool complexity (CPC) category (positive)**. Scope has classified the issuer's management of the interplay between complexity and transparency provided to investors with a 'low' CPC category, allowing for a maximum additional uplift of up to three notches on top of the governance uplift. (ESG factor)

2. **Overcollateralisation (positive)**. The 5.7% of overcollateralisation as of 30 March 2022 for capital centre S and 6.8% for capital centre T can shield the current AAA ratings against an issuer downgrade of up to five notches.

3. **Sound credit quality (positive)**. The cover pools comprise a mix of residential and commercial assets, predominantly secured by Danish mortgages. The cover assets benefit from a low average loan-to-value ratio of about 48% for both capital centres.

4. **Market risks (positive)**. Aided by the Danish balance principle, market risks (in particular, asset-liability mismatches) are nearly eliminated.

One or more key drivers of the credit rating action are considered an ESG factor.

Rating-change drivers

Scope's Stable Outlook on the covered bonds reflects a rating buffer of five notches, including three notches of potential cover pool support. The ratings may be downgraded upon: i) an issuer rating downgrade by more than five notches; ii) a deterioration in Scope's view on governance support factors relevant to the issuer and Danish covered bonds in general and on the interplay between complexity and transparency; and/or iii) an inability of the cover pool to provide an uplift in case the issuer rating is downgraded by more than two notches.

Quantitative analysis and assumptions

The cash flow analysis projected cover pool defaults assuming an inverse Gaussian distribution. Scope derived an effective weighted-average lifetime mean default rate of 2.3% for capital centre S and 2.4% for capital centre T, after applying a cure rate of 50%, and weighted-average coefficients of variation of respectively 48% and 75%. The coefficient of variation for capital centre T assumes increased borrower defaults in case of an increase in margins by up to 500bp and a failure to refinance the covered bonds. These assumptions were based on the bank's credit performance data, in particular vintage and loss data, as well as benchmarking.

Scope also assumed asset-recovery rates ranging between 96.5% in the base scenario and 74.3% in the stressed scenario for capital centre S and between 95.1% and 79.6%, respectively, for capital centre T. Scope established total security-value haircuts for the properties securing the mortgage loans of 20.0%-65% in the base scenario and 42.5%-80% in the stressed scenario, with the level depending on the location and type of property.

The credit risk analysis of substitute assets used a portfolio-analysis framework. The portfolio's default and loss distribution did not materially contribute to the credit risk of the mortgage portfolios due to its strong credit quality.

Scope used the resulting loss distribution and default timing to project the covered bond programmes' losses and reflect their amortisation structures. The analysis also incorporated the impact of rating-distance-dependent interest-rate and foreign exchange stresses. The Danish balance principle covered bond programmes are not very sensitive to changes of market-risk parameters. Scope used a 'lower for longer' scenario in which interest rates drop to a minimum of negative 1% after two years and remain at that rate until the last bond has been repaid. In combination with high prepayment scenarios, the programmes were most sensitive to an appreciation of the euro, Norwegian krone and Swedish krona against the base currency – the Danish krone – by up to 35% in the most stressful scenario.

Scope tested for low (1%) and high (up to 25%) prepayments to stress the programmes' sensitivity to unscheduled repayments. Both programmes are most sensitive to high prepayments as these reduce the available excess spread over the transaction's life.

Recovery lag assumptions were 18 months for residential loans and 30 months for commercial loans and substitute assets. A weighted annual average servicing fee of 27bp was assumed for capital centre S and 31bp for capital centre T.

To calculate the cover pools' net present value in the event of an asset sale (on the remaining grandfathered bullet bonds or an interest shortfall), refinancing premiums of 150bp for residential mortgage loans and 300bp for commercial mortgage loans were added to the rating-distance and scenario-dependent discount curve.

Rating driver references

1. Realkredit Danmark A/S – public issuer rating
2. Governance support assessment Denmark
3. Confidential and public quarterly cover pool reporting, complementary annual performance updates

Stress testing

No stress testing was performed.

Cash flow analysis

The Credit Ratings uplift is based on a cash flow analysis using Scope Ratings' covered bond model (Covered Bonds Expected Loss Model version 1.0). The model applies Credit Rating distance-dependent stresses to scheduled cash flows to simulate the impact of increasing credit and market risks. The model outcome is the expected loss for a given level of overcollateralisation.

Methodology

The methodologies used for these Credit Ratings and Outlooks, (Covered Bond Rating Methodology, 25 April 2022; General Structured Finance Rating Methodology, 17 December 2021; Counterparty Risk Methodology, 13 July 2021), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The models used for these Credit Ratings and Outlooks are (Covered Bonds Expected Loss Model version 1.0; Portfolio Model version 1.0) available in Scope Ratings' list of models, published under https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://scoperatings.com/governance-and-policies/regulatory/eu-regulation. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/governance-and-policies/rating-governance/definitions-and-scales. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The Outlook indicates the most likely direction of the Credit Ratings if the Credit Ratings were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The Rated Entity and/or its Related Third Parties participated in the Credit Rating process.
The following substantially material sources of information were used to prepare the Credit Ratings: public domain, the Rated Entity, third parties and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting the/these Credit Rating(s) originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data.
Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and Outlooks and the principal grounds on which the Credit Ratings and Outlooks are based. Following that review, the Credit Ratings were not amended before being issued.

Regulatory disclosures

These Credit Ratings and Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and Outlooks are UK-endorsed.
Lead analyst: Mathias Pleißner, Senior Director
Person responsible for approval of the Credit Ratings: Benoit Vasseur, Executive Director
The Credit Ratings/Outlooks were first released by Scope Ratings on 29 August 2018. The Credit Ratings/Outlooks were last updated on 3

August 2021.

Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

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With more than 250 employees operating from offices in Berlin, Frankfurt, Hamburg, London, Madrid, Milan, Oslo and Paris, Scope Group is the leading European provider of independent credit ratings, ESG and fund analysis. Based on forward-looking and innovative methodologies, Scope offers a European perspective that contributes to greater diversity of opinion for institutional investors worldwide. **Scope Ratings** is the largest European credit rating agency, registered in accordance with EU and UK rating agency regulation, offering opinion-driven and non-mechanistic credit risk analysis. **Scope ESG Analysis** provides tools for analysing and reporting on ESG impact and risk, as well as second-party opinions on green, social and sustainable bonds. **Scope Fund Analysis** rates more than 10,000 funds and asset managers across all major asset classes. The shareholders of Scope Group include CEO and founder Florian Schoeller and anchor shareholder Stefan Quandt, numerous senior personalities in European finance and industry as well as institutional investors from several European countries. More on www.scopegroup.com

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