Scope Ratings affirms at AAA/Stable the Austrian mortgage-covered bonds issued by Wüstenrot

Lower stressed maturity mismatches result in lower overcollateralisation needed to support the rating. The credit quality of the domestic residential cover pool remains sound. High stakeholder cohesiveness increases the rating floor.

Rating action

Scope Ratings GmbH (Scope) has today affirmed its AAA/Stable rating on the Austrian covered bonds (Hypothekenpfandbriefe) issued by Salzburg-based Bausparkasse Wüstenrot AG (Wüstenrot). The Outlook remains Stable.

Rating rationale

Sound issuer rating (positive). Wüstenrot's sound credit quality[1] reflects its low-risk business profile and adequate capitalisation.

Cover pool support (positive). Cover pool support[2] is the primary rating driver and adds as much as seven notches of credit uplift, two notches on top of governance support factors. The cover pool uplift reflects:

1. **Cover pool complexity category (positive).** Scope assigns the interplay between complexity and transparency a cover pool complexity category of 'low', allowing for a maximum additional uplift of three notches on top of the governance uplift. (ESG factor).

2. **Overcollateralisation (positive).** The 30.2% of overcollateralisation as of 31 March 2022, on an eligible-loan basis, shields the covered bonds from market and credit risks and is well above the minimum 6.0% of overcollateralisation that supports the additional two-notch cover pool-based uplift.

3. **Sound credit quality (positive).** The cover pool solely comprises residential and domestic cover assets with a low average unindexed eligible loan to value of about 50%.

4. **Asset-liability management (negative).** Mismatch risk is low. The programme remains exposed to low interest rates, reflecting a 28.5% share of floating-rate assets against 4.4% of floating-rate covered bonds. This is further amplified when stressing potential mortgage prepayments. The excess spread provided by the cover pool over the low-coupon covered bonds, however, reduces the potential costs of carry.

Governance support (positive). The strength of the Austrian legal covered bond and resolution framework[3] supports up to five notches of uplift above the issuer rating, up from four notches previously. This provides a floor against a deterioration in the credit quality of the cover pool (ESG factor).

Stronger visibility and higher domestic stakeholder cohesiveness drive the increase in governance support. This reflects the consolidation of the previous three covered bond legislations into one, ongoing industry efforts to create a common Austrian covered bond brand and the regular use of public placements, also among midsize banks.

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

Rating-change drivers

Scope's Stable Outlook on the mortgage-covered bonds reflects a rating buffer of one notch from cover pool support. The rating may be downgraded upon: i) a deterioration in Scope's view on the credit quality of the issuer by more than one notch; ii) a deterioration in Scope's view on governance support factors (ESG factor) relevant to the issuer and Austrian mortgage-covered bonds in general as well as on the interplay between complexity and transparency (ESG factor); and/or iii) an inability of the cover pool to provide additional rating uplift.

Quantitative analysis and assumptions

Scope's projections of default on Wüstenrot's mortgage loans use an inverse Gaussian distribution. Scope derived an effective lifetime mean default rate of 7.5% and coefficient of variation of 60%, based on internal loan-by-loan risk assessments provided by the bank and benchmarking.

Scope's recovery rate calculations reflect rating-distance-dependent market value declines as well as assumptions regarding the Austrian housing market and its unique characteristics. Scope's stressed security values range between 50.0% and 67.5%, depending on the property's location. This results in a recovery rate in the most stressed scenario of 90.0% (unchanged).

Credit risk only accounts for 2pp of the 6.0% rating-supporting overcollateralisation, reflecting the low-risk nature of the fully residential mortgage cover pool.

Scope used the resulting loss distribution and default timing to project the covered bond programme's losses and reflect its amortisation structure. The analysis also incorporates the impact of rating-distance-dependent interest rate stresses. The covered bond programme is most sensitive to a 'lower for longer' scenario, in which interest rates drop to negative 1% after two years and remain at that rate until the last bond has been repaid. This reflects the interest rate mismatch, with 96% of fixed-rate covered bonds against only 72% of fixed-rate cover assets. High prepayments (15%) would amplify the impact as the weighted average life of cover assets would reduce to five years from the scheduled 14 years and the generated cash would accrue interest based on the short-term market rate.

Market risk accounts for 4pp of the 6% rating-supporting overcollateralisation, 6pp below the 10pp Scope calculated in its previous analysis. The decrease mainly reflects Wüstenrot's issuance of two low-coupon, medium-term sub-benchmarks after Scope's last review, resulting in less interest rate paid on the covered bonds. As of 31 March 2022, the weighted average life of covered bonds is 9.4 years, around five years less than in the previous analysis, leading to a significantly lower cost of carry.

Wüstenrot's issuance activity, however, comes at the cost of a less balanced covered bond maturity profile.

Around 60% of the covered bonds outstanding are expected to mature in a window of less than 1.5 years, between late 2028 and early 2030. If recourse to the cover pool is needed shortly before, this would create material liquidity gaps and the need for stressed asset sales. Scope accounted for this risk in its sensitivity analysis.

To calculate the cover pool's net present value in the event of an asset sale, a refinancing premium of 150bp for Austrian residential mortgage loans was added to the rating-distance- and scenario-dependent discount curve.

The analysis applies country- and asset-type-specific servicing fees paid annually by the cover pool. For the residential mortgage loans, Scope assumed a servicing fee of 25bp. Scope further assumed a recovery timing of 30 months for residential mortgage loans in Austria.

To reinforce the assessment of rating-supporting overcollateralisation, Scope also tested the programme's sensitivity against prepayments of up to 25%, front-loaded defaults and its forward looking view on the programme's liability cash flow structure.

Rating driver references

1. Wüstenrot – private issuer rating (Confidential)
2. Confidential quarterly cover pool reportings (Confidential)
3. Govenance support assessment Austria

Stress testing

No stress testing was performed.

Cash flow analysis

The Credit Rating 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 this Credit Rating and/or Outlook, (Covered Bond Rating Methodology, 25 April 2022; General Structured Finance Rating Methodology 17 December 2021), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.

The model used for this Credit Rating and/or Outlook (Covered Bonds Expected Loss Model version 1.0) is 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 Rating if the Credit Rating was 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 Rating: public domain, the Rated Entity, and Scope Ratings' internal sources.

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Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Rating and/or Outlook and the principal grounds on which the Credit Rating and/or Outlook are based. Following that review, the Credit Rating was not amended before being issued.

Regulatory disclosures

The Credit Rating and/or Outlook is issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Rating and/or Outlook is UK-endorsed.

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The Credit Rating and/or Outlook was first released by Scope Ratings on 6 April 2017. The Credit Rating and/or Outlook was last updated on 7 July 2021.

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