Credit Rating Announcement

10 May 2023

Scope affirms AAA rating of Wüstenrot's Austrian mortgage-covered bonds, with Stable Outlook

The issuer's sound credit strength combined with governance and cover pool support result in the highest rating. Market risks are moderate. Sound credit quality from domestic, residential and low loan-to-value cover assets.

Rating action

Scope Ratings GmbH (Scope) has today affirmed its AAA/Stable ratings 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.

Governance support (positive). The strength of the Austrian legal covered bond and resolution framework[2] supports up to five notches of uplift above the issuer rating. This effectively provides a floor against deterioration in the cover pool's credit quality (ESG factor).

Cover pool support (positive). Cover pool support[3] is the primary rating driver and adds two additional notches of uplift. It factors the following rating considerations:

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

2. **Overcollateralisation (positive).** The 22.5% of overcollateralisation as of 31 March 2023, on an eligible-loan basis, shields the covered bonds from market and credit risks. It is well above the unchanged 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 averaged unindexed eligible loan-to-value ratio of about 51.5%.

4. **Asset-liability management (negative).** Mismatches are moderate. The programme remains exposed to low interest rates, reflecting a 24.2% share of floating-rate assets and fixed loans with a reset date versus 3.4% of floating-rate covered bonds. It is most sensitive to high prepayments as these factors

together result in significant costs of carry for the programme.

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

Rating-change drivers

Scope's Stable Outlook on the mortgage-covered bonds reflects a rating buffer of one notch from unused cover pool support. The rating could be downgraded upon: i) more than one notch of deterioration in Scope's view on the credit quality of the issuer; 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 defaults 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 the agency's assumptions regarding the Austrian housing market and its unique characteristics. Scope's stressed security values range between 50.0% and 70.0% depending on the property's location. This results in recovery rates of 90.0% (unchanged) in the most stressed scenario.

Credit risk only accounts for an unchanged 2 pp of the 6.0% of 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 incorporated the impact of rating distance-dependent interest rate stresses.

Market risk accounts for an unchanged 4 pp of the 6% supporting overcollateralisation. 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 96.6% of fixed-rate covered bonds versus 75.8% of fixed-rate cover assets, most of which have an interest reset prior to final maturity. This mismatch is further amplified under high prepayments (15%) as the weighted average life of cover assets decreases to around five years (from 13.4 years) and the generated cash would accrue interest based on the short-term (negative) market rate.

To calculate the cover pool's net present value in the event of an asset sale, a refinancing premium of 150 bps 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 residential mortgage loans, Scope assumed a servicing fee of 25 bps. Scope further assumed a recovery period of 30 months for residential mortgage loans in Austria.

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

Rating driver references

1. Wüstenrot – private issuer rating
2. Governance support assessment for Austria
3. Confidential quarterly cover pool reporting

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 Outlook, (Covered Bond Rating Methodology, 25 April 2022, General Structured Finance Rating Methodology 25 January 2023), are available on https://scoperatings.com/governance-and-policies/rating-governance/methodologies.
The model used for this Credit Rating and Outlook is (Covered Bonds Expected Loss 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 Rating if the Credit Rating 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 Rating: public domain, the Rated Entity, 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 Credit Rating 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 Rating and Outlook and the principal grounds on which the Credit Rating and Outlook is based. Following that review, the Credit Rating was not amended before being issued.

Regulatory disclosures

The Credit Rating and Outlook is issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Rating and Outlook is UK-endorsed.
Lead analyst: Mathias Pleißner, Senior Director
Person responsible for approval of the Credit Rating: Marco Troiano, Managing Director
The Credit Rating/Outlook was first released by Scope Ratings on 6 April 2017. The Credit Rating/Outlooks was last updated on 13 June 2022.

Potential conflicts

See www.scoperatings.com under Governance & Policies/Regulatory for a list of potential conflicts of interest disclosures 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

Contact

Analyst	Mathias Pleissner	m.pleissner@scoperatings.com
Team leader	Karlo Fuchs	k.fuchs@scoperatings.com

Scope Ratings GmbH • Lennéstraße 5 • D-10785 Berlin • Phone: +49 30 27891-0 • Fax: +49 30 27891-0
www.scoperatings.com