HYPO - Bank Burgenland AG

Austrian Hypothekenpfandbriefe – Performance Update

Covered bond rating
AAA

Outlook
Stable

Last rating action
22 Nov 2023

Issuer rating
A-

Outlook
Stable

Last rating action
15 Nov 2023

Rating rationale (summary)

The AAA ratings with a Stable Outlook on the Austrian mortgage-covered bonds (Hypothekenpfandbriefe) issued by HYPO-Bank Burgenland AG (Bank Burgenland) are based on the bank's issuer rating of A-, enhanced by six notches of cover pool support.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 September 2023	EUR 1,346.9m	Residential and commercial mortgage loans	EUR 790.1m	AAA/Stable

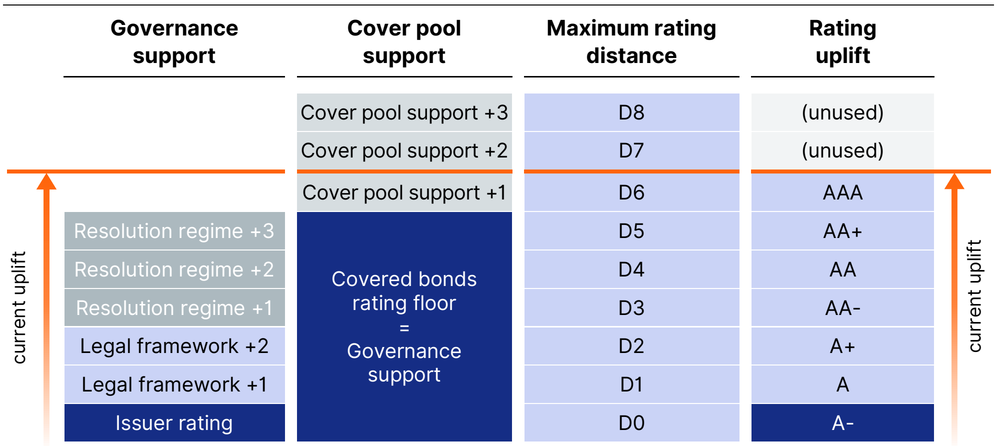
Bank Burgenland's A-/Stable issuer rating reflects its well-established, profitable and regionally focused banking operations in the Austrian regions of Burgenland, Vienna and Styria. Despite a traditional focus on real estate financing, Bank Burgenland's business model is very well-diversified thanks to good market positions in retail and private banking as well as in the institutional business areas of asset management and custodian banking.

Governance support factors from the Austrian legal and resolution framework provide a five-notch uplift above the bank's rating which effectively forms a rating floor.

We have assigned the covered bonds a cover pool complexity (CPC) category of 'low' for the interplay between complexity and transparency. This allows for a maximum additional uplift of three notches on top of the governance uplift and enables the programme to be rated AAA, reflecting the credit strength of the covered bond programme.

The programme does further benefit from a two-notch buffer against an issuer downgrade as the maximum theoretical uplift constitutes eight notches, as opposed to the six notches used to achieve the highest rating for these covered bonds.

Figure 1: Covered bond rating building blocks



Related Research

[Scope affirms at AAA/Stable the Austrian mortgage-covered bonds issued by Bank Burgenland, November 2023]

[Scope affirms Bank Burgenland's A- issuer rating with Stable Outlook, November 2023]

Changes since the last performance update

The minimum level of overcollateralisation (OC) required to support the AAA rating remains unchanged at 10.0%. The programme keeps on benefiting from strong excess spread, supported by the relatively low average fixed rate funding costs and its mostly floating rate assets. This interest rate mismatch does however expose the programme to decreasing rates, especially if average funding costs increase due to ongoing refinancing under the current environment. Further, we see, despite value depreciation, a decreasing loan-to-value (LTV) ratio, which positively drives recoveries.

The issuer

Bank Burgenland's issuer rating of A-/Stable reflects its well-established, profitable, regionally focused business model in the Austrian state of Burgenland, the Vienna metropolitan area and Styria, complemented by its good access to real estate markets in its home markets and in the rest of Austria. The issuer rating also reflects the reliable profit contributions that Bank Burgenland's institutional banking divisions have achieved through asset management and custodial services.

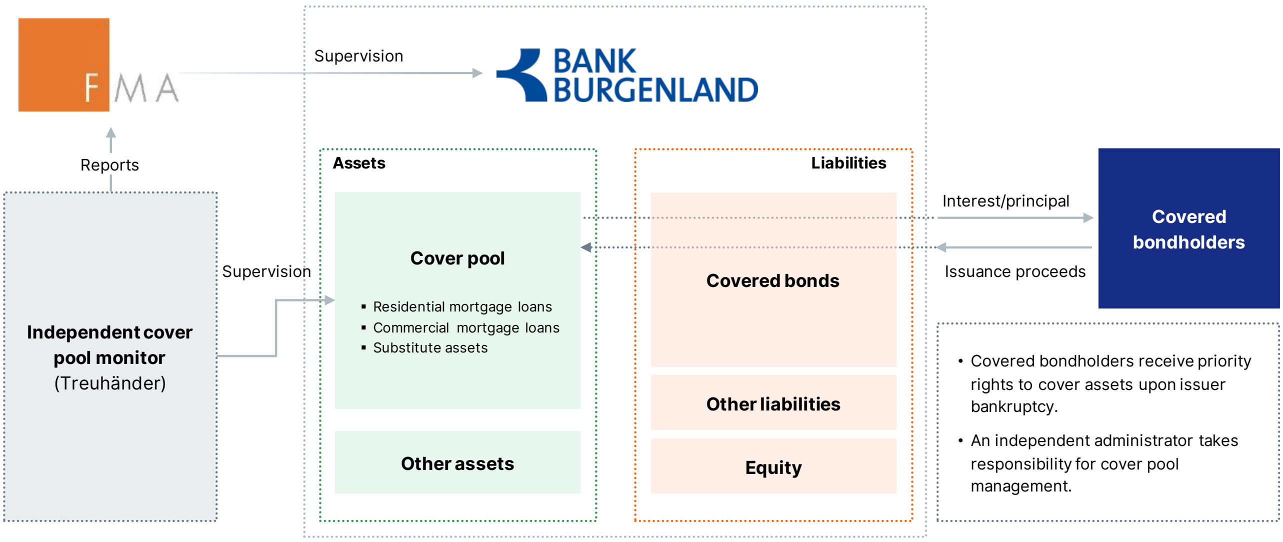
Together, Bank Burgenland, its banking subsidiary Schelhammer Capital and its other bank-related service companies form the GRAWE Banking Group, an integral part of GRAWE Group, an Austrian multi-line insurance group. Bank Burgenland and its subsidiaries are integrated in GRAWE Group's risk control processes. The bank is managed according to the arm's length principle. Due to the group's mutual ownership structure, management is strongly focused on internal capital generation and conservative reserve building, which is also reflected in its banking subsidiaries.

Further details on our credit assessment of Bank Burgenland are available at www.scoperatings.com.

Programme structure

Bank Burgenland issues covered bonds using an on-balance sheet structure. Its issuances are governed by the new Austrian Covered Bond Act (PfandBG) and supervised by Austria's Financial Market Authority (FMA).

Figure 2: Issuance structure



Source: Scope Ratings

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Governance support analysis

Two notches of legal framework uplift …

We continue to assign the maximum legal framework uplift of two notches following our analysis of the Austrian covered bond framework. The updated legislation came into force on 8 July 2022 and transposed the European Covered Bond Directive into local law. The new framework consolidated the three previous legislations, improved and aligned it more closely with best practice as seen in other covered bond frameworks across Europe.

… plus three notches of resolution regime uplift

Bank Burgenland's covered bonds also benefit from an additional three-notch uplift which reflects the exclusion of covered bonds from bail-in as well as our view on the resolvability and probable maintenance of Bank Burgenland in a hypothetical scenario of regulatory intervention, and the moderate importance of covered bonds in Austria.

Our latest assessment of relevant governance support factors for Austrian covered bonds is available here.

Cover pool analysis

Bank Burgenland's mortgage-covered bond ratings are cover pool-supported, with six out of eight possible notches currently needed to achieve the highest rating. Governance support provides a five-notch rating uplift and, effectively, a floor against a deterioration in cover pool credit quality.

Since our last review in 2022, the minimum supporting OC needed to achieve the highest rating remains unchanged at 10.0%. This is reflecting the stable asset performance, low maturity but relatively high interest rate mismatches. The latter exposes the programme to declining interest rates. Further we have sized for the discretionary decision of the special administrator to call outstanding covered bonds. Our base case assumes that all options are exercised at its first date while any extension would be credit negative.

Cover pool characteristics

Reporting date	Q3 2023	Q3 2022
Balance (EUR m)	1,346.9	1,186.9
Residential	70.6%	68.7%
Commercial	29.2%	30.1%
Substitute	0.2%	1.2%

General information

Reporting date	Q3 2023	Q3 2022
No. of loans	4,815	4,565
Avg. size (EUR)	279,202	256,815
Top 10 (%)	20.3%	17.5%
Remaining life (y)	11.7	13.2
Seasoning (y)	5.7	4.5
WA eligible-loan LTV	47.1%	49.4%
WA whole-loan LTV	55.0%	55.9%

Repayment type (%)

Reporting date	Q3 2023	Q3 2022
Annuity	84.3%	82.2%
Interest-only	15.7%	17.8%

Interest rate type (%)

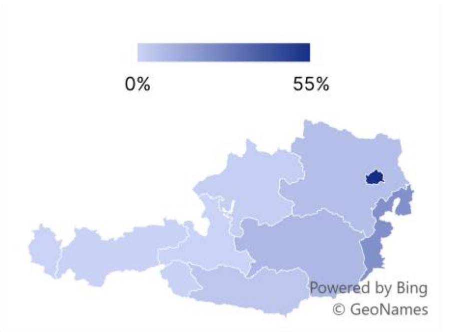
Reporting date	Q3 2023	Q3 2022
Fixed	34.8%	31.4%
Floating	65.2%	68.6%

Cover pool composition

The cover pool comprises well-seasoned, domestic commercial and residential mortgage loans in eastern Austria. The low weighted average loan-to-value (LTV) ratio of 47.1% (from 49.4% in 2022) on an eligible-loan basis indicates high protection against credit losses in the event of borrower default. The Austrian Covered Bond Act stipulates a maximum LTV ratio of 80% for residential mortgage assets. However, Bank Burgenland continues to voluntarily limit its eligible LTV ratio to 60%. The average whole-loan LTV stands at 55% (from 55.9%).

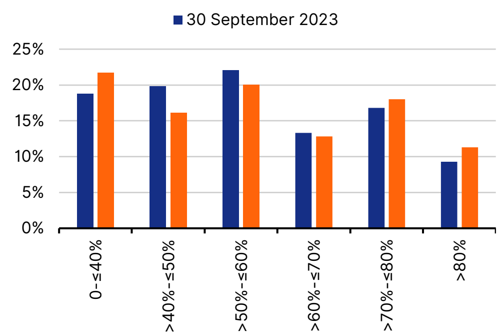
The residential share accounts for 70.6%, split into commercial debtors like SMEs (14%) and larger housing corporations (53%). This is also driving the relatively high concentration with the top 10 obligors accounting for 20.3% (from 17.5%). Non-recourse and special purpose vehicle structures are rare.

Figure 3: Regional distribution



Source: Scope Ratings, Bank Burgenland

Figure 4: LTV distribution (whole loan)



Source: Scope Ratings, Bank Burgenland

Asset risk analysis

We have resized the sub-portfolios by allocating all loans exposed to owner-occupied residential property to the residential sub-portfolio with the rest being commercial. This has the effect that most of the housing associations will be allocated to the commercial sub-pool. With this, the residential sub-portfolio accounts for 40%.

The residential sub-pool is granular with 2,573 (Scope aggregated) borrowers. The largest borrower accounts for 0.94% (by total). This enables us to analyse the sub-portfolio using an inverse Gaussian distribution. We established a mean default rate of 11%, up from 9.5% previously, and a coefficient of variation of 60%. The parameters for the default distribution were derived using the bank's loan-by-loan risk assessments which have been mapped to Scope's updated PD metrics.

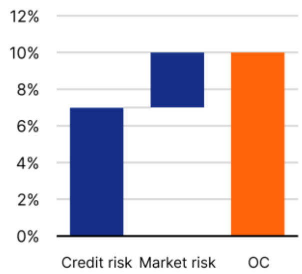
The commercial sub-pool accounts for 684 (Scope aggregated) borrowers with the largest borrower accounting for 5.2% (by total). Our projections of default in the cover pool used a non-parametric default distribution, which can be approximated with a mean default rate of 10.4% from 11.5% earlier. Its implied coefficient of variation is 72.5% (from 60%). We used a correlation framework to incorporate the impact of geographical, industry and obligor concentrations. We further used the bank's loan-by-loan risk assessments mapped to Scope's updated PD metrics.

We estimated a recovery rate of up to 100% under a base case scenario (D0) for both the residential and the commercial pool. In the most stressful scenario (D8), we estimated a recovery rate of 78.3% (up from 72.5%) for the residential pool and 61.6% (down from 62.5%) for the commercial pool. Our recovery rate calculations reflect rating distance-dependent market value declines as well as assumptions regarding the Austrian housing market and its unique characteristics.

Cash flow risk analysis

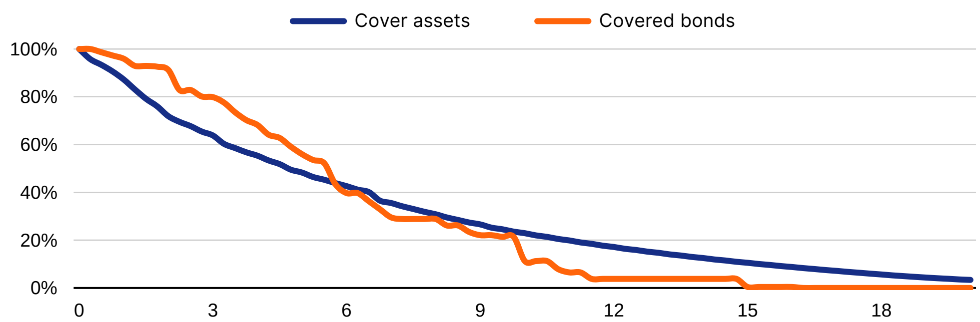
The rating-supporting OC of 10.0% reflects the programme's sensitivity to low prepayments (high earlier) in combination with a stressed lower-for-longer interest rate scenario. These factors reflect the programme's vulnerability to distressed asset sales when available cash is insufficient to pay maturing bonds. This is reflected in market risks that are unchanged and account for a moderate 3 pp of the supporting OC of 10.0%.

Rating-Supporting OC breakdown



Source: Scope Ratings

Figure 5: Amortisation profile (relative)



Source: Scope Ratings, Bank Burgenland

Asset-liability mismatches

	Assets	Liabilities
EUR	100.0%	100.0%
Fixed	34.8%	93.4%
Floating	65.2%	6.6%
WAL (years)	7.4	6.0*

* Considering first call rights

Asset liability mismatches are low. As of Q3 2023, the weighted average life (WAL) of the outstanding covered bonds is 6 years, after accounting for call rights that may be exercised by the issuer. In case call rights are not executed, the WAL is 10.5 years. In comparison, the WAL of the scheduled cover pool is 7.4 years and (unstressed) matches well the profile of the liabilities.

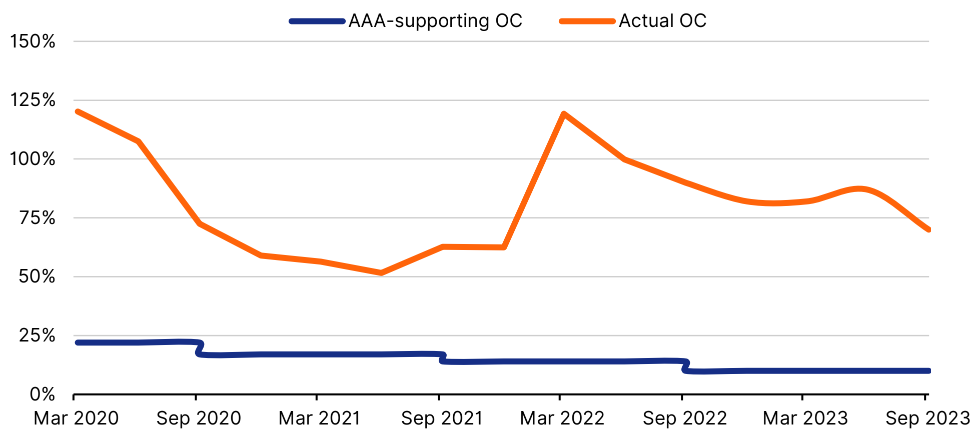
As typical for Austrian mortgage-covered bonds, there is structural interest rate risk. Around 65% of the cover assets pay a variable rate, while most of the covered bonds pay fixed rates. The fixed cover assets are however not necessarily fixed for life and expose the programme to additional interest rate mismatches at the loan's reset date. For resetting loans, we assume that they will switch to floating rates at their individual reset date and at the respective (stressed) rate.

In total, credit risk accounts for another 7 pp of the supporting OC. This is moderate, reflecting the portfolio's mean default rate of 10.6% (from 10.7%), a coefficient of variation of 68.4% (from 59.9%) and a stressed recovery rate of 68.3% (from 65.2%). It also reflects the low prepayment scenario that exposes the programme to potential asset sales under discount.

Availability of overcollateralisation

Bank Burgenland's credit strength allows us to fully account for the provided OC of 70.5% as of Q3 2023. We are not aware of plans that would significantly change the risk profile or reduce available OC to levels that would no longer support the current rating uplift.

Figure 6: OC development



Source: Scope Ratings, Bank Burgenland

Other risk considerations

Main counterparty exposure relates to Bank Burgenland

The rated bonds are exposed to Bank Burgenland's roles as originator, servicer, account provider and paying agent. No documented replacement mechanisms would automatically shield the covered bonds from a credit deterioration of, for instance, the counterparties providing bank accounts. However, in such a scenario we believe the strong alignment of interests between the bank and the covered bondholders would prevent negative impacts before a regulator intervenes. As part of its risk management process, the bank regularly monitors its accounts to ensure that any required remedial action is taken at an early stage.

In addition, we expect any regulatory intervention in Bank Burgenland to involve the use of available resolution tools with the aim of maintaining the issuer. We do not expect the active management and servicing of the cover pool to be severely impacted in such a scenario.

Country risk does not affect the ratings

Sovereign risk does not limit the ratings of Bank Burgenland's mortgage-covered bonds. We believe the risks of institutional framework meltdown, legal insecurity and currency-convertibility problems are remote.

Governance remains key ESG factor

Governance considerations such as the strength of supervision and prudent management play a major role in our covered bond analysis, reflected in both our governance analysis and our cover pool support analysis. In addition, our CPC category measures the issuer's management of the interplay between complexity and the level of transparency provided to investors. For Bank Burgenland, this allows for the maximum additional cover pool support uplift of up to three notches on top of the governance uplift.

Information provided by the issuer did not enable us to incorporate potential credit benefits from ESG-compliant cover assets in our analysis (e.g. better recovery prospects for more energy-efficient collateral or a lower liquidity premium).

Sensitivity analysis

Two-notch buffer against potential change in issuer rating

Bank Burgenland's mortgage-covered bond ratings benefit from a buffer against an issuer downgrade of up to two notches. Assuming the issuer's willingness to support the highest ratings as well as a stable covered bond programme risk profile, a one-notch downgrade would increase the rating-supporting OC requirement to 14.0%.

Constraint through rating-supporting OC unlikely

The OC of 70.5% greatly exceeds the 10.0% needed to support the AAA rating. We do not expect rating-supporting OC to constrain the rating in the short to medium term. This assumption reflects the issuer's stable underwriting criteria and the fact that the cover pool's credit quality does not materially differ from the additional, available eligible assets or the bank's loan book.

Appendix: Summary of covered bond characteristics

Reporting date	30 September 2023	30 September 2022
Issuer name	Hypo-Bank Burgenland AG	
Country	Austria	
Covered bond name	Hypothekenpfandbrief (Hypf) Austrian mortgage-covered bonds issued under the PfandBG	
Covered bond legal framework	Austrian legal covered bond framework	
Cover pool type	Residential and commercial mortgages	
Composition	Residential = 70.7%	Residential = 68.7%
	Commercial = 29.1%	Commercial = 30.1%
	Substitute assets = 0.2%	Substitute assets = 1.2%
Issuer rating	A-/Stable	A-/Stable
Current covered bond rating	AAA/Stable	AAA/Stable
Covered bond maturity type	Hard bullets	Hard bullets
Cover pool currencies	EUR (100%)	EUR (100%)
Covered bond currencies	EUR (100%)	EUR (100%)
Governance support (notches)	5	5
Maximum additional uplift from CPC Cat (notches)	3	3
Maximum achievable covered bond uplift (notches)	8	8
Covered bond rating buffer (notches)	2	2
Cover pool/eligible assets (EUR m)	1,525.4 / 1,347.9	1,371.2 / 1,186.9
of which substitute assets and deposits (EUR bn)	2.5	14.5
Covered bonds (EUR m)	790.1	624.9
Overcollateralisation: current/legal minimum	70.5% / 2.0%	89.9% / 2.0%
Overcollateralisation to support current rating	10.0%	10.0%
Overcollateralisation upon a one-notch issuer downgrade	14.0%	14.0%
Weighted average life of assets	7.4	7.5
Weighted average life of liabilities*	6.0	7.0
Number of loans	4,815	4,565
Average loan size (EUR)	279,202	256,815
Top 10 exposures	20.4%	17.5%
Interest rate type – assets	Fixed: 34.8	Fixed: 31.4%
	Floating: 65.2%	Floating: 68.6%
Interest rate type – liabilities	Fixed: 93.4%	Fixed: 100.0%
	Floating: 6.6%	Floating: 0.0%
Weighted average eligible-loan LTV ratio	47.1%	49.4%
Geographic split (top three)	Vienna (55.2%)	Vienna (51.3%)
	Burgenland (22.2%)	Burgenland (24.8%)
	Styria (9.3%)	Styria (9.4%)
Default measure (residential / commercial)	Inv. Gaussian / Non-parametric	Inv. Gaussian / Non-parametric
Mean default rate (residential / commercial)	11.0% / 10.4%	9.5% / 11.5%
Coefficient of variation (residential / commercial)	60.0% / 72.7%	60.0% / 60.1%
Base – recovery assumption (residential / commercial)	99.9% / 99.9%	95.0% / 95.0%
Stressed – recovery assumption (residential / commercial)	78.3% / 61.6%	72.5% / 62.5%
Max. liquidity premium (residential / commercial)	200 bps / 400 bps	200 bps / 400 bps
Servicing fee (residential / commercial)	25 bps / 50 bps	25 bps / 50 bps

*Assuming first call option is exercised by the issuer

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