Hypo - Bank Burgenland AG
Austrian Hypothekenpfandbriefe – Performance Update

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 at least six notches of cover pool support.

Cut-off date	Cover pool	Cover asset type	Covered bonds	Rating/Outlook
30 September 2021	EUR 853.9m	Residential and commercial mortgage loans	EUR 524.9m	AAA/Stable

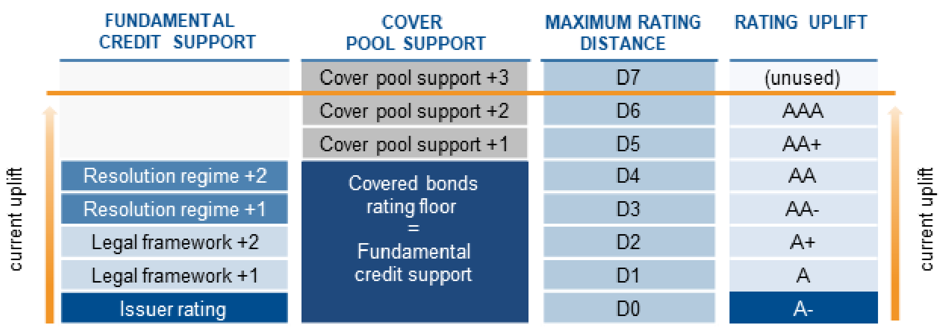
Bank Burgenland's A-/Stable rating reflects its well-established, profitable, regionally focused banking business in the Austrian state of Burgenland, the Vienna metropolitan area and Styria. Its sound credit profile also reflects its good access to real estate markets in its home markets and in the rest of Austria.

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

We have assigned the covered bonds a cover pool complexity (CPC) score of 1 for the interplay between complexity and transparency. This allows for a maximum additional uplift of three notches on top of the fundamental uplift and enables the programme to be rated AAA, reflecting the credit strength of the covered bond programme.

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

Figure 1: Covered bond rating building blocks



Stable Outlook

The Stable Outlook on the covered bonds reflects the Stable Outlook on the issuer rating and a rating buffer of one notch.

Changes since the last performance update

The level of over-collateralisation (OC) that supports the AAA rating has decreased to 14.0% from 17.0%. The reduction reflects a reduction in the remaining life and average coupon of outstanding covered bonds, both of which reduce the cost of carry. The credit quality of cover assets remains high.

Ratings & Outlook

Issuer rating	**A-**
Outlook	Stable
Last rating action date	20 Dec 2021
Covered bond rating	**AAA**
Outlook	Stable
Last rating action date	30 Nov 2021

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Related research

Scope affirms at AAA/Stable the Austrian mortgage-covered bonds issued by Bank Burgenland
November 2021

Scope assigns Bank Burgenland first-time rating of A- with Stable Outlook
December 2021

Austria's covered bonds: transposing EU directive brings credit-positive consolidation
April 2021

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The issuer

Bank Burgenland's issuer rating of A-/Stable reflects its well-established, profitable, regionally focused banking business 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 success that Bank Burgenland's institutional banking divisions have achieved in asset management and custodian bank services.

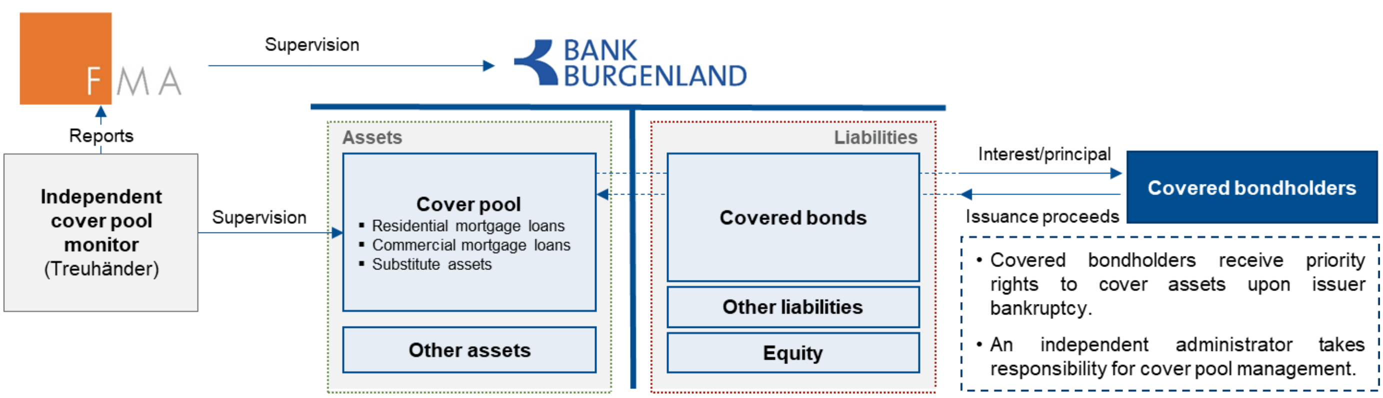
Together, Bank Burgenland, its banking subsidiary Schelhammer Capital Bank and its other bank-related service companies form GRAWE Banking Group, an integral part of GRAWE Group, an Austrian multi-line insurance group. Bank Burgenland is managed by its parent according to the arm's length principle, whereby the bank and its subsidiaries are fully integrated in GRAWE Group's risk control processes. Due to the group's mutual ownership structure, management has a strong focus on internal capital generation and conservative reserve-building. This is 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. As a former Landeshypothekenbank (federal state mortgage bank), its issuances of mortgage-covered bonds are governed by the Austrian Covered Bond Act (Pfandbriefgesetz) and supervised by Austria's Financial Market Authority (FMA).

Figure 2: Issuance structure



Source: Scope Ratings.

Fundamental credit support analysis

The Austrian covered bond framework, combined with our positive view on the resolution regime, provides the covered bonds with a fundamental analysis-based credit differentiation of four notches above the issuer rating.

Two notches of legal framework uplift …

Our analysis of the current Austrian Covered Bond Act confirms that the framework just meets the criteria to assign maximum credit differentiation under our methodology. The provisions ensure that: i) the cover pool is segregated from the issuer's insolvency estate; ii) bond payments continue after insolvency; and iii) identified risks can be mitigated by OC, which generally remains available after insolvency. Austrian covered bonds also benefit from specific regulatory oversight. However, we recognise the framework's lack of clarity on liquidity and risk management for covered bonds.

The Austrian parliament agreed the new covered bond law in November 2021, consolidating three existing frameworks and adjusting areas needed to comply with the harmonisation of covered bond frameworks in the EU (see here for our comment). The consolidated framework will provide better liquidity risk mitigation, but some aspects cannot be assessed definitively. We will update our legal framework assessment when secondary legislation or additional guidance on the regulation is available. At this stage, changes are expected to be moderately positive. The new legislation will come into effect on 8 July 2022, replacing the current frameworks.

… plus two notches of resolution regime uplift

Bank Burgenland's covered bonds also benefit from an additional two-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. In our opinion, Bank Burgenland is not a systemically important covered bond issuer, and Austrian covered bond stakeholders are not sufficiently supportive or cohesive to justify an additional uplift.

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

Cover pool characteristics

Reporting date	Q3 2020	Q3 2021
Balance (EUR m)	879.5	853.9
Residential	70.9%	72.0%
Commercial	27.9%	26.7%
Substitute	1.2%	1.3%

General information

Reporting date	Q3 2020	Q3 2021
No. of loans	3,788	3,903
Avg. size (EUR)	229,313	215,853
Top 10 (%)	13.2%	14.3%
Remaining life (y)	11.4	11.8
Seasoning (y)	5.0	5.4
WA eligible-loan LTV	49.6%	47.4%

Repayment type (%)

Reporting date	Q3 2020	Q3 2021
Annuity	78.8%	81.2%
Interest-only	21.2%	18.8%

Interest rate type (%)

Reporting date	Q3 2020	Q3 2021
Fixed	26.3%	27.0%
Floating	73.7%	73.0%

Cover pool analysis

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

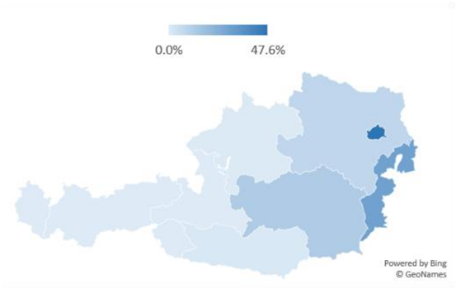
Since our last review in 2020, the minimum supporting OC needed to achieve the highest rating has decreased to 14.0% from 17.0%, reflecting the programme's increased excess spread due to a reduction in the remaining life and average coupon of outstanding covered bonds.

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 47.4% on an eligible-loan basis indicates high protection against credit losses in the event of borrower default. The Austrian Mortgage Bond Act does not stipulate a maximum LTV ratio for cover pool assets. However, Bank Burgenland voluntarily limits its eligible LTV ratio to 60%.

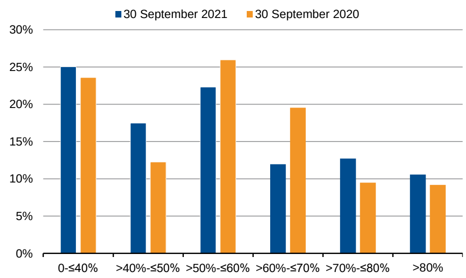
Commercial debtors are SMEs (17.2%) and larger housing corporations (48.4%). Non-recourse and special purpose vehicle structures are rare. By property usage, 70.9% of the pool is secured by residential properties. Multifamily houses and flats account for most of the portfolio and are largely located in Vienna.

Figure 3: Regional distribution



Source: Scope Ratings, Bank Burgenland

Figure 4: LTV distribution (whole-loan)



Source: Scope Ratings, Bank Burgenland

Asset risk analysis

The residential sub-pool is highly granular, which enables us to analyse it using an inverse Gaussian distribution. We established a mean default rate of 12.5% and a coefficient of variation of 60%. The parameters for the default distribution were derived using the bank's loan-by-loan risk assessments and benchmarking.

For the commercial sub-pool, our projections of default in the cover pool used a non-parametric default distribution, which can be approximated with a mean default rate of 8.6% and a coefficient of variation of 72.7%. We used a correlation framework along with the bank's loan-by-loan risk assessments to incorporate the impact of geographical, industry and obligor concentrations.

We estimated a recovery rate of 95% under a base-case scenario (D0) for both the residential and the commercial pool. In the most stressful scenario (D7), we estimated a recovery rate of 82.5% for the residential pool and 65.0% 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. Stressed security value haircuts ranged between 45.0% and 70.0% depending on the property's location.

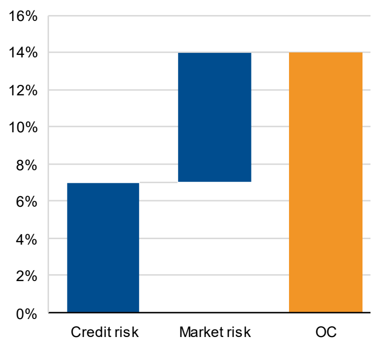
Cash flow risk analysis

The rating-supporting OC of 14.0% reflects the programme's sensitivity to high prepayments in combination with a stressed lower-for-longer interest rate scenario. Combined, these factors result in a significant cost of carry for the programme. Market risks account for 7 pp of the supporting OC of 14.0%.

As of Q3 2021, the weighted average life (WAL) of the outstanding covered bonds is 7.3 years, after accounting for call rights that may be exercised by the issuer. In comparison, the WAL of the scheduled cover pool is 6.8 years. In a high prepayment scenario, the WAL of the assets falls to around three years, further increasing the gap between the cover assets and the covered bonds. As is typical of Austrian mortgage-covered bonds, there is structural interest rate risk. 73.0% of the cover assets pay a variable rate, while all the covered bonds pay fixed rates.

In total, credit risk accounts for another 7 pp of the supporting OC. This is moderate, reflecting the portfolio's mean default rate of 10.2%, a coefficient of variation of 66.7% and a stressed recovery rate of 73.7%. It also reflects the high prepayment scenario that drives the results, reducing the lifetime of the assets and consequently limiting the allocation of defaults.

Rating-supporting OC: breakdown

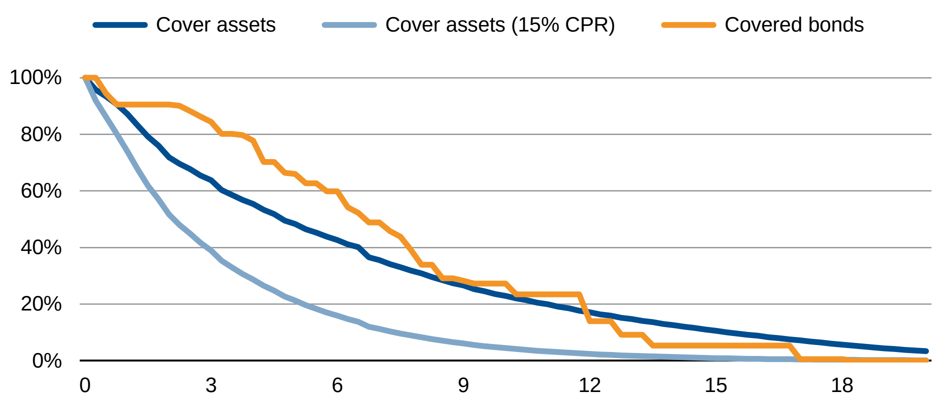


Source: Scope Ratings

Asset-liability mismatches

	Assets	Liabilities
EUR	100.0%	100.0%
Fixed	27.0%	100.0%
Floating	73.0%	0.0%
WAL (years)	6.8	7.3

Figure 5: Amortisation profile (relative)

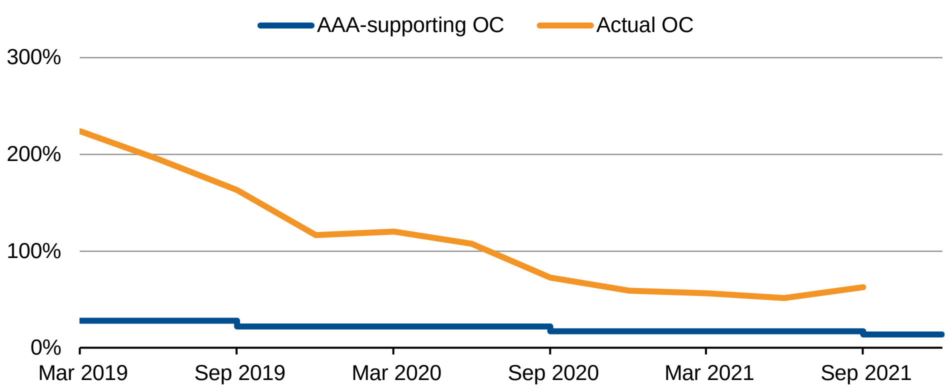


Source: Scope Ratings, Bank Burgenland

Availability of over-collateralisation

Bank Burgenland's credit strength allows us to fully account for the provided OC of 62.7%. 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 fundamental analysis and our cover pool support analysis. In addition, our CPC score 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 fundamental 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

One-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 one notch. 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 rating-supporting OC to 16.0%.

Constraint through rating-supporting OC unlikely

The current OC of 62.7% greatly exceeds the 14.0% 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 2020	30 September 2021
Issuer name	Hypo-Bank Burgenland AG	
Country	Austria	
Covered bond name	Hypothekenpfandbrief (Hypf) Austrian mortgage-covered bonds issued under the Pfandbriefgesetz	
Covered bond legal framework	Austrian legal covered bond framework	
Cover pool type	Residential and commercial mortgages	
Composition	Residential = 68.1% Commercial = 31.0% Substitute assets = 0.9%	Residential = 72.0% Commercial = 26.7% Substitute assets = 1.3%
Issuer rating	Not disclosed	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%)
Fundamental cover pool support (notches)	4	4
Maximum additional uplift from CPC score (notches)	N/A	3
Maximum achievable covered bond uplift (notches)	7	7
Covered bond rating buffer (notches)	1	1
Cover pool/eligible assets (EUR m)	998.8 / 879.5	961.9 / 853.9
of which substitute assets and deposits (EUR bn)	10.9	11.4
Covered bonds (EUR m)	509.9	524.9
Over-collateralisation: current/legal minimum	72.5% / 2.0%	62.7% / 2.0%
Over-collateralisation to support current rating	17.0%	14.0%
Over-collateralisation upon a one-notch issuer downgrade	20.0%	16.0%
Weighted average life of assets	7.3	6.8
Weighted average life of liabilities*	8.3	7.3
Number of loans	3,788	3,903
Average loan size (EUR)	229,313	215,853
Top 10 exposures	13.2%	14.3%
Interest rate type – assets	Fixed: 26.3% Floating: 73.7%	Fixed: 27.0% Floating: 73.0%
Interest rate type – liabilities	Fixed: 100.0% Floating: 0.0%	Fixed: 100.0% Floating: 0.0%
Weighted average eligible-loan LTV ratio (unindexed)	49.6%	47.4%
Geographic split (top three)	Vienna (50.6%) Burgenland (28.4%) Styria (10.6%)	Vienna (47.6%) Burgenland (29.5%) Styria (12.7%)
Default measure (residential / commercial)	Inv. Gaussian / Non-parametric	Inv. Gaussian / Non-parametric
Mean default rate (residential / commercial)	12.5% / 9.5%	12.5% / 8.6%
Coefficient of variation (residential / commercial)	60.0% / 76.4%	60.0% / 72.7%
Base – recovery assumption (residential / commercial)	95.0% / 95.0%	95.0% / 95.0%
Stressed – recovery assumption (residential / commercial)	87.5% / 62.5%	82.5% / 65.0%
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
**D0 and D7 denote the stresses commensurate with the rating distance from the minimum and maximum achievable covered bond uplift.

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