

Ratings Assigned To BRFkredit's Capital Centre E Covered Bond Issuances

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OVERVIEW

- We have assigned a 'AAA/Stable' long-term rating and a 'A-1+' short-term rating to BRFkredit's issuances of "særligt dækkede obligationer" out of its Capital Centre E.
- The portfolio backing the bonds consists of first- or second- lien loans secured on mainly residential, but also commercial and multifamily properties in Denmark.
- We have assigned these ratings based on our criteria for rating covered bonds. However, the methodologies and assumptions underlying these criteria are under review. The ratings on all outstanding covered bonds drawn under this covered bond program may be affected as a result of this review.

LONDON (Standard & Poor's) Nov. 18, 2011—Standard & Poor's Ratings Services today assigned a 'AAA' long-term credit rating and a 'A-1+' short-term credit rating to BRFkredit A/S's (A-/Stable/A-2) issuances of "særligt dækkede obligationer" (SDO; Danish legislation-enabled covered bonds) out of its Capital Centre E. We have assigned a stable outlook to the long-term rating (see list below).

Standard & Poor's ratings address timely payment of interest and ultimate payment of principal on or before legal final maturity of the bonds.

BRFkredit's Capital Centre E is an existing capital center and has separate program documentation, which it uses to finance fixed rate, adjustable-rate mortgages (ARMs) and floating-rate mortgage loans by issuing SDOs of various maturities.

Publication Date

Nov. 18, 2011

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Table 1

Current Maturity Distribution

Bond characteristics	Vol. (Mil. DKK)	%
Fixed-rate	16.5	15
1-year maturity	46.3	43
2-3-year maturity	26.5	25
4-5-year maturity	16.8	16
Above 5 years	2.0	2
Total	108.1	100

The majority of new issuance from Capital Centre E has a one-year maturity term. The one-year covered bonds are issued through auctions held in December 2011, and thereafter in October and December each year.

If the issuer becomes insolvent, the covered bondholders will have recourse to a separate, ringfenced capital center, and a capital center reserve fund. Furthermore, an assigned administrator (“Kurator”) will administer the cover pool, and if necessary, refinance the mortgage loans.

Currently Capital Centre E consists of loans secured by mortgages on residential and commercial properties located in Denmark. There are a large proportion of loans in Copenhagen which is as expected, considering the distribution of the Danish population.

Table 2

Geographical Distribution (%)

Denmark	100.0
Copenhagen	45.1
Zealand	14.6
Central Jutland	16.4
South Denmark	17.1
North Jutland	5.4
Other (Greenland and Faroe islands)	1.4

Table 3

Property Distribution By Type (%)

Single family	54.80
Subsidized housing	15.66
Private rental (commercial)	14.44
Office	12.67
Industry	1.34
Tier 1 (hotels, leisure, etc.)	0.59
Retail	0.48
Tier 2 (Agriculture)	0.01
Land and unfinished build	0.005

Most loans in Capital Centre E consist of loans refinanced from the current Capital Centre B but also new origination made by the issuer. BRFkredit currently originates loans through their five regional offices, real estate agents, and a number of partnerships with regional banks.

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Unlike most other Danish mortgage banks with capital centers rated by S&P, BRFkredit intends to keep ARM loans in their existing capital centers, including both fixed-rate mortgage loans and ARM loans refinanced by short-term bond issuance. BRFkredit applies the general balance principle to issue the SDOs, often associated with matched funding, which matches interest rate and maturity profiles. However, to fund the ARM loans, the bonds issued only match the loan's interest profile, not the legal maturity. By law and contractual terms, BRFkredit must provide continuous funding by issuing new covered bonds at pre-agreed intervals until the loan reaches maturity.

Further, the borrower is contractually obligated to accept the full cost of funding for the mortgage loans. Due to the specifics of the balance principle of the Danish mortgage system, we do not model a sale of the cover pool at the first maturity of the bond, but assume that the issuer refinances the bond at (stressed) market rates. We consider the refinancing of the ARM loans to be a potential credit risk as interest may increase substantially between interest reset periods, and hence expose the borrower to the risk that a loan's scheduled future periodic payments may increase substantially (a "payment shock"). We therefore increase our base case foreclosure frequency rate for ARM loans by 20%.

We have currently not observed any higher refinancing cost for this type of mortgage loans. Should we observe an increase in funding costs of ARMs compared with other mortgage loan products, we may reflect the different investor perception by adjusting our refinancing assumptions accordingly.

We have reviewed the asset and cash flow information provided and projected as of Sept. 30, 2011 to determine a "category 1" program categorization for Capital Centre E and a current asset-liability mismatch (ALMM) measure of "low". According to our covered bond criteria, the combination of both factors potentially allows for a seven-notch uplift above the issuer credit rating (see "Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009).

Comparing our assessment of the target credit enhancement with the available credit enhancement, we believe that the cover pool can fully support the potential rating uplift for our 'AAA' rating on these legislation-enabled mortgage covered bonds.

The stable outlook reflects our current view that adverse changes to our counterparty credit rating on BRFkredit, or to our ALMM measure, would not automatically result in a change to the covered bond rating. We also believe that BRFkredit has the ability and willingness to manage the covered bonds at conditions commensurate with the rating that we have assigned.

Table 4

Capital Centre E's Key Characteristics (As Of Sept. 30, 2011)

Classification of ALMM mismatch	Low
Program categorization	1
Maximum potential rating	AAA
Current available credit enhancement (%)	12.54
Target credit enhancement commensurate with the highest credit rating (%)	10.76

Note that we calculate the current credit enhancement as (assets – liabilities)/liabilities.

TRANSACTION SUMMARY AND PORTFOLIO CHARACTERISTICS

Table 5

Key Portfolio Characteristics (As Of September. 30, 2011)

Total principal balance (DKK)	121,765,129,585
Bonds outstanding (DKK)	108,194,944,045
Total number of loans	61,336
Largest loan value (DKK)	425,371,824.0
Average loan (DKK)	1,763,971.0

Weighted-average LTV ratio (whole pool 72.29%)[1]

Subsidized housing (%)	85.45
Commercial[2] (%)	60.65
Private rental (commercial) (%)	77.62
Single family (%)	70.92
Level of arrears (whole pool 0.54%)	
Subsidized housing (%)	0.00
Commercial (%)	0.64
Private rental (commercial) (%)	1.04
Single family (%)	0.54
Properties in default (% of whole pool):	0.38
Weighted-average seasoning (whole pool – 33.3 months)	
Commercial	35.8
Single family	31.2
Proportion of ARMs (%)	84.7
Proportion of Residential IO loans (%)	63.4
Top 20 loans as % of pool	4.4
Reserve fund (% of CB)	12.5
Reserve fund composition:	
BRF SDOs (%)	76.93
BRF ROs (%)	3.80
Other Danish covered bonds (%)	13.16
Bank bonds (%)	6.11

[1]Based on Standard & Poor's adjusted calculation.

[2]Office, industry, tier 1 and 2

LTV—Loan-to-value.

IOF—Interest-only feature.

ARMs—Adjustable-rate mortgages.

ROs—"Realkreditobligationer".

SDOs—"særligt dækkede obligationer".

Our credit analysis accounts for these characteristics and comprises:

- The determination of the weighted-average foreclosure frequency (WAFF) ratio, which we essentially base on the loan-to-value (LTV) ratio of the underlying borrowers; and

- The determination of the weighted-average loss severity (WALS) ratio, which we derive from the LTV ratio and the expected market value decline of the property.

The product of the WAFF and WALS is the net loss that we assume may affect the portfolio in a 'AAA' scenario. At a 'AAA' rating level, the closing WAFF and WALS are:

WAFF	22.85%
WALS	38.99%
Assumed net credit loss (WAFF x WALS)	8.91%

BRFkredit has stated that it intends to continue originating ARM loans in Capital Centre E. We consider BRFkredit's Capital Centre E to be an established capital center and do not expect the issuer to materially change the current credit composition of the capital center.

POTENTIAL EFFECTS OF PROPOSED CRITERIA CHANGES

We have assigned the ratings on these covered bonds based on our criteria for rating covered bonds (see " Revised Methodology And Assumptions For Assessing Asset-Liability Mismatch Risk In Covered Bonds," published on Dec. 16, 2009). As part of our cash flow analysis, we used Standard & Poor's Covered Bond Monitor to calculate the target credit enhancement for the covered bonds. However, the assumptions and methodologies used in this cash flow analysis are under review (see " Advance Notice Of Proposed Criteria Change: Methodologies And Assumptions For Rating Certain Covered Bonds And CDOs," published on Aug. 5, 2010).

This review may result in further changes to the criteria. As a result, our future assumptions and methodologies used in our Covered Bond Monitor model may differ from our current criteria. The criteria change may affect the ratings on all outstanding covered bonds in this program. Until such time that we adopt new criteria for rating covered bonds, we will continue to rate and surveil these covered bonds using our existing criteria (see "Related Criteria And Research").

APPENDIX

BASE ASSUMPTIONS FOR THE CREDIT ANALYSIS OF DANISH MORTGAGE LOANS: RESIDENTIAL

Table 6

Base WAFFs (%)

AAA 12

WAFF—Weighted-average foreclosure frequency.

Table 7

Adjustments To The WAFF

LTV >70%

Base multiplied by 1.1 to 3. (Increases as LTV increases and caps when LTVs reach 100%).

Seasoning

Between 10% and 25% reduction to base, No adjustment applied to loans in arrears.

Buy-to-let

Base multiplied by 1.67.

Floating interest rate without cap (ARM loans)

20% of base.

Jumbo loans (> DKK 3,000,000)

1% to 20% of base. (Increases as loan size increases and caps when loan size reaches DKK 4,200,000).

Geographic concentration of > 10% in non-urban areas

20% increase to base WAFF for loans in region affected.

Arrears

Case by case consideration depending on arrears management and performance data. Up to 75% foreclosure frequency.

Bankruptcy

Case by case consideration. Up to 100% foreclosure frequency.

WAFF—Weighted-average foreclosure frequency.

ARM—Adjustable-rate mortgages.

LTV—Loan-to-value.

Table 8

Base Market Value Decline (%)

AAA 40

Table 9

Adjustment To Valuation

Valuation haircut 10% reduction on valuations made within the last calendar year. Applied in calculation of WALs only.

WALS—Weighted-average loss severity.

Table 10

Adjustment To Loss Severity

Jumbo properties (>DKK 3,750,000) Loss severity increases by between 1% to 20%. (Increases as loan size increases and caps when loan size reaches DKK 5,000,000).

Table 11

Commercial Property Type

Base WAFFs (%) AAA

Subsidized housing 12

Private rental 25

Agriculture 25

Office/retail/industrial 25

Land/incomplete buildings 50

Hotels/care homes/hospitals/exhibition centers 50

Leisure facilities/golf courses/other 55

WAFF—Weighted-average foreclosure frequency.

Table 12

Adjustments To The WAFF

LTV >70%

Base multiplied by 1.1 to 3. (Increases as LTV increases and caps when LTVs reach 100%).

Seasoning

Between 10% and 25% reduction to base, No adjustment applied to loans in arrears.

Floating interest rate without cap (ARM loans)

Base times 20%.

Geographic concentration of > 10% in non-urban areas
20% increase to base WAFF for loans in region affected.

Arrears

Case by case consideration depending on arrears management and performance data.

Up to 75% foreclosure frequency.

Bankruptcy

Case by case consideration. Up to 100% foreclosure frequency.

WAFF—Weighted-average foreclosure frequency.

ARM—Adjustable-rate mortgages.

Table 13

Commercial Property Type

Base market value decline (%) AAA

Subsidized housing	60
Private rental	55
Agriculture	55
Office/retail/industrial	55
Land/incomplete buildings	100
Hotels/care homes/hospitals/exhibition centers	75
Leisure facilities/golf courses/other	75

Table 14

Adjustment To Valuation

Valuation haircut 10% reduction on valuations made
in the period Q1 2005 – Q4 2008.
Applied in the calculation of
WALS only.

WALS—Weighted-average loss severity.

RELATED CRITERIA AND RESEARCH

- Global Structured Finance Scenario And Sensitivity Analysis: The Effects Of The Top Five Macroeconomic Factors, Nov. 4, 2011
- Principles Of Credit Ratings, Feb. 16, 2011
- Advance Notice Of Proposed Criteria Change: Methodologies And Assumptions For Rating Certain Covered Bonds And CDOs, Aug. 5, 2010

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- Update And Clarification To Counterparty Criteria For Interest Rate Swap Counterparties In 'AAA' Rated Transactions, April 1, 2009
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- Expanding European Covered Bond Universe Puts Spotlight on Key Analytics, July 16, 2004
- Cash Flow Criteria For European RMBS Transactions, Nov. 20, 2003
- Revised Criteria for Rating Danish Covered Bonds (Realkreditobligationer), July 10, 2003

Related articles are available on RatingsDirect. Criteria, presales, servicer evaluations, and ratings information can also be found on Standard & Poor's Web site at www.standardandpoors.com.

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RATINGS LIST

Program/ Rating

Country: Covered bond type

RATINGS AND OUTLOOK ASSIGNED

BRFkredit A/S - Capital Centre E

Long-term: AAA/Stable

Short-term: A-1+

Denmark: Særligt Dækkede Obligationer (Legislation-Enabled Covered Bonds)

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