S&P Global
Ratings

RatingsDirect®

Transaction Update: Wuestenrot Bausparkasse AG (Mortgage Covered Bond Program)

Hypothekenpfandbriefe

Primary Credit Analyst:
Natalie Swiderek, Madrid (34) 91-788-7223; natalie.swiderek@spglobal.com

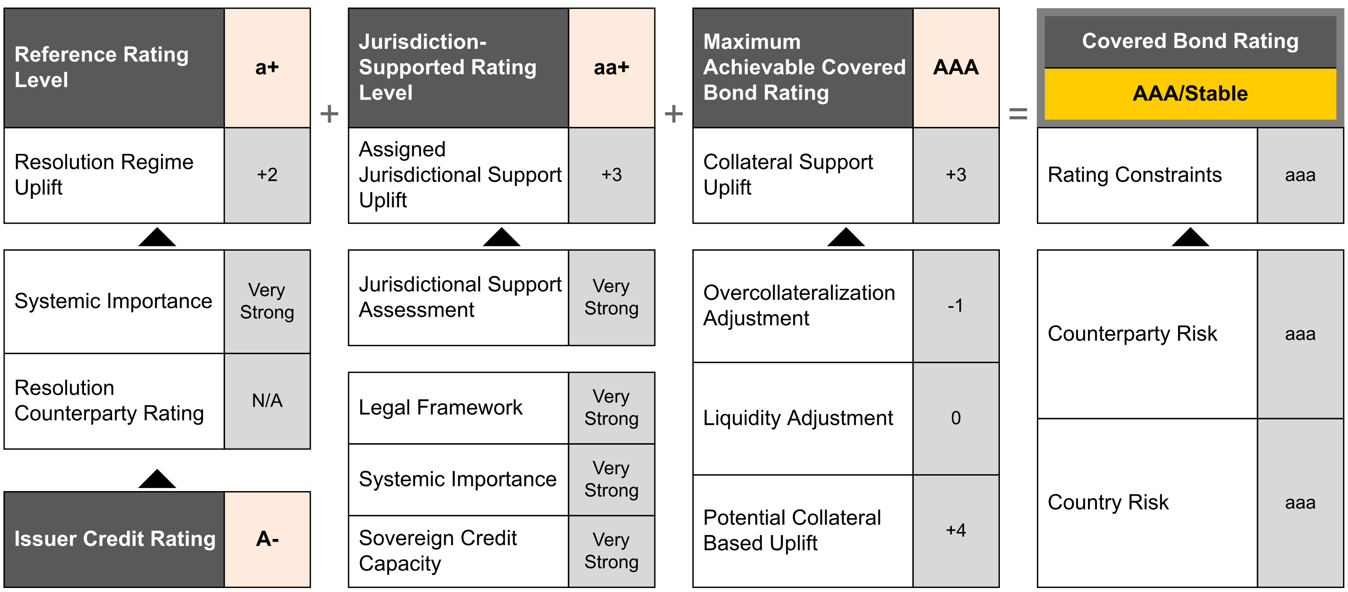
Research Contributor:
Tushar Karmokar, CRISIL Global Analytical Center, an S&P affiliate, Mumbai

Table Of Contents

Transaction Update: Wuestenrot Bausparkasse AG (Mortgage Covered Bond Program)

Hypothekenpfandbriefe

Ratings Detail



N/A--Not applicable.

Major Rating Factors

Strengths

- Granular, seasoned and geographically diversified cover pool, comprising exposures to German predominately residential mortgages.
- Well-matched asset and liability maturity profiles.
- Very strong jurisdictional support and 180 days' liquidity coverage required by law.

Weakness

- Commingling and bank account risk before the issuer's insolvency that is not addressed structurally or by the German legal framework, but is mitigated by the available collateralization.

Outlook

S&P Global Ratings' stable outlook on Germany-based Wuestenrot Bausparkasse AG's (WBSK) mortgage covered bonds ("Hypothekenpfandbriefe") reflects our view that a two notch lowering of our long-term issuer credit rating (ICR) would not in itself trigger a downgrade of the covered bonds, all else remaining equal. This is because the program benefits from two unused notches of uplift.

We may lower our ratings on the covered bonds if we were to lower the long-term ICR on the issuer by more than two notches or if the overcollateralization commensurate with the rating exceeded the available overcollateralization.

Rationale

We are publishing this transaction update as part of our periodic review of WBSK's mortgage covered bond program.

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014, and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

In our analysis, we assume the issuer's insolvency and look to the resolution regime, the jurisdictional support, and the cover assets to repay the covered bonds.

From our analysis of the legal and regulatory framework for covered bonds in Germany, we believe that the assets in WBSK's cover pool are isolated from the risk of the issuer's bankruptcy or insolvency. This asset isolation allows us to assign a higher rating to the covered bonds than our long-term ICR on WBSK.

We conducted a review of WBSK's operations in 2019, which we view as prudent. We believe satisfactory procedures are in place to support our ratings on the covered bonds.

WBSK is domiciled in Germany (unsolicited; AAA/Stable/A-1+), which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We consider that mortgage covered bonds have a very strong systemic importance to Germany. Therefore, under our covered bonds criteria, we assess the reference rating level (RRL) as 'a+'. This uplift recognizes the increased likelihood that the issuer could still service its covered bonds without reverting to a sale of assets in the cover pool, even after writing down or stopping payments to senior unsecured obligations.

We considered the likelihood for the provision of jurisdictional support. Based on a very strong jurisdictional support assessment for mortgage programs in Germany, we assigned three notches of uplift from the RRL (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018). Therefore, we assess the jurisdiction-supported rating level (JRL) as 'aa+'.

Following the assessment of the RRL and JRL, we analyze the cover pool's credit quality and the availability of liquidity support and committed overcollateralization to determine the maximum collateral uplift above the JRL. Our credit and cash flow analysis is based on data as of Oct. 1, 2019. The portfolio comprises German residential (80.2%) and non-residential mortgages (13.3%), and substitute assets (6.5%). Based on our cash flow analysis, the available credit enhancement (24.2%) exceeds the required credit enhancement for a 'AAA' rating (8.2%).

The covered bonds are eligible for three notches of collateral based uplift, given that the available credit enhancement covers the target credit enhancement, the covered bonds benefit from 180 days of liquidity, but there is no overcollateralization commitment commensurate with the rating.

The ratings on the program and related issuances are not constrained by legal, operational, sovereign, or counterparty risks.

Program Description

Table 1

Program Overview*	
Jurisdiction	Germany
Covered bond type	Legislation-enabled
Outstanding covered bonds (Bil. €)	1.98
Redemption profile	Hard bullet
Underlying assets	Residential mortgages, commercial mortgages, and substitute assets
Assigned jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Available credit enhancement (%)	24.19
Target credit enhancement (%)	9.42
Credit enhancement required for current rating (%)	8.22
Assigned collateral support uplift	1
Unused notches for collateral support	2
Total unused notches	2

*Based on data as of Oct. 1, 2019.

WBSK is a German "Bausparkasse", residential mortgage loan provider, and covered bond issuer. It is the core banking entity of Germany-based Wuestenrot & Wuerttembergische AG.

The covered bonds are regulated by the German covered bond framework and are issued under WBSK's debt issuance program, or stand-alone documentation. The cover pool assets are segregated from the issuer's remaining assets through entry in a cover pool register. Investors in covered bonds have recourse to WBSK and to a portfolio of mortgage and substitute assets assigned to the cover pool as collateral.

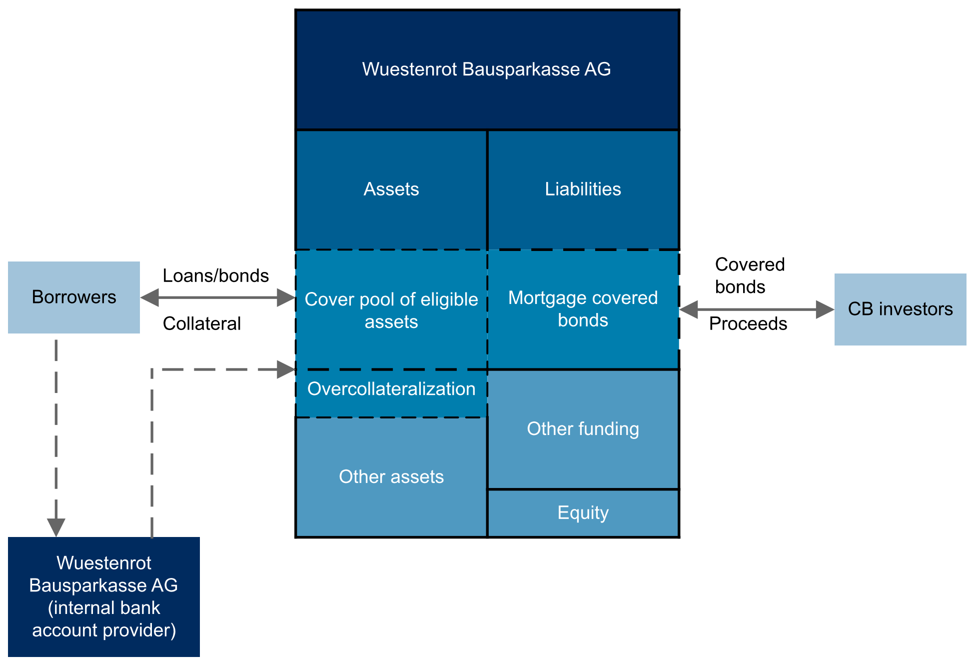
The covered bonds and cover pool assets are euro-denominated and predominantly fixed rate paying. There are no derivatives in the cover pool. WBSK is the issuer and bank account provider (see chart below).

Table 2

Program Participants			
Role	**Name**	**Rating**	**Rating dependency**
Issuer	Wuestenrot Bausparkasse AG	A-/Stable/A-1	Yes
Account bank	Wuestenrot Bausparkasse AG	A-/Stable/A-1	No

Chart 1

Program Structure



Rating Analysis

Legal and regulatory risks

The German Covered Bond Act (Pfandbriefgesetz; "PfandBG") and the relevant secondary legislation provide the legal framework for the issuance of German covered bonds (Pfandbriefe). Under the framework, banks can issue public-sector, mortgage, ship, and aircraft covered bonds.

We consider that the German covered bond legal framework satisfies the relevant legal aspects of our covered bonds criteria. This enables us to assign ratings to the covered bonds that exceed the long-term ICR on the issuer.

Covered bond investors have a preferential claim to a cover pool of assets. For mortgage covered bonds, this may comprise exposures to properties and rights equivalent to real property located in a member state of the European Union, the European Economic Area, Switzerland, the U.S., Canada, or Japan. The issuer may use mortgages as cover pool assets up to the first 60% of the property's value only, as estimated in accordance with the PfandBG. The cover pool may also include exposures to public-sector entities from the same geographic area as stipulated for the mortgage assets. Additionally, the cover pool can comprise eligible substitute assets.

According to the PfandBG, the issuer must maintain overcollateralization of at least 2% on a net present value basis for the outstanding covered bonds, and ensure 180 days of liquidity needs are covered by liquid assets at all times.

An independent trustee is responsible for monitoring the cover pool (cover pool monitor) until an independent cover pool administrator is appointed in case of the issuer's insolvency. The German Federal Financial Supervisory Authority (BaFin), appoints and supervises the cover pool monitor and cover pool administrator. BaFin also regularly conducts a covered bond audit.

We have analyzed the risk that, if the issuer becomes insolvent, cash received from the cover pool assets could be commingled with the cash belonging to the bank, resulting in a loss to the cover pool. We have determined that the German Covered Bond Act effectively segregates cash received after the issuing bank's insolvency, but that cash received shortly before insolvency and not reinvested in the cover pool assets could be exposed to commingling risk. We address this risk in our counterparty section.

In our analysis of legal risk we considered the guidelines in "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017, as well as our covered bonds rating framework criteria.

Operational and administrative risks

We review operational risk according to our covered bonds rating framework criteria. We consider the procedures used by the issuer in the origination and monitoring of the cover pool assets. We have conducted a review of origination, underwriting, collection, risk monitoring, and default management procedures for WBSK's cover pool assets. We also reviewed the cover pool's management and administration. In our view, WBSK has prudent underwriting and loan management policies. Therefore, we have not applied any adjustments to our credit or cash flow assumptions as a result of our assessment of operational risk.

WBSK maintains, voluntarily, overcollateralization levels that exceed the legal minimum requirement, in order to support the current ratings on the covered bonds. Covered bonds are a key funding tool for WBSK, and we believe that the issuer will continue to manage overcollateralization at the current rating level.

Furthermore, in our view potential backup servicers would be available if the issuer were to become unable to manage the program, considering that Germany is an established covered bond market and the underlying mortgages do not comprise product features that would materially limit the range of available servicers.

Resolution regime analysis

As part of our covered bonds criteria, our analysis considers the resolution regime in place in Germany to determine the RRL. The RRL on WBSK, which is the starting point for any further ratings uplift in our analysis, is 'a+'. We consider the following factors:

- WBSK is domiciled in Germany, which is subject to the EU's BRRD.
- Absent an assigned resolution counterparty rating for WBSK, we add two notches of uplift to the ICR because we assess the systemic importance for German mortgage covered bonds as very strong.

Jurisdictional support analysis

We conduct a jurisdictional support analysis to assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative. This is reflected in our JRL, which is our assessment of the creditworthiness of a covered bond program taking into account jurisdictional support, but before giving benefit to a covered bond program's ability to access other refinancing sources.

Our assessment of the expected jurisdictional support for German mortgage covered bond programs is very strong (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on Oct. 16, 2018). This means that WBSK's covered bonds can receive up to three notches of jurisdictional support uplift from the RRL. The covered bonds make use of these notches to achieve a 'aa+' JRL.

We also consider that the issuer's cover pool continues to comply with legal and regulatory minimum standards in Germany and that there are no limitations from the foreign currency rating on the German sovereign.

Collateral support analysis

Our analysis of the residential and the commercial portion of the cover pool is based on the application of the specific stresses defined for Germany under our European residential loans criteria and our commercial real estate criteria (see "Methodology And Assumptions: Assessing Pools Of European Residential Loans," published on Aug. 4, 2017, and "Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds," published on March 31, 2015).

As of Oct. 1, 2019, the cover pool comprises German residential (80.2%) and commercial mortgages (13.3%), and substitute assets (6.5%) (see table 3).

Since our previous review, the collateral pool's composition and credit quality have remained stable. As the cover pool balance reduced more than the balance of outstanding covered bonds the credit enhancement reduced to 24.2% from 27.4% but remains well above the target credit enhancement of 9.4% commensurate with the maximum potential collateral based uplift.

The mortgage cover pool is granular and well-seasoned with low loan-to-value ratios compared to other German covered bond programs we rate.

The below tables provide an overview of the cover pool's composition.

Table 3

Cover Pool Composition

	As of Oct. 1, 2019		As of Oct. 1, 2018	
Asset type	**Value (€)**	**Percentage of cover pool (%)**	**Value (€)**	**Percentage of cover pool (%)**
Residential mortgages	1,973,442,089	80.23	2,208,439,013	80.76
Commercial mortgages	326,303,343	13.26	366,160,671	13.39
Substitute/public finance assets	160,000,000	6.50	160,000,000	5.85
Total	2,459,745,432	100.00	2,734,599,684	100

Table 4

Key Credit Metrics

	As of Oct. 1, 2019	As of Oct. 1, 2018
Average loan size (€)	61,799	62,364
Weighted-average original LTV ratio (%)	56.68	57.08

Table 4

Key Credit Metrics (cont.)

	As of Oct. 1, 2019	As of Oct. 1, 2018
Weighted-average residential loan seasoning (months)*	141.99	136.32
Balance of loans in arrears (%)	0.22	0.3
Credit analysis results:		
Weighted-average foreclosure frequency (%)	8.72	9.73
Weighted-average loss severity (%)	6.80	8.13
'AAA' credit risk (%)	7.02	6.36

*Seasoning refers to the elapsed loan term. LTV--Loan-to-value.

Table 5

Cover Pool Assets By Loan Size

	Percentage of cover pool (%)	
(€)	**As of Oct. 1, 2019**	**As of Oct. 1, 2018**
0 – 50,000	23.03	22.75
50,000 – 100,000	39.84	41.83
100,000 – 150,000	20.47	21.04
150,000 – 200,000	7.86	8.12
200,000 – 250,000	3.69	3.09
250,000 – 300,000	1.40	1.14
300,000 – 350,000	0.71	0.53
350,000 – 400,000	0.50	0.23
400,000 – 450,000	0.39	0.26
450,000 – 500,000	0.28	0.24
500,000 – 550,000	0.42	0.22
550,000 – 600,000	0.23	0.10
> 600,000	1.18	0.46
Total	100	100

Table 6

Original LTV Ratios (%)

	Percentage of cover pool (%)	
	As of Oct. 1, 2019	**As of Oct. 1, 2018**
0-60	54.12	53.08
60-80	45.88	46.92
80-90	0	0.0
90-100	0	0.0
>100	0	0.0
Total	100	100

Table 7

Residential Mortgages Seasoning Distribution*

	As of Oct. 1, 2019	As of Oct. 1, 2018
Weighted-average loan seasoning (months)*	141.99	136.32
Less than 5 years (%)	11.35	11.89
Between 5 and 6 years (%)	4.25	7.06
Between 6 and 7 years (%)	7.07	7.39
Between 7 and 8 years (%)	7.71	7.94
Between 8 and 9 years (%)	7.67	4.19
Between 9 and 10 years (%)	4.08	5.79
More than 10 years (%)	57.67	55.47

*Seasoning refers to the elapsed loan term.

Table 8

Geographic Distribution Of Loan Assets

	Percentage of cover pool (%)	
Residential mortgages	**As of Oct. 1, 2019**	**As of Oct. 1, 2018**
Baden-Wuerttemberg	18.57	18.35
Bavaria	18.15	17.37
Berlin	2.63	2.53
Brandenburg	5.45	5.48
Bremen	0.42	0.46
Hamburg	0.92	0.86
Hesse	9.21	9.32
Lower Saxony	8.30	8.35
Mecklenburg-Vorpommern	2.31	2.39
North Rhine-Westphalia	13.99	14.45
Rhineland-Palatinate	5.53	5.67
Saarland	1.34	1.41
Saxony	4.17	4.21
Saxony-Anhalt	2.83	2.88
Schleswig-Holstein	3.28	3.33
Thuringia	2.89	2.96
Total		100
Commercial mortgages		
Baden-Wuerttemberg	14.08	13.52
Bavaria	11.07	10.65
Berlin	13.61	14.66
Brandenburg	5.06	4.87
Bremen	0.17	0.17
Hamburg	1.16	1.20
Hesse	12.23	11.82
Lower Saxony	5.21	5.39
Mecklenburg-Vorpommern	3.29	3.34

Table 8

Geographic Distribution Of Loan Assets (cont.)		
North Rhine-Westphalia	16.10	15.74
Rhineland-Palatinate	3.52	3.35
Saarland	1.21	1.21
Saxony	5.83	6.34
Saxony-Anhalt	2.69	2.84
Schleswig-Holstein	1.54	1.61
Thuringia	3.22	3.30
Total	100	100

Table 9

Collateral Uplift Metrics

	As of Oct. 1, 2019	As of Oct. 1, 2018
Asset WAM (years)	4.32	4.20
Liability WAM (years)	5.47	5.80
Available credit enhancement	24.19	27.37
Required credit enhancement for first notch of collateral uplift (%)	7.62	7.11
Required credit enhancement for second notch of collateral uplift (%)*	8.22	7.85
Required credit enhancement for third notch of collateral uplift (%)	8.82	8.60
Target credit enhancement for maximum collateral uplift (%)	9.42	9.34
Potential collateral-based uplift (notches)	4.00	4.00
Adjustment for liquidity (Y/N)	N	N
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	3.00	3.00

*Credit enhancement required for current rating. WAM--Weighted-average maturity.

We assess the credit quality of the mortgage cover pool by estimating the credit risk associated with each loan in the pool. We then calculate the aggregate risk to assess the cover pool's overall credit quality. To quantify the potential losses associated with the entire pool, we weight each loan's foreclosure frequency and loss severity by its percentage of the total pool balance. The product of the weighted-average foreclosure frequency (WAFF) and weighted-average loss severity (WALS) estimates the required loss protection, assuming all other factors remain unchanged.

Our credit results have remained stable compared to our previous review. As of Oct. 1, 2019, for the combined residential and commercial mortgage pool we estimated a WAFF of 8.72% and an expected loss given default (WALS) of 6.80%. We base these metrics on the 'AAA' credit stresses that we applied. The slight reduction in our WALS assumptions is due to an increase in the reported share of multifamily housing exposures within the commercial pool, which the issuer previously classified as "other" commercial properties. Under our commercial real estate criteria, multifamily housing attract a lower market value decline assumption (75%) compared to operating properties, which in turn leads to an overall lower combined WALS all else equal.

The issuer actively manages substitute cover pool assets, which leads to some variation in the portfolio's size and our default risk assessment over time. In line with our criteria "Methodology And Assumptions For Assessing Portfolios Of

International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," published on Dec. 9, 2014, we consider that the substitute portfolio exhibits low granularity. We therefore assume that in a 'AAA' stress scenario all substitute assets rated lower than 'AAA' default. We currently assess the asset default risk as 100% and calculate a recovery rate of 25% (down from 42% as of our previous review due to a change in the composition of these assets), which is applied immediately in our cash flow analysis.

The results of our credit analysis including default and recovery rates represent inputs to our cash flow analysis. Our weighted-average recovery period assumption in our cash flow modelling for the combined mortgage pool is 25.3 months. In addition, we assume a stressed refinancing spread for the mortgage pool of 506.6 basis points (bps), which is based on our "Assessments For Target Asset Spreads According To Our Covered Bonds Criteria," published on Oct. 16, 2018. Accordingly, we apply a stressed refinancing spread of 425 bps to German residential mortgages, and 1,000 bps to commercial mortgages.

We stress the cover pool's cash flows, incorporating among other factors, various default patterns, default timings, various interest rate stresses, prepayment rates, and delinquencies assumptions, which we run at different points over the weighted-average life of the covered bonds. In addition, in our analysis, we consider the risk that cash collections received from the cover pool assets shortly before the issuer's insolvency, and not reinvested in cover pool assets, could be lost through commingling with the issuer's cash (see "Counterparty risk").

Our cash flow analysis determines the target credit enhancement needed to achieve the maximum potential collateral-based uplift, inclusive of 100% refinancing costs, and the credit enhancement required to cover 'AAA' credit risk assuming no asset-liability maturity mismatch. Accordingly, we calculate a target credit enhancement of 9.4%, and a 'AAA' credit risk of 7.0%. Both figures have remained stable compared to our 2019 review. The small increase is mainly due to changes in the composition of the substitute assets, which attract a 100% default rate and a lower recovery rate assumption than in our 2019 review. In addition, there is an increased share of covered bonds (13%) due for repayment within four quarters after the reporting date, which leads to an increase in the target credit enhancement. These factors are partially offset by the improvements in our WAFF and WALS for the mortgage portfolio.

The covered bonds benefit from an available credit enhancement of 24.2% well in excess of the target credit enhancement of 9.4%. As a result, the maximum potential collateral-based uplift from the JRL is four notches. We then assess whether reductions to these four notches are required by reviewing the coverage of six months of liquidity and the level of overcollateralization commitment. Based on the legal requirement to cover at least 180 days of liquidity needs through liquid assets at all times, we do not apply any reduction to reflect liquidity risk (see "Legal and regulatory risks"). However, in order to support the covered bond ratings, the issuer provides overcollateralization in excess of the legal minimum, on a voluntary basis only. Consequently, we reduce the maximum potential collateral-based uplift by one notch.

This results in a collateral-based uplift of three notches above the JRL of 'aa+', of which one notch is used to achieve a 'AAA' rating with a required credit enhancement of 8.2%. The covered bond program therefore benefits from two unused notches of uplift, which provides a cushion to the 'AAA' rating in the event of an issuer downgrade by up to two notches, all else equal.

Counterparty risk

We have assessed counterparty risk under our counterparty criteria ("Counterparty Risk Framework Methodology And Assumptions," published on March 8, 2019).

There are no derivatives registered in the cover pool. WBSK acts as bank account provider to the covered bond program. We have identified bank account and commingling risk as relevant counterparty risks for the program.

Our legal analysis of the German Covered Bond Act has concluded that cover pool collections received post-issuer insolvency are not at risk of being commingled with the issuer's insolvency estate but could potentially be delayed. We believe that this risk is mitigated by the fact that the German Covered Bond Act requires the issuer to maintain liquid assets to cover 180 days of liquidity needs at all times.

However, cover pool collections received prior to the issuer's insolvency may be lost (i.e., commingled with the bank's general account balances), if they have not been reinvested prior to the issuer's insolvency. In the absence of structural mitigants, we took commingling and bank account risk into account when determining the required credit enhancement at the 'AAA' rating level by assuming that one month of collections equivalent to 2.5% of the cover pool are lost. The available overcollateralization of 24.2% covers the required credit enhancement of 8.2% at the 'AAA' rating level, inclusive of such risks.

As a result, counterparty risk does not constrain the rating on the covered bonds.

There are no derivatives registered in the cover pool.

Country risk

We consider country risk under our structured finance sovereign risk criteria (see "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumption," published on Jan. 30, 2019).

The cover pool includes exposures towards German residential and commercial mortgages and substitute assets comprising sovereign exposures to France, Spain, Finland, and Ireland.

Based on our unsolicited long-term rating on Germany (AAA/Stable/A-1+), sovereign risk does not constrain the covered bond ratings. Additionally, other sovereign exposures are not significant enough to cap the covered bond ratings under our sovereign risk criteria.

Related Criteria

- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumption, Jan. 30, 2019
- Criteria - Structured Finance - General: Methodology And Assumptions: Assessing Pools Of European Residential Loans, Aug. 4, 2017
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- Criteria - Structured Finance - Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015

- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions: Analyzing European Commercial Real Estate Collateral In European Covered Bonds, March 31, 2015
- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Criteria - Structured Finance - Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Insights Q4 2019, Dec. 12, 2019
- Global Covered Bond Characteristics And Rating Summary Q4 2019 Dec. 12, 2019
- Global Outlook: Covered Bond Harmonization Set To Raise The Bar In 2020, Nov. 26, 2019
- European Economic Snapshots: Further Slowdown Amid Rising Uncertainties, Oct. 22, 2019
- Europe's Housing Markets Lose Speed As The Economy Weaken, Sept. 24, 2019
- Covered Bond Monitor: Technical Note, Sept. 6, 2019
- Germany-Based Wuestenrot & Wuerttembergische Group Affirmed At 'A-'; Outlook Stable, July 19, 2019
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Germany 'AAA/A-1+' Ratings Affirmed; Outlook Stable, April 12, 2019
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Request For Comment: Counterparty Risk Framework: Methodology And Assumptions, Oct. 9, 2018
- Glossary of Covered Bond Terms, April 27, 2018