

# Sør Boligkreditt AS

## Mortgage Covered Bonds

Covered Bonds / Norway

### First Rating Assignment

2011

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### Definitive Ratings

Cover Pool(in NOK)	Ordinary Cover Pool Assets	Covered Bonds (in NOK)	Rating
5, 886,925,000	Residential Mortgage Loans	4,000,000,000	Aaa

The ratings address the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

### Transaction Summary

Moody's has assigned definitive long-term rating of Aaa to the mortgage covered bonds (*obligasjoner med fortrinnsrett* or covered bonds) issued by Sør Boligkreditt AS (the issuer). The covered bonds are full-recourse to the issuer. The issuer is a wholly owned subsidiary of Sparebanken Sør (rated A3/Prime-2; the parent company). The covered bond rating is linked to the credit strength of the issuer's parent company, mainly because Sparebanken Sør has established a revolving credit facility for the benefit of the issuer. Sparebanken Sør's commitment to the covered bond programme is further underlined by the range of functions it carries out on behalf of the issuer. The support provided by Sparebanken Sør also means that the reference point for Moody's timely payment indicator (TPI) for this covered bond programme (currently "Probable-High") will be the senior unsecured rating of Sparebanken Sør.

The covered bonds are governed by Norwegian covered bond legislation. In the case of the issuer's insolvency, the claims of the covered bondholder will be secured by a pool of assets (cover pool). As of 31 March 2011, the assets in the issuer's cover pool amounted to approximately NOK5.9billion. All the assets in the cover pool are Norwegian residential mortgages.

In summary, the covered bond rating takes into account, among other factors: (i) the credit strength of the Sparebanken Sør; (ii) the Norwegian legal framework for covered bonds; and (iii) the credit quality of the cover pool, which is reflected in the collateral score of 8.1%.

The overcollateralisation is currently 47.2% on a nominal basis, of which Moody's considers 11.5% to be "committed". The minimum overcollateralisation that is consistent with the current Aaa ratings is 10.5%. Moody's has assigned a TPI of Probable-High for the covered bonds issued by Sør Boligkreditt.

Moody's considers the transaction to be linked to the credit strength of the parent, in this case Sparebanken Sør. This is particularly true from a default probability perspective. If Sparebanken Sør's credit strength deteriorates, we would expect the rating of the covered bonds to come under pressure all things being equal.

If Sparebanken Sør's rating or the quality of its assets pool deteriorated, the issuer would have the ability, but not the obligation, to increase the overcollateralisation in the cover pool. Failure to increase the level of overcollateralisation under these circumstances could lead to negative rating actions.

Moody's will monitor this transaction using the rating methodology for covered bond transactions.<sup>1</sup>

## Opinion

### Strengths of the Transaction

**Issuer:** The covered bonds are full recourse to the issuer, which is a wholly owned subsidiary of Sparebanken Sør. The covered bond rating is linked to the credit strength of the parent company of the issuer, Sparebanken Sør (rated A3/Prime-2). Sparebanken Sør has established a revolving credit facility for the benefit for the issuer. Sparebanken Sør's commitment to the covered bond programme is further underlined by the range of functions it carries out on behalf of the issuer.

**The Norwegian Legal Framework:** The covered bonds are governed by the Norwegian covered bond legislation. There are a number of strengths in this legislation, which include *inter alia* the following:

- » The issuer is regulated and supervised by the Financial Supervisory Authority of Norway (NFSA or *Finanstilsynet*).
- » Upon the issuer's insolvency, the claims of the covered bondholder will be secured by a pool of assets. Eligibility criteria for assets in the cover pool are set out in the Norwegian covered bond legislation. The ordinary cover pool assets can be residential mortgages, commercial mortgage and public-sector debt. Mortgage covered bonds can only be issued against 75% of the loan to value (LTV) of residential mortgages and 60% of the LTV of commercial mortgages.
- » The value of the cover pool has to exceed the value of preferential claims against the pool itself (i.e. covered bondholder and claims of swap counter parties, if swaps are in the cover pool). Moody's understands that as a rule, derivative contracts and substitute assets are valued at prudent market value. However, bank deposits, which are redeemable with a notice of up to 30 days, and floating-rate loans are valued at their nominal value (plus accrued interest). The value of the outstanding covered bonds is determined by the sum of the discounted face value of the covered bonds and discounted coupon payments (present value).
- » There is an external cover pool monitor (*uavhengig gransker*) who is responsible for monitoring various operations with respect to the cover pool.

### Credit Quality of the Cover Pool:

- » The covered bonds are supported by a cover pool. The cover pool comprises Norwegian residential mortgages.
- » 97% of the mortgage loans are held by owner-occupier borrowers.
- » All of the mortgage loans are performing as of the date of this report.
- » The credit quality of the cover pool is reflected by the collateral score of 8.1%.

### Refinancing Risk:

- » Refinancing risk for Norwegian residential mortgage loans is lower than in many other jurisdictions as the issuer has the ability to reset loan rates on floating-rate residential mortgages. Moody's understands that the right to reset the margins on floating rate loans is based on the Norwegian Financial Institutions Act and requires giving the borrower six weeks' notice. Upon issuer default, the insolvency administrator of the issuer (who will be also responsible for the management of the cover pool) will be able to similarly reset the loan rates. We believe this right to reset margins should materially reduce the level of refinancing risk compared to most other cover bond jurisdictions.
- » The net liquidity inflow on the balance sheet of the issuer for the following six-month period should at all times be positive as stipulated by the Norwegian covered bond legislation. Stress tests on liquidity will be carried out.
- » All covered bonds outstanding under this programme benefit from a 12-months extension period.

### Interest Rate and Currency Mismatches:

- » No currency risk and only limited interest rate risk, because, as of 31 December 2010, all outstanding covered bonds and cover pool assets are floating rate and denominated in Norwegian kroner.
- » Interest rate and currency mismatches are expected to be swapped in addition to stringent internal limits imposed on interest rate and currency exposures.
- » Sør Boligkredit has swap agreements in place with counterparties that are not part of the Sparebanken Sør group. Moody's believes that these swaps are stronger than the standard swaps used in covered bond programmes outside Norway. However, as of the date of this report, there are no derivatives in the cover pool.

### De-Linkage:

- » Set-off risks is well addressed by the combination of the Norwegian covered bond legislation and the transaction structure of the issuer's covered bond programme.

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### Weaknesses and Mitigants

**Issuer:** As with most covered bonds, until issuer default the issuer can materially change the nature of the programme. For example, new assets may be added to the cover pool, new covered bonds issued with varying promises and new hedging arrangements entered into. These changes could impact the credit quality of the cover pool as well as the overall refinancing risk and market risks. **Mitigants:** (i) The covered bondholders have a direct claim on the issuer and benefit from the support provided by Sparebanken Sør; and (ii) the requirements and controls imposed by the Norwegian covered bond legislation.

### Credit Quality of the Cover Pool:

- » As of 31 March 2011, 75.7% of the loans in the cover pool are secured on properties in the Aust-Agder and Vest-Agder regions. This may increase the probability of significant losses. **Mitigant:** Moody's collateral score model takes into account, *inter alia*, the impact of borrower, regional and country concentrations.
- » Approximately 50% of the mortgage loans are interest only loans or flexi loans with bullet repayments. This may increase the probability for borrowers to default at the maturity of the loan. **Mitigants:** Moody's will monitor the cover pool and incorporate into our analysis the aforementioned risk factors.

**Refinancing Risk:** Following an issuer default, to achieve timely principal payment, covered bondholders may need to rely on proceeds being raised through the sale of, or borrowing against, assets in the cover pool. Following an issuer default, the market value of these assets may be subject to high volatility. **Mitigants:** (i) The credit strength of the issuer and the support of Sparebanken Sør. The stronger the credit of Sparebanken Sør, the lower the chance of being exposed to refinancing risk; (ii) the issuer's ability to raise interest rates on the underlying collateral, which is subject to six weeks notice; and (iii) the stressed refinancing margins used in Moody's modelling.

**Interest Rate and Currency Mismatches:** As of the date of this report, all the assets in the cover pool and the covered bonds are floating rate and denominated in Norwegian kroner. Moody's understands that under the programme Sør Boligkredit may issue fixed-rate covered bonds denominated in other currencies. This may give rise to potential interest rate and currency mismatches. **Mitigant:** There are interest rate and currency hedging agreements in place with third parties.

**Time Subordination:** After issuer default, later-maturing covered bonds are subject to time subordination. Principal cash collections may be used on a first-come, first-served basis, paying earlier-maturing covered bonds prior to later-maturing covered bonds. This could lead to overcollateralisation being eroded before any payments are made to later-paying covered bonds. **Mitigant:** If the bankruptcy administrator is of the opinion that it may not be able to repay covered bondholders in full and introduces a halt of the payments. All preferential claims over the cover pool will be calculated by discounting them to present value, on the date when payments have been halted. The liquidation proceeds from the cover pool will be used to repay the claims of all preferential creditors of the cover pool on a present value basis.

## Structure Summary

Issuer:	Sør Boligkreditt (unrated)
SponSør Bank:	Sparebanken Sør (rated A3/ Prime-2)
Structure Type	Mortgage covered bonds (obligasjoner med fortrinnsrett)
Issued under Covered Bonds Law:	Yes
Applicable Covered Bonds Law:	Norwegian covered bond legislation
Main Originators:	Sparebanken Sør
Main Servicers:	Sparebanken Sør
Intra-Group Swap Provider:	No
Monitoring of Cover Pool:	Cover pool monitor, mandatory by operation of the Norwegian covered bond legislation
Trustees:	n/a
Timely Payment Indicator:	Probable-High

## Covered Bonds Summary

Total Covered Bonds Outstanding:	NOK 4,000,000,000
Currency of Covered Bonds:	Norwegian kroner (100%)
Extended Refinance Period:	Yes, 12 months for all outstanding covered bonds
Principal Payment Type:	Soft bullet (12-month extension period)
Interest Rate Type:	Floating-rate covered bonds (100%)

## Collateral Summary (see Appendix 1 for further information)

Size of Cover Pool:	NOK 5,886,925,000
Main collateral type in Cover Pool:	Residential mortgages (100%)
Main Asset Location:	Norway (100%)
Loans Count:	6,634
Currency:	Norwegian kroner (100%)
Concentration of 10 Biggest Borrowers:	1.4% for the residential mortgage loans
WA Current LTV:	59.7%
WA Seasoning:	28 months
WA Remaining Term:	218 months
Interest Rate Type:	Floating-rate assets (100%)
"Committed" Overcollateralisation:	11.5%
Current Overcollateralisation:	47% (on a nominal basis)
Collateral Score:	8.1%
Cover Pool Losses:	12.85%
Further Details:	See Appendix 1
Pool Cut-off Date:	31 March 2011

## Structural and Legal Aspects

In its capacity as a regulated financial institution (*kredittforetak*) under the terms of the Norwegian covered bond legislation, Sør Boligkreditt has obtained a licence from the NFSA to issue covered bonds (*obligasjoner med fortrinnsrett*). The licence and its subsequent maintenance are subject to the issuer satisfying, on an ongoing basis, several requirements in respect to procedures and risk control systems set out by the Norwegian covered bond legislation and other applicable regulations.

Sparebanken Sør, which 100% owns the issuer, has sold a portion of its residential mortgage loan book to Sør Boligkreditt. Moody's expects regular further transfers from Sparebanken Sør to the issuer.

Sparebanken Sør provides a revolving credit facility to the issuer that covers the amount of the outstanding covered bonds.

### *Scenarios upon issuer default*

Upon the insolvency of the issuer, the Norwegian covered bond legislation would not contemplate the dissolution of the issuer, nor would it include any acceleration event or event of default. In the event of the issuer's insolvency, either of the following two scenarios may occur:

- » Payments to the creditors with a preferential claim over the cover pool (which includes covered bondholders and, if derivatives form part of the cover pool, derivative counterparties) would be continued by the bankruptcy administrator of the bank. The bankruptcy administrator would be appointed by the competent court, and would be responsible for running the general insolvency estate and the cover pool of the issuer.
- » The bankruptcy administrator decides that it may not be able to repay covered bondholders in full and introduces a halt of the payments. The creditors would be informed of the halt to payments and the date on which it is to be introduced. All preferential claims over the cover pool would be calculated by discounting them to present value, on the date when payments have been halted. The liquidation proceeds from the cover pool would be used to repay the claims of all preferential creditors of the cover pool on a present value basis.

According to the structure of this covered bond programme, payment flows with respect to the assets in the cover pool are made directly to an account in the issuer's name, which forms part of the cover pool. Moody's understands that the issuer intends to set up the same procedure for payments under derivatives, if derivative were part of the cover pool. This collection account is held at Sparebanken Sør. We believe with

this setup covered bondholders are exposed to commingling risk upon issuer default and bankruptcy of Sparebanken Sør. We have taken this into account in our expected loss and TPI analysis.

### *Set-off risk by operation of the Norwegian covered bond legislation*

Under the Norwegian covered bond legislation, no right of set-off may be declared for an asset included in the cover pool. It is Moody's understanding that, if a borrower exercises set-off in violation of the Norwegian covered bond legislation, the issuer will have a monetary claim against the borrower equal to the amount set-off. This claim can be brought before the courts and enforced. In addition, the issuer does not take deposits from its residential mortgage customers.

### *Clawback risk is mitigated by notification of the borrowers*

All borrowers will be notified at the time of transfer from Sparebanken Sør to the issuer. It is Moody's understanding that provided that the borrowers have been notified of the transfer of the loans to the issuer and the transfer has been performed in accordance with market practice, it cannot be subject to clawback by the transferor or any public administrator appointed in respect of the transferor.

## Moody's Rating Methodology

The approach used by Moody's for rating covered bond transactions is detailed in our Rating Methodology.<sup>2</sup> The impact of the credit strength of Sparebanken Sør, quality of the collateral and market risks is considered below.

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### Credit Strength of the Issuer

The covered bonds are full recourse to the issuer, which is a wholly owned subsidiary of Sparebanken Sør. The commitment of the parent company, which has established a revolving credit facility for the benefit of the issuer, to the covered bond programme is further underlined by the range of functions it carries out on behalf of the issuer.

The support provided by Sparebanken Sør means that the covered bond rating is directly linked to the parent company's credit strength. As previously mentioned, the reference point for Moody's TPI for this covered bond programme is also the senior unsecured rating of Sparebanken Sør.

For more information on Sparebanken Sør, see "Related Research".

## The Credit Quality of the Cover Pool

Moody's was provided with good-quality information on the cover pool assets. As of 31 March 2011, 100% of the cover pool assets are residential mortgage loans. All properties that are serving as security for the mortgage loans, are located in Norway, of which the vast majority is located in regions of Aust-agder and Vest-agder.

The cover pool assets, which total NOK5.9 billion, are backing a total of NOK 4 billion in outstanding covered bonds. This translates into over-collateralisation of 47% on a nominal basis, of which Moody's considers 11.5% to be committed.

According to the issuer, all residential mortgage loans in the cover pool are performing. The Norwegian covered bond legislation ensures that in any case, the 75% LTV threshold calculation takes any prior ranks into consideration. Under Norwegian covered bond legislation only the loan parts within the first 75% LTV threshold are eligible for inclusion in the cover pool in the case of residential mortgage loans. This is the case even if there are prior-ranking land charges over the property, which serves as security for the mortgage loan in the cover pool.

See Appendix 1 for more information on the cover pool.

## Residential Mortgages

From a credit perspective, Moody's views the following characteristics of the mortgage loans as positive:

- » All of the mortgage loans are performing as of the cut-off date of this report.
- » The weighted-average LTV of the residential mortgages is 59.7% (unindexed LTV). The loans have an average seasoning of 28 months.
- » 97% of the properties, which serve as security for the mortgage loans, are occupied by the borrower.
- » 97.4% of the loans are granted to employed persons, with the remainder of the loans granted to self-employed individuals. Based on provisions in the Transfer and Servicing Agreement between Sparebanken Sør and the issuer Moody's understands that mortgage loans to employees of Sparebanken Sør group are not eligible for the transfer to Sparebanken Sør Boligkredit's cover pool.
- » The income of the borrower has been independently verified, and the income restricts the amount that can be lent. Moody's understands that at the time of granting the

loan, Sparebanken Sør verifies the income of all applicants from independent sources.

From a credit perspective, Moody's regards the following portfolio characteristics of the residential mortgage loans as negative:

- » Around 75.7% of the properties securing the residential mortgages in the cover pool are concentrated in regions of Aust-Agder and Vest Agder.
- » Around 50% of the loans in the cover pool are flexi loans with a bullet principal repayments, which in Moody's view may increase default risk due to large one-off payment obligations for borrowers at loan maturity.
- » As is common in Norway, all valuations backing loans are valued based on an automated valuation method (AVM) provided by Eiendomsverdi. However, only valuations with a high confidence level are accepted. Where valuation data of sufficient quality is unavailable, the valuation will be supported by an external valuer report. In each case, the valuer will visit the property before making a valuation.

For further information on the income underwriting and valuation see Appendix 2.

## Summary Collateral Analysis: Collateral Score

These factors have been incorporated into Moody's analysis. We calculate collateral scores based on the characteristics of the mortgage loans in the pool using a scoring model. Our analysis takes into account *inter alia* the impact of borrower, regional and country concentration, as well as the different types of properties securing the loan.

The result of the cover pool analysis is the collateral score.<sup>3</sup> Moody's calculates a collateral score based on the credit quality of the cover pool assets as previously described. In addition, the collateral score published in this report reflects all adjustments made. As such, this number includes the cushion built in to address the aforementioned factors. For this transaction, the collateral score of the current pool is 8.1%.

## Other Credit Considerations

As with most covered bonds issued in Europe, there are few restrictions or limitations on the future composition of the cover pool. This may have the effect of creating substitution risk.

**Mitigants** to substitution risk, which should protect the quality of the cover pool over time, include:

- » Norwegian covered bond legislation requirements. Covered bond may only be issued against mortgages with a LTV of up to 75% of the prudent market value for residential loans and 60% of the prudent market value for commercial mortgages. Moody's understands that the issuer does not intend to include any commercial mortgage loans in the cover pool.
- » As per the regulations, the issuer will not take into account non-performing loans when computing the required matching test. However, the priority right of the covered bondholder remains as long as such loans are registered in the cover pool. Furthermore, it is Moody's understanding that non-performing mortgage loans will not be added to the cover pool. However, mortgage loans that move into arrears while in the cover pool will remain in the pool, but will not be taken into consideration for the mandatory cover test. The issuer has the ability to replace such assets with performing assets if the quality of the cover pool deteriorates.
- » The cover pool composition will be monitored.

If the quality of the collateral deteriorates below a certain threshold, the issuer would have the ability, but not the obligation, to increase the overcollateralisation in the cover pool to support the current rating. If additional overcollateralisation is not added following a deterioration of the collateral, this could lead to a negative rating action.

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## Refinancing Risk

Following an issuer default, where the "natural" amortisation of the cover pool assets alone cannot be relied on to repay the principal, Moody's assumes that funds must be raised against the cover pool at a discount if covered bondholders are to receive timely principal payment. After an issuer default, the market value of these assets may be subject to certain volatility. Examples of the stressed refinance margins we use for different types of residential and commercial mortgage loans are published in our covered bonds rating methodology.<sup>4</sup>

Aspects of this programme that are positive, with respect to refinancing risk include:

- » Provisions to allow for a principal refinancing period of twelve months, which should, in the event of an issuer default, improve the sales value of the cover pool and increase chances of timely principal payments on the covered bonds.

- » The ability of the lender to increase the interest rate charged on floating-rate loans to the underlying borrowers with a notice period of six weeks. This right also applies to any potential bankruptcy administrator in charge of the cover pool after a potential issuer default.
- » The expectation that swaps will be stronger from a timely payment point of view than most other swaps seen in the covered bonds market, if swaps were to be added to the cover pool.

Aspects of this programme that are negative, with respect to refinancing risk include:

- » Moody's understanding that all covered bonds issued under this programme will have a bullet repayment. However, the covered bonds will have an extension period of twelve months.
- » Our expectation that cover pool assets will have a higher weighted-average life compared to the outstanding covered bonds.
- » The material geographical concentration of the cover pool, with 75.7% of the mortgage loans located in regions of Aust-Agder and Vest-Agder. This may increase the probability of significant losses, but Moody's has taken this fact into account in its collateral score.
- » The lack of a separate cover pool administrator upon issuer default. The Norwegian covered bond legislation provides for a bankruptcy administrator to be appointed upon issuer default. The bankruptcy administrator will be responsible for both the insolvency estate and management of the cover pool.

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## Interest Rate and Currency Mismatches

As with the majority of European covered bonds, there is the potential for interest rate and currency mismatches. For example, following issuer default, covered bondholders may be exposed to interest rate risk, which could arise from the different payment promises and durations made on the cover pool and the covered bonds.

Following issuer default, the Moody's covered bond model looks separately at the impact of increasing and decreasing interest rates on the expected loss of the covered bonds, taking the path of interest rates that lead to the worst result. The interest and currency stressed rates used over different time horizons are published in Moody's covered bonds rating methodology.<sup>5</sup>

TABLE 1  
Overview Assets and Liabilities

	Assets (%)	Liabilities (%)	WAL Assets (Years)	WAL Liabilities (Years)
Fixed rate	0%	0%	n/a	n/a
Variable rate	100%	100%	18.2	4.3

WAL = weighted-average life, n/a = not applicable

Moody's understands that the issuer intends to hedge any interest rate and currency mismatches. We expect the swaps to be entered into with a third party rated at least A2.

Furthermore, we understand that: (i) the swaps contain provisions to assist in the timely payment of covered bonds; (ii) the swap collateral posting provisions should provide material support up until issuer default; and (iii) replacement triggers may protect bondholders following issuer default. As of 31 March 2011, there were no derivatives in the cover pool.

Aspects specific to this programme that are interest rate and currency mismatch-positive include:

- » The floating-rate nature of all loans in the cover pool. Interest risk may be limited by the variable nature of the assets in the cover pool.
- » The stringent internal limits imposed on interest rate and currency exposures.
- » Moody's expectation that, from a credit standpoint, the swaps, if added to the cover pool, will be stronger than most other swaps found in the covered bond market. Key provisions that will increase the chances of the swap surviving after an issuer default include: (i) the bankruptcy administrator, who will effectively manage the cover pool; and (ii) reduced payment provision under the swaps, which would mitigate a late payment on the covered bonds. Furthermore, Moody's expects the swaps to be entered into with counterparties that are not part of the Sparebanken Sør group.

Aspects specific to this programme that are interest rate and currency mismatch-negative include:

- » The material change of the nature of the programme by the issuer prior to default. All of the assets in the cover pool and the covered bonds are denominated in Norwegian kroner, as of the date of this report. However, like most covered bond programmes, prior to issuer default, the issuer can materially change the nature of the programme. For example, Sparebanken Sør Boligkreditt may issue fixed-rate covered bonds denominated in currencies other than Norwegian kroner. This would introduce material interest rate and/or currency mismatches, which nonetheless has to

be hedged according to the Norwegian covered bond legislation.

## Linkage

All covered bonds are linked to the underlying issuer rating. Sør Boligkreditt is a wholly owned subsidiary of Sparebanken Sør and benefits from the parent company's credit strength. The covered bonds will come under rating stress if the credit strength of the issuer or its parent deteriorates. Reasons for this could include:

- » Refinancing risk: Following issuer default, if principal receipts from cover pool collection are insufficient to meet the principal payment on a covered bond, funds may need to be raised against the cover pool. However, the issuer's default may negatively affect the ability to raise funds against the cover pool.
- » Exposure to decisions made at the discretion of the issuer in its role as manager of the covered bond programme. For example, prior to an issuer default, the issuer may add new assets to the cover pool, issue further bonds and enter new hedging arrangements. Such actions could negatively affect the value of the cover pool.
- » More generally, the incorporation of the strength of the issuer in accordance with Moody's rating methodology.

As a result of this linkage, the probability of default for the covered bonds may be higher than expected for senior unsecured debt with the same rating. However, Moody's primary rating target is the expected loss that also takes severity of loss into account, which in this case is consistent with the covered bond rating.

Moody's TPI<sup>6</sup> assesses the likelihood that timely payments will be made to covered bondholders following an issuer default, and thus determine the maximum rating a covered bond programme can achieve with its current structure while allowing for the addition of a reasonable amount of over-collateralisation.

Aspects to this programme that are TPI-positive include:

- » The extended refinance period of 12 months for all outstanding covered bonds.
- » Moody's expectation that swaps, if added to the cover pool, would be stronger from a credit standpoint than most other swaps found in the covered bond market. Compared with most swaps, there are a number of provisions included in cover pool swaps, which increase the chances that: (i) the swaps survive issuer default; (ii) the bankruptcy administrator will effectively manage the cover pool; and



(iii) the swaps will survive a late payment on the covered bonds. Furthermore, we expect the cover pool swaps to be entered into with counterparties that are not part of the Sparebanken Sør group.

- » Moody's understanding that set-off risk for loans registered in the cover pool, which are made under Norwegian law and located in Norway, is excluded by the operation of the Norwegian covered bond legislation. Furthermore, since the issuer will not take any deposits, covered bondholders should not be exposed to set-off risk.
- » The credit quality of the cover pool assets, which is reflected by the collateral score of 8.1%.

Aspects to this programme that are TPI-negative include:

- » The lack of a separate cover pool administrator in the event of issuer default. The Norwegian covered bond legislation provides for a bankruptcy administrator, who runs the cover pool in the interest of the covered bondholders, to be appointed in case of issuer default. However the bankruptcy administrator will also be responsible for running the estate of the insolvent issuer.
- » The large potential for currency risk (due to the expected issuance of covered bonds, which are not denominated in Norwegian kroner). However, Moody's understands that the issuer intends to hedge foreign currency risks using cover pool derivatives.
- » The issuers collection account is with its parent company Sparebanken Sør, which means in our view commingling risk, if both the issuer and Sparebanken Sør are insolvent.
- » The relatively small size of the Norwegian market.

Moody's has assigned a TPI of Probable-High to this transaction. The support provided by Sparebanken Sør also means that the reference point for our TPI for this covered bond programme will be the senior unsecured rating of Sparebanken Sør. However, the robustness of a covered bond rating usually depends on the credit strength of the issuer to a large degree.

The number of notches by which the issuer's rating may be downgraded before the covered bonds are downgraded under the TPI framework is measured by the TPI leeway. Based on the current TPI the TPI leeway for this programme is zero notches, meaning if the Sparebanken Sør's rating is downgraded to Baa1 the covered bonds of Sør Boligkreditt are downgraded, too, all other things being equal.

## Monitoring

The issuer is expected to deliver certain performance data to Moody's on an ongoing basis. If this data is not made available, our ability to monitor the ratings may be impaired. This could negatively impact the ratings or, in some cases, our ability to continue to rate the covered bonds.

## Appendix 1: Cover Pool Information

### Residential Mortgage Loans

Overview		Specific Loan and Borrower characteristics	
Collateral Score:	8.1%	Loans benefiting from a guarantee:	0.0%
Asset balance:	5, 886, 925,000	Interest Only Loans:	0.0%
Average loan balance:	887,387	Loans for second homes / Vacation:	0.0%
Number of loans:	6,634	Buy to Let loans / Non owner occupied properties:	0.0%
Number of borrowers:	6,467	Limited income verified	0.0%
Number of properties:	n/d	Adverse Credit Characteristics(**):	0.0%
WA Remaining Term (in months):	218		
WA Seasoning (in months):	28		
Details on LTV		Performance	
WA current LTV (*):	59.7%	Loans in arrears (≥ 2months - < 6months):	0.0%
WA Indexed LTV:	53.5%	Loans in arrears (≥ 6months - < 12months):	0.0%
Valuation type:	Market Value	Loans in arrears (> 12months):	0.0%
LTV threshold:	75%	Loans in a foreclosure procedure:	0.0%
Junior ranks:	n/d		
Prior ranks:	3.2%	Multi-Family Properties	
		Loans to tenants of tenant-owned Housing Cooperatives:	3.1%
		Other type of Multi-Family loans (****):	n/a

(\*) Based on original property valuation

(\*\*) Refers to Borrowers with previous missed payments, Borrowers with a previous personal bankruptcy or Borrowers with record of court claims against them at time of origination

(\*\*\*) n/d : information not disclosed by Issuer

(\*\*\*\*) This "other" type refers to loans directly to Housing Cooperatives and to Professional Landlords

CHART A

#### Balance per LTV-band

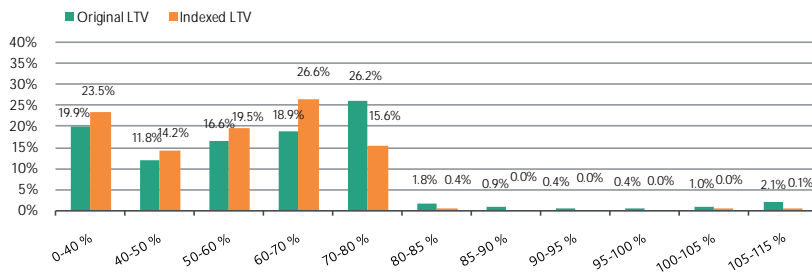


CHART B

#### Cover Pool Composition

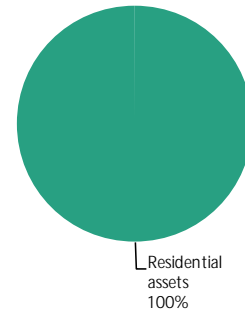


CHART C

#### Seasoning

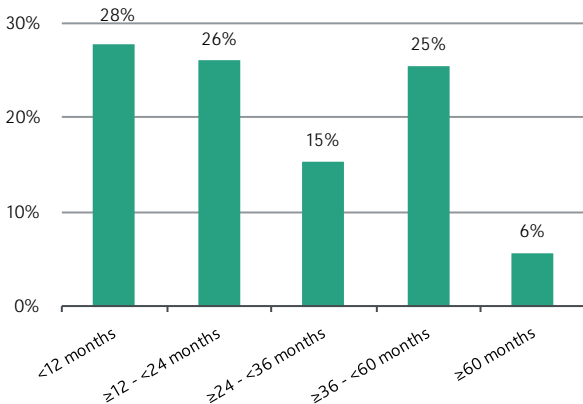


CHART D

#### Interest Rate Type

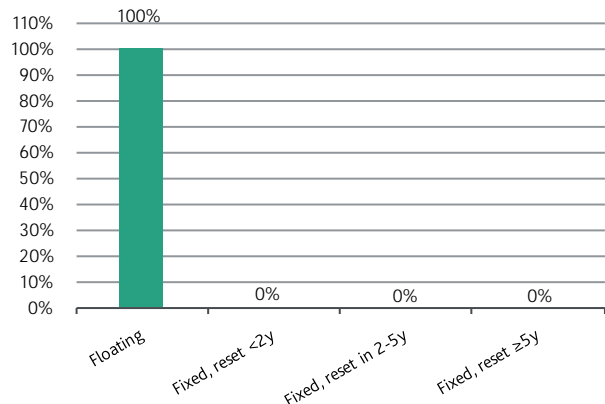
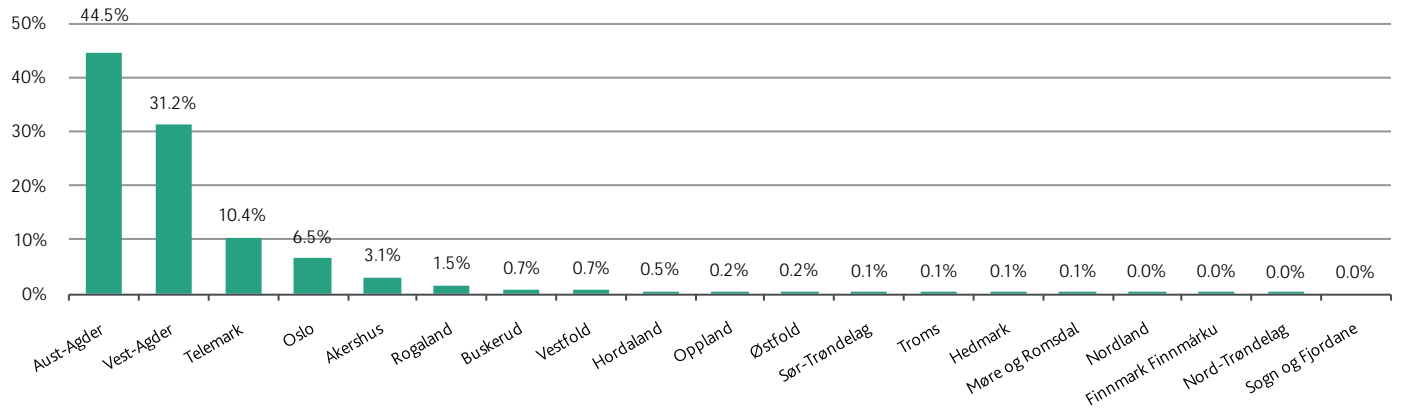


CHART E

## Regional Distribution



## Qualitative Collateral Information

All pool characteristics are actual levels (rather than assumed levels) based on reports from Sparebanken Sør Boligkreditt.

## Appendix 2: Income Underwriting and Valuation

### 1. Income Underwriting

1.1	Is income always checked?	Yes
1.2	Does this check ever rely on income stated by borrower ("limited income verification") income stated by the borrower?	No, we also check tax return.
1.3	What is the percentage of loans in the cover pool that have limited income verification?	None
1.4	If limited income verification loans are in the cover pool, describe what requirements does the lender have in place for these loans?	Not applicable
1.5	Does income in all cases constrain the amount lent (for example, through some form of income sufficiency test (IST))?	Yes, we have debt ratio scale that says if an IST should be performed. We might make exceptions, but this is very rare.
1.6	If not, what percentage of cases are exceptions?	We do not have a data source that makes it possible to state a percent, but it's a very low number. (sample check was performed, 3 out of 200 loans were exceptions)
For the purposes of any IST		
1.7	Is confirmed income after tax sufficient to cover both the interest and principal?	Yes
1.8	If so, over what period is it assumed that principal will be paid (typically on an annuity basis)? Any exceptions?	Maximum 30years, but normally less.
1.9	Does the age of the borrower constrain the period over which principal can be amortised?	No
1.10	Are any stresses made to interest rates when carrying out the IST? If so, when and for what type of products?	Yes. The client must be able to repay with an nominal interest of 9%.
1.11	Are all other debts of the borrower taken into account at the point a loan is made?	Yes
1.	How are the living expenses of the borrower calculated? What is the stated 12 maximum percentage of income (or income multiple if relevant) that will be relied on to cover debt payments (specify if income is pre or post tax)	Expenses are based on standard indices prepared by the SIFO model. SIFO is a non-bias governmental institute that conducts consumer research and testing. These are published yearly and are implemented in our computer systems. Our rules says that clients shall be able to handle these standard living expenses and repay the mortgage with an nominal interest of 9%, including all other debts. (This standard budget may be corrected up or down after a close look at the clients situation).
Other comments		If the client is new to us, we perform a detailed control of the economy and documentation. If the client is well known to us, we often use last year's tax return and transactions on their accounts as documentation.

Source: Sparebanken Sør Boligkreditt

### 2. Valuation

2.1	Are valuations based on market or lending values?	Market values. Maximum LTV for loans in the covered bond company is 75% of market value.
2.2	Are all, or the majority of, valuations carried out by external (with no direct ownership link to any company in the sponsor bank group) valuers?	All valuations are carried out by using a system delivered by Eiendomsverdi as (AVM).
2.3	How are valuations carried out where external valuers are not used?	NA (See 2.2.)
2.4	What qualifications do external valuers require?	- Member of one of the two appraiser associations, or - Well known to us as a professional, or - Real estate agent The valuer must know the local market for the property.
2.5	What qualifications do internal valuers require?	Not applicable
2.6	Do all external valuations include an internal inspection of a property?	No
2.7	Any exceptions?	In most cases our customer consultants know the different areas and price levels.
2.8	Do all internal valuations include an internal inspection of a property?	Not applicable
2.9	Any exceptions?	Not applicable
Other comments		None

Source: Sparebanken Sør Boligkreditt

## Related Research

For a more detailed explanation of Moody's approach to this type of transaction as well as similar transactions please refer to the following reports:

### Rating Methodologies:

- » ["Moody's Rating Approach to Covered Bonds," March 2010 \(SF191950\)](#)
- » ["Assessing Swaps as Hedges in the Covered Bond Market," September 2008 \(SF142765\)](#)
- » ["Moody's Approach to Rating Financial Entities Specialised in Issuing Covered Bonds," August 2009 \(SF175831\)](#)

### Special Reports:

- » ["Moody's EMEA Covered Bond Monitoring Overview: Q2 2010," April 2010 \(SF229472\)](#)
- » ["EMEA Covered Bonds 2011 Outlook & 2010 Review: Sovereign and issuer weaknesses set to drive 2011 EMEA covered bond performance", January 2011 \(SF229366\)](#)
- » ["European Covered Bond Legal Frameworks: Moody's Legal Checklist," December 2005 \(SF66418\)](#)
- » ["Moody's Approach to Automated Valuation Models in Rating UK RMBS," August 2008 \(SF121128\)](#)

### Announcement:

- » ["Covered bond issuer ratings important for accuracy and stability of covered bond ratings," 30 April 2009](#)

### Credit Opinion:

- » [Sparebanken Sør, 5 April 2011](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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- <sup>1</sup> As described in the Rating Methodology reports "[Moody's Rating Approach to Covered Bonds](#)" published in March 2010, and "[Assessing Swaps as Hedges in the Covered Bond Market](#)", published in September 2008. All can be found on [www.moodys.com](http://www.moodys.com) in the Credit Policy & Methodologies directory, within the Ratings Methodologies subdirectory. Other methodologies and factors that may have been considered in the process of rating this issue can also be found in the Credit Policy & Methodologies directory.
- <sup>2</sup> "[Moody's Rating Approach to Covered Bonds](#)", published in March 2010 (see Related Research).
- <sup>3</sup> The collateral score can be seen as the amount of risk-free enhancement required to protect a Aaa rating from otherwise unsupported assets. Therefore, the stronger the credit quality of the collateral, the lower the collateral score. This only considers the credit deterioration of the assets and ignores any risk from any market risks (see Rating Methodology "[Moody's Rating Approach to Covered Bonds](#)").
- <sup>4</sup> Please see Related Research: "[Moody's Rating Approach to Covered Bonds](#)", published in March 2010.
- <sup>5</sup> Please see Related Research: "[Moody's Rating Approach to Covered Bonds](#)", published in March 2010.
- <sup>6</sup> Please see Related Research: "[Moody's Rating Approach to Covered Bonds](#)", published in March 2010.

» contacts continued from page 1

**ADDITIONAL CONTACTS:**

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Report Number: SF245041

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