

Global Covered Bond Insights Q1 2024: Issuance Still Strong As Market Exits Central Bank Funding

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This report does not constitute a rating action



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Key Takeaways

- In 2024 we expect issuance activity to remain high, while mortgage origination stays muted. Stable credit quality will continue to help covered bond programs maintain their current ratings.
- Our ratings outlook on covered bonds remains stable, despite geopolitical tensions, market turbulence, the economic slowdown, and deteriorating asset performance.
- Overcollateralization should absorb any increase in losses, and unused notches of uplift in the ratings reduce the risk of covered bond downgrades even if there are downgrades among issuers.

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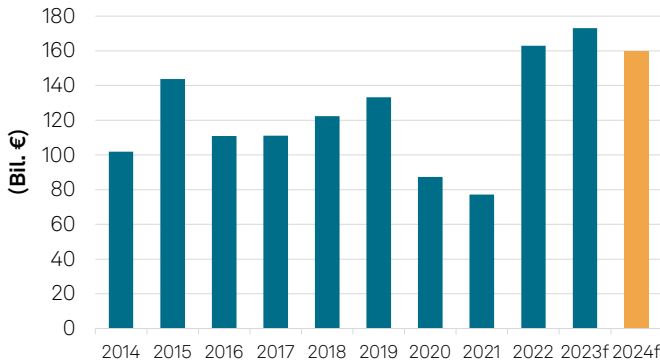
Benchmark European covered bond issuance hit a ten-year high in 2023, with issuers focusing on secured funding as they repaid earlier borrowings from central bank liquidity schemes. The trends supporting covered bond issuance may be slightly weaker in 2024, but issuance will likely remain close to recent highs, at about €160 billion.

We understand that the deal pipeline for the first quarter of 2024 will be busy, but uncertainty for the remainder of 2024 is high. Issuance activity will depend on whether higher-for-longer interest rates will make longer covered bond maturities attractive again. If so, we could see significant issuer interest in increasing the duration of their outstanding covered bonds.

Higher-for-longer interest rates are also squeezing commercial real estate (CRE) valuations, pushing capitalization rates up, and weighing on debt service coverage ratios and refinancing prospects. While we believe that more loans may default in 2024, we do not expect this to significantly impair the credit quality of the covered bonds that we rate.

Chart 1

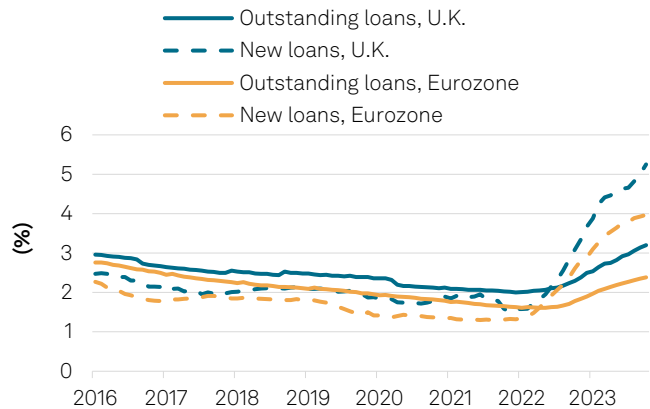
European investor-placed benchmark covered bond issuance



f--Forecast. Source: S&P Global Ratings.

Chart 2

Higher borrowing costs have yet to hit the majority of mortgage holders



Effective interest rates across all types of mortgage loans. Sources: European Central Bank, Bank of England, S&P Global Ratings. See also "European Housing Markets: Sustained Correction Ahead," July 20, 2023.

2023 Market Insight Highlights

In 2023, we examined how some of the major economic trends of the year could affect the main European covered bond markets.

Amid higher-for-longer inflation, we found that available credit enhancement and the presence of unused notches would further isolate covered bond ratings from pressures in the banking sector.

Ahead of a sustained correction in nominal housing prices across Europe, we said the credit enhancement available in the covered bond programs that we rate should be sufficient to absorb losses from increased mortgage arrears.

We also provided country-specific insights, looked at how covered bonds could ease pressure on CRE, and explored emerging covered bond markets in Central and Eastern Europe. The below roundup compiles some of the key takeaways from our research in 2023.

Covered Bonds Could Ease The Pain In European Commercial Real Estate

- European CRE is struggling with rising interest rate-induced repricing pressures and structural changes in the office property segment.
- Exposure to CRE and the potential for further covered bond funding varies significantly, depending on the covered bond issuer and jurisdiction.
- Covered bonds may be a potential source of stable funding for such assets.

Covered Bonds In New Markets: A Shifting Paradigm

- The transposition of the EU's harmonization directive will allow issuance in new markets in Central and Eastern Europe, while some of the existing frameworks outside the European Economic Area may be updated to achieve third-party equivalence.
- New issuers and markets will emerge, adopting innovative structures, using different assets, and challenging the current definition of covered bonds.

Danish Covered Bond Market Insights

- Danish mortgage borrowers have repurchased fixed, low interest rate covered bonds, refinancing to mortgages with adjustable rates. This has reduced their mortgage debt but increased interest rate sensitivity.
- House prices have stabilized, but a pending tax reform is fueling some uncertainty around the future direction of house prices.

Dutch Covered Bond Market Insights

- In the light of increasing interest rates, the mismatch in both maturity and interest rates on the asset and liability side may lead to higher required credit enhancement for Dutch covered bond ratings.

French Covered Bond Market Insights

- France was the largest market for covered bond issuance in 2023 as local banks continued to rely on covered bonds as a funding source.

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- The central-bank-set usury rate that lenders can charge to home loan clients along with new legally binding residential loan underwriting guidelines have restricted new home loan origination.

German Covered Bond Market Insights

- German benchmark covered bond issuance is lower than the total last year, but issuance has remained resilient.
- Exposure to CRE and mortgage assets outside of Germany differ significantly between programs.

Norwegian And Finnish Covered Bond Market Insights

- Subdued housing supply and increasing demand continue to support property prices in both countries.
- The increasing cost of covered bond issuance is lowering mortgage margins, which could lead to higher credit enhancements commensurate with the ratings on outstanding covered bonds.

Spanish Covered Bond Market Insights

- Residential mortgage performance remains supported by a resilient labor market and strong household wealth.
- The Spanish covered bond framework is now aligned to the EU covered bond directive through two Royal Decree Laws.

Swedish Covered Bond Market Insights

- Decreasing house prices and higher interest rates continue to dampen mortgage lending activity, while sticky deposit savings has kept covered bond issuance low.
- Swedish issuers could support covered bond issuance backed by multifamily or tenant-owner right associations currently held by Swedish property companies, in our view.

Payment Shock In Swedish Covered Bond Pools

- Swedish house prices remain under pressure. For a sample of over a million mortgage loans backing Swedish covered bond programs, the average monthly payment has risen significantly and will continue to rise.
- Many loans backing Swedish covered bonds pay interest only. These loans are more sensitive to rate rises and see almost twice the monthly payment increase compared with amortizing loans in our sample.

Core Characteristics And Risk Indicators

The main core characteristics and risk indicators are accessible [here](#).

Global Covered Bond Insights Q1 2024

Tutorial video: How to navigate Global Covered Bond Interactive

Overview
Ratings distribution and outlook
Country focus

Key insights

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- Overcollateralization should absorb any increase in losses, and unused notches of uplift in the ratings reduce the risk of covered bond downgrades even if there are downgrades among issuers.

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The data can be downloaded in excel format from the link included in the CapitalIQ version of the article.

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European investor-placed benchmark covered bond issuance (bil. €)

f=Forecast, Source: S&P Global Ratings.

Covered bond rating actions (count)

Source: S&P Global Ratings.

Recent covered bond rating actions

	New issue	Withdrawn	Affirmed	Upgraded	Downgraded	On CreditWatch
Issuer						
Country of issuer						
Covered bond type						
Asset type						
Current covered bond rating						
Covered bond rating in Q3 2023						
ICR						

No new issues for Q4 2023

ICR=Issuer credit rating, DCB=Dutch covered bond, LCB=Legislation-enabled covered bonds, EDC=European Covered Bonds, GCB=Greek covered bonds.

As of December 15, 2023

S&P Global Ratings

Related Research

- [Covered Bonds Outlook 2024: Stability Amid Turbulence](#), Dec. 11, 2023
- [EMEA Structured Finance Chart Book: November 2023](#), Nov. 21, 2023
- [Global Covered Bond Insights Q4 2023: Weathering The Housing Market Correction](#), Oct. 20, 2023
- [Economic Outlook Eurozone Q4 2023: Slower Growth, Faster Tightening](#), Sept. 25, 2023
- [German Covered Bond Market Insights 2023](#), Sept. 13, 2023
- [Credit FAQ: What An Acceleration Of Quantitative Tightening Could Mean For Eurozone Banks](#), Sept. 13, 2023
- [French Covered Bond Market Insights 2023](#), Sept. 7, 2023
- [European Housing Markets: Sustained Correction Ahead](#), July 20, 2023
- [Covered Bonds Outlook Midyear 2023: Rising Interest Rates Will Test Asset Performance](#), July 19, 2023
- [Global Covered Bond Insights Q3 2023: Strong Issuance Is Here To Stay](#), June 29, 2023
- [Covered Bonds In New Markets: A Shifting Paradigm](#), May 24, 2023
- [Covered Bonds Could Ease The Pain In European Commercial Real Estate](#), May 16, 2023
- [Global Covered Bond Insights Q2 2023: The Implications Of Rising Interest Rates](#), April 12, 2023
- [Covered Bonds Outlook 2023: Sailing Through Choppy Waters](#), Dec. 6, 2022

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