Helaba

Covered Bond Special
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Singaporean covered bonds: Prime credit quality made in Asia

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Today's market environment is marked by high degree of uncertainty. A combination of energy price shocks, elevated inflation, rising interest rates, a challenging macroeconomic outlook, persistent supply chain disruption and the turmoil arising from the war in Ukraine have resulted in significant volatility on markets. At the same time, they are fuelling the search for safe haven investments. Given this backdrop, it comes as little surprise that, thanks to their resilience, **covered bonds** are enjoying a **surge in popularity among investors**.

Following a recent boom in the issuance of these popular instruments on primary European markets, the current turbulence could well prove to be a boon for issues from the APAC region. The relatively limited size of the market means **covered bonds from Singapore** do not play a major role globally. But they do **score top marks** in terms of the quality of the issues themselves, the country rating and the high ratings of the issuing banks (**see appendix**). In view of the relatively short, weighted average time to maturity of 1.9 years and the associated maturities of Singaporean covered bonds, a steady stream of new issues can be expected over the next few years. A euro-denominated volume of EUR 5.5 billion in benchmark covered bonds is due to mature from now until 2025 alone.

In this Covered Bond Special, we present you with a brief overview of the Singaporean covered bond market.

Key features:

Singapore	AAA/Aaa/AAA
Residential property loans (EUR bn)	109
Covered bond type	Mortgage Covered Bonds
Residential cover assets (%)	100%
Issuers	DBS Bank Ltd. Oversea Chinese Banking Corporation (OCBC) United Overseas Bank (UOB)
Maximum LTV ratios (residential and commercial property)	80%
Legal / regulatory OC	3%
Substitute assets	15%
Valuation method	Market Value
ECB-/LCR eligible	No (not G10) / Yes
Collateral types pursuant to Art. 129 CRR	Yes, with 20 % risk weight
Issuance method hard bullet/soft bullet/CPT	no/yes/no

Sources: Fitch, Moody's, S&P, ECBC, issuer websites, Helaba Research & Advisory

The **three issuers** from Singapore - **DBS Bank Ltd, Oversea-Chinese Banking Corporation (OCBC) and United Overseas Bank (UOB)** - are universal banks that hold a covered bond licence. Of particular note is that all Singaporean covered bonds have been awarded a top "AAA" rating by the major rating agencies. All the respective parent banks enjoy ratings in the "A" range, which underpins the bonds' rating stability.

MAS raises cap on covered bond issuance - systemic importance of market growing

In October 2020, MAS (the Monetary Authority of Singapore) raised the cap on covered bond issuance **to 10 % of banks' total assets** from a previous limit of 4 %. This step enabled institutions to expand their issuance activity, cater to a larger market and, consequently, reduce their overall funding costs and risks. As the Singapore market has grown, so has the systemic importance of covered bonds. The desire to maintain confidence in covered bonds is also rising. That makes it altogether more likely that supportive measures will be taken by the market and supervisory authorities in the future.

A small market with steadily rising volumes and an 8-year track record

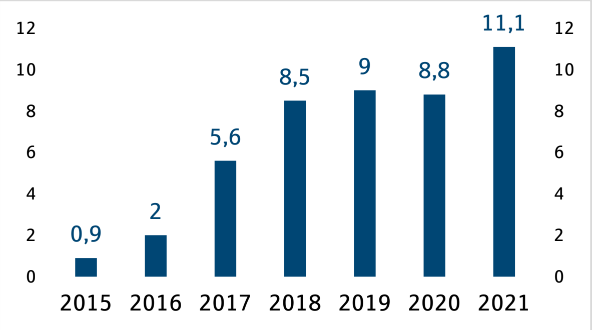
Since 2015, Singaporean issuers have placed benchmark bonds with a combined volume equivalent to **EUR 17.3 billion** (as of 2 December 2022), with **United Overseas Bank** (UOB) accounting for the largest share of this issuance.

The outstanding volume of Singaporean mortgage covered bonds has also been growing continuously.

EUR is the primary issuance currency for all three Singaporean issuers. The proportion of covered bonds issued in euro in Q3 2022 was as follows: OCBC 85.7 %, UOB 78 % and DBS Bank 40.5 %. The latter is more active than its competitors in USD and GBP, which account for 26.6 % and 23.8 % of total issuance, respectively. In contrast, OCBC and UOB only use GBP as a secondary currency area (14.3 % and 22 %, respectively). To date, there has been no issuance of covered bonds with sustainability features.

Outstanding volume exhibits steady growth

Outstanding volume in EUR (billions)

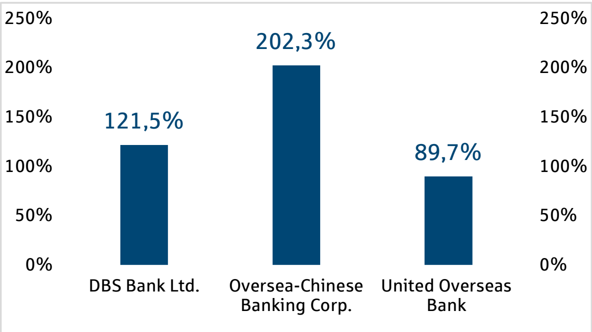


Sources: ECBC, Helaba Research & Advisory

High over-collateralisation ratio and rating buffer support stable rating outlook

High over-collateralisation provides security

Nominal over-collateralisation of Singaporean issuers in %



Sources: Issuer websites, Helaba Research & Advisory, as of: Q3 2022

With over-collateralisation (OC) ratios of between 89 % and 202 % (as of end of September 2022), Singaporean issuers comfortably exceed both the statutory minimum requirement of 3.0 % as well as the minimum OC ratio consistent with their respective ratings as calculated by Moody's of 1 % (DBS) and 0 % (UOB and OCBC).

In addition to high over-collateralisation ratios, the covered bond ratings include a buffer to the issuer reference rating that supports a stable rating outlook. Moody's has assigned a 3-notch uplift to DBS Bank and a 5-notch uplift to OCBC and UOB. S&P applies 3 notches of uplift to UOB's covered bond programme. In line with the agencies' standards, a downgrade of up to 3 or 5 notches (depending on the issuer) would not affect the covered bond rating provided that the risk profile of the underlying cover pool does not change and sufficient over-collateralisation is available.

Significant interest rate and maturity mismatches

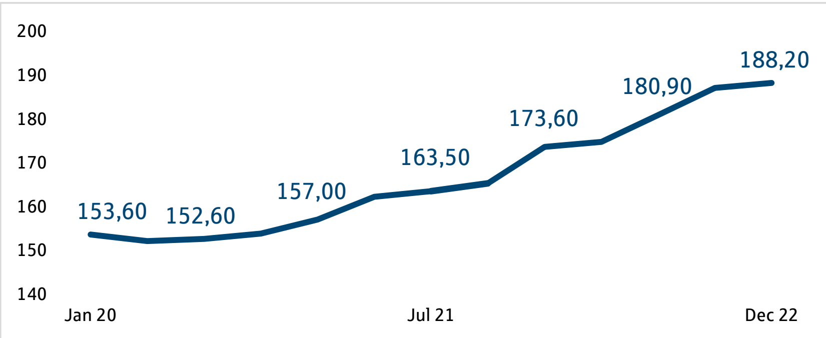
The average weighted time to maturity of the three Singaporean issuers' cover pools ranges from 19 to 20 years, while that of the covered bonds themselves is only 1 to 3 years. As a result, there are significant mismatches. In terms of interest rates, too, the funding structure is characterised by substantial incongruities that pose corresponding interest rate risks, albeit their extent varies depending on the share of fixed-coupon covered bonds and fixed-interest cover assets (see appendix).

Singapore among the most expensive housing markets in the world

Singapore is one of the world's most expensive residential property markets and is regarded as a safe haven by foreign investors. Forecasts indicate that **property values** are set to **grow steadily** in the years ahead. This was also the case at the peak of the COVID-19 crisis in 2021, when a total of 28,734 residential property transactions were recorded - an increase of 57 % compared to 2020. Of all transactions in 2021, 12,574 were for new builds and 15,677 for resales. This trend has been fuelled by demand for larger living spaces coupled with the prospect of permanent work-from-home arrangements. **In the three months to September 2022**, prices of residential housing in Singapore rose by **3.8 %** from the previous quarter. This compares to a 3.5-percent increase in Q2 2022 over the first three months of the year and was the **tenth consecutive quarter of rising prices** on the Singaporean residential property market.

Sustained growth in Singapore's private residential property price index

Index points



Sources: Urban Redevelopment Authority, Helaba Research & Advisory

However, there is a risk that the rising cost of living and higher interest rates may have a negative impact on the rapid pace of price appreciation. The government has meanwhile **tightened lending limits** on housing loans to ensure "prudent borrowing" and to avert any future difficulties.

Due to limited supply, it is likely that **prices for residential property** in Singapore will see **modest gains** over the next 12 months - even if interest rates rise. Overall, the continued growth of Singapore's residential property market in the last eighteen months underscores confidence in the country's real estate market.

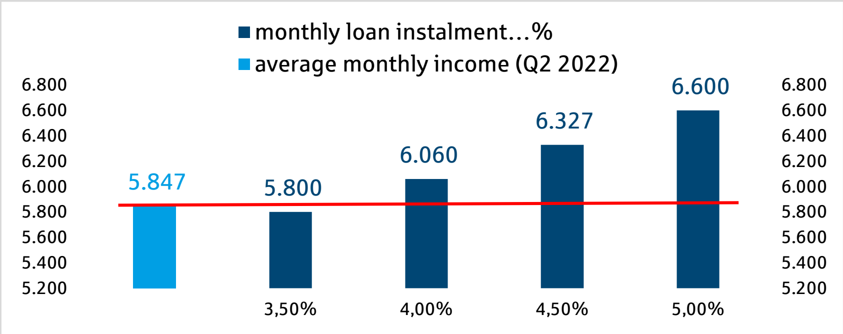
Private households - mortgage rates rise and borrowing slows

Our assumption is that **mortgage rates** in Singapore will rise in line with global benchmark rates until the middle of 2023, as central banks around the world push ahead with efforts to combat inflation with monetary tightening. Given that around half of all mortgages in Singaporean cover pools are floating-rate loans, they will be impacted by higher lending rates. That said, the **high savings rate** of Asian households should provide a certain degree of relief. In some parts of the region, total savings exceed household debt. In the future, though, there will be a more uneven variation in the distribution of liquid assets between households with different levels of debt. Credit risks will particularly increase for more vulnerable segments of the population (those with lower incomes or fewer liquid assets).

For private households, indicators are pointing to a **slowdown in borrowing**. Faced with a weaker and increasingly uncertain economic situation, households are becoming more cautious and are limiting their discretionary spending. In our view, there will be a trend towards a further deterioration in the **affordability of housing** over the next 12 months as a gradual increase in household income will not suffice in compensating for interest rate hikes and higher property prices. In August, first-time buyers of residential property in Singapore needed 19.4 % of their average monthly household income to meet mortgage payments for new home loans. This compares to 17.3 % in December 2021.

Monthly mortgage payments at different interest rates

S$ thousands per S$1 million home loan



Sources: Bloomberg, Helaba Research & Advisory

On a positive note, encouraging signals are coming from the labour market with the creation of jobs in sectors such as aviation and tourism. This should contribute to a slight improvement in private household incomes.

Covered bond framework: Singaporean covered bonds on a good path to achieve EU equivalence

MAS Notice 648 and, in particular, **Chapter 19 of the Banking Act** form the basis for Singapore's covered bond legal framework. However, Singaporean covered bonds are largely based on **contractual agreements** and are governed by the principles of the common law of contract, which applies to all aspects of a bond's structure. In conjunction with specific provisions for covered bonds that have been implemented, this creates an overall framework that is comparable with other European jurisdictions. As such, **Singapore's legal system is similar to that of the United Kingdom** in that, essentially, the structure of covered bonds is based on legislation or legal statutes that have been formally enacted by the Parliament of the Republic of Singapore. Guidelines issued by MAS, which are derived from **MAS Notice 648** as amended, provide clarity with respect to the characteristics of a covered bond from Singapore.

The rating agency **Fitch is of the view** that Singapore's legal framework for covered bonds is **on track to achieve equivalence with European Union standards**, as it is consistent with the majority of aspects of the EU Covered Bond Directive (CBD). Additionally, the agency stresses that Singaporean covered bonds have a AAA rating and are therefore **equal to or even higher than covered bonds in the EU**. The currency swaps used to hedge liabilities also meet the requirements of the EU Directive. However, a **limiting factor** that the agency notes is that the liquidity of Singaporean covered bonds is secured by means of a 12-month soft bullet redemption period rather than the 180-day liquidity buffer, as required by the Covered Bond Directive. This could ultimately influence the EU Commission's conclusion of equivalence.

In respect of **LCR eligibility**, the challenge for Singaporean covered bonds is to apply the transparency requirement of **Article 14 CBD**, despite not falling within the scope of the EU CBD. In our view, investor reports from DBS, UOB and OCBC already satisfy this criterion. Fundamentally, the LCR Delegated Regulation requires **equivalent supervision** pursuant to CBD requirements and the application of **regulatory provisions of Article 129 of the Capital Requirements Regulation (CRR)**. According to the EBA, this will be assessed on a case-by-case basis. **Supervisory and regulatory** provisions of a third country must at least be equivalent to those applied in the European Union (**LCR Article 11 (1d)(ii)**). We believe that, pending an "equivalence confirmation", it can be assumed that the requirements for LCR eligibility are met with reference to MAS Notice 648. Accordingly, Singaporean covered bonds are classified as LCR Level 2a assets with a risk weight of 20 %.

Key figures*	DBS Bank	Overseas Banking Corp.	United Overseas Bank
Outstanding covered bond volume (EURm)	7.671,0	3.161,7	8.845,5
Total cover assets (EURm)	17.396,0	10.050,4	16.781,0
thereof derivatives (%)	-	31,5	53,0
thereof substitute assets (%)	1,5	0	1,2
Over-collateralisation (%)	121,50%	202,30%	89,70%
Fixed-coupon covered bonds (%)	67,1	85,1	74,8
Fixed-rate cover assets (%)	53,5	30,8	66
Weighted average, CB (years)	3,04	0,9	1,3
Weighted average, cover assets (in years)	20	19,2	20,9
Residential cover assets (%)	100	100	100
Commercial cover assets (%)	0	0	0
Loan to Value (LTV) unindexed (residential) (%)	53,3	54	56
Loan to Value (LTV) indexed (residential) (%)	45,2	43,8	49,7
Loan seasoning ≥ 60 months	48,6	57,5	35,8
Non-performing loans (NPLs) (<90 days) (%)	0	0	0
10 largest exposures	0,2	0,7	0,6
Number of borrowers	-	-	-
Loans repayable on demand (%)	0	0	0
Buy-to-let / Non-owner occupied	27,7	24,6	19,8
Key indicators for rating**			
Covered bond ratings (Moody's/Fitch/S&P)	Aaa/AAA/-	Aaa/AAA/-	Aaa/-/AAA
Buffer to issuer reference rating	3/-/-	5/-/-	5/-/3
Credit risk (Moody's: Collateral Score/S&P: WAFF&WALS)	5,0%/-	5,0%/-	5,0%/2,4%
Market risk (Moody's: Market Risk)	20,6%	20,6%	20,6%
Committed over-collateralisation: (Moody's/S&P)	1,0 %/-	0,0 %/-	0,0 %/9,1%

* Q3 2022

** Q2 2022

Sources: Covered Bond Label, issuer websites, Moody’s, Fitch, S&P, Helaba Research & Advisory

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