FitchRatings

Fitch Rates Panama's Banco La Hipotecaria's Inaugural Covered Bonds 'BBB'

Link to Fitch Ratings' Report(s):

Banco La Hipotecaria, S.A. - Mortgage Covered Bonds (/site/re/10054247)

Fitch Ratings - Sao Paolo - 03 December 2018: Fitch Ratings has assigned a final rating of 'BBB' with a Stable Outlook to Banco La Hipotecaria, S.A.'s (BLH, BB+/Stable) first contractual mortgage covered bond program. The first issuance is USD11 million, with a 5.5% coupon and in the form of five-year soft bullet covered bonds with a 12-month principal maturity extension period and three months of interest protection.

There is no covered bond framework in Panama, but Fitch believes that the contractual arrangements for the program and local legal framework are effective so that the cover assets are sufficiently ring-fenced from the remaining portion of the issuer's balance sheet. The covered bondholders will benefit from a dual recourse as the covered bonds will rank pari passu, among themselves and will be BLH's direct, unconditional and unsubordinated obligations. In the event of an issuer default, the covered bondholders will also benefit from security in a special purpose vehicle (SPV) thatholds the collateral trust assets assigned to it by BLH and will guarantee covered bond payments. The collateral trust SPV isolates its assets from the estate of the issuer.

RATING ACTIONS

ENTITY/DEBT	RATING		PRIOR
Banco La Hipotecaria, S.A.			
senior secured, Mortgage Covered Bonds, Mortgage Covered Bonds	LT BBB New Rating		BBB(EXP)

KEY RATING DRIVERS

BLH's 'BBB' mortgage covered bond rating is constrained by Panama's sovereign Long-Term Issuer Default Rating (IDR: BBB/Stable) due to the cover pool's exposure to the sovereign. About a third of the residential mortgages are granted to civil servants, and more than 70% have subsidies given by the government of the Republic of Panama. Also, the account bank should carry the greater of a 'BBB' rating and the sovereign rating of Panama. The Stable Outlook reflects the sovereign's Outlook, a two-notch buffer against the downgrade of the issuer's IDR, and the current account bank rating (BBB+/Stable). The program documents state that if the account bank is downgraded below the minimum threshold of the greater of a 'BBB' rating and the sovereign rating of Panama remedial actions would be triggered within 60 calendar days.

The rating is based on BLH's 'BB+' Long-Term IDR and a recovery uplift of two notches (of the three assigned to the program). No further uplift is given despite assigning a payment continuity uplift (PCU) of one notch and a recovery uplift of three notches, which would translate into a total four-notch uplift above the issuer's Long-Term IDR. The mentioned constraint limits the full uplift to two notches of recoveries, and, as such, Fitch does not test for timely payments.

The 'BBB' breakeven overcollateralization (OC) of 12% (equivalent to a breakeven asset percentage (AP) of 89.5%) is based on a 'BBB' stressed credit loss of 11.7% as the program is rated based on recoveries given default analysis.

UPLIFTS ASSIGNED ABOVE THE BANK'S IDR

IDR Uplift

Fitch assigned a zero-notch IDR uplift as there is no advanced bank resolution framework in Panama. Even if there were one in place, we would not have sufficient clarity on the bank's ability to maintain payments on the bonds in a resolution scenario, as there is no lender of last resort in Panama.

Payment Continuity Uplift (PCU)

Despite the 12-month principal extension and three-month liquidity reserve for interest protection, Fitch has assigned a one-notch PCU. Fitch believes that once the liquidity reserve has been used for one interest payment in a jump-to-default event of the issuer just before a covered bond payment date, interest and principal collections from the cover pool may be insufficient to meet the subsequent interest payments on the bonds in time. This is because of potential delays in the collection of the tax credit related to the interest subsidies offered to borrowers and to the current low seasoning of the cover pool, which make principal collections low. We also see a potential interest-rate mismatch between assets and liabilities.

These risks are partly mitigated by the portfolio ratio requirements, especially the "pool net weighted average interest rate ratio" and the "pool gross weighted average interest rate ratio" and by the backup servicer and account bank being very familiar with BLH's systems, facilitating an immediate takeover in the event of an issuer default. Also, while difficult, there is a possibility for some asset sales. We thus expect some level of protection for timely interest payment.

Recovery Uplift

A three-notch uplift for recoveries is assigned as the 25% contractual OC (80% AP) provides more protection than the 11.7% 'BBB' stressed credit loss. This credit loss drives the 'BBB' breakeven OC.

COVER POOL CREDIT QUALITY

The covered bonds are secured by a cover pool of USD39.6 million, consisting of 1,302 residential mortgage loans granted to Panamanian residents for the acquisition of owner-occupied property (principal residence), based on a cut-off date of end-September 2018.. From time to time, the issuer will assign additional assets to the SPV with the aim to maintain the maximum contractual level of AP. A total of 88% of the payments are paid by direct debit from the borrowers' payroll.

The cover pool's weighted-average (WA) original loan/value ratio (OLTV) is 85.8%. The WA seasoning is 40 months, while the WA loan term is 353 months. The payment-to-income ratio is around 24%, while the debt-to-income ratio is about 36%. The cover pool benefits from having preferential interest rate mortgages through a subsidy granted by the Republic of Panama; however, the program documents limit this to 80% of the pool.

Cover Pool Credit Analysis

Fitch has analyzed and stressed the cover pool using its Latin America RMBS Rating Criteria. BLH's quality of origination, servicing procedures and staff qualifications are in line with other Panamanian prime lenders and are of high quality.

Given the exposure to interest rate increases and expiration of fiscal credits, Fitch defined a cushion to the expected gross default of 2.8% to arrive at a 'B' weighted average foreclosure frequency (WAFF) of 3.5% and a 'B' weighted average recovery rate (WARR) of 63.2%. Fitch calculated that, in a 'BBB' scenario, there would be a cumulative WAFF of 18.9% and a WARR of 44.5% for the cover pool. The 'BBB' rating loss rate is 10.5%. For the purpose of its covered bonds recovery given default analysis, Fitch converts this rating loss rate into a credit loss, which is the percentage equalising the covered bonds with the cover pool net of the amount of stressed losses and with a theoretical OC of zero. This leads to an 11.7% credit loss for the program.

RATING SENSITIVITIES

BLH's covered bond rating of 'BBB' would be vulnerable to a downgrade if the relied-upon OC falls below the 'BBB' breakeven OC of 12%, if the bank's Long-Term IDR falls below 'BB-', or if the total number of notches represented by the PCU and the recovery uplift is reduced to one or less. An upgrade of the rating of BLH's covered bonds would be possible if Panama's sovereign rating is upgraded. Ratings are always subject to the relied-upon OC being sufficient to cover Fitch's break-even OC for a given rating level.

Fitch's breakeven AP for the covered bond rating will be affected, among other factors, by the profile of the cover assets relative to outstanding covered bonds, which can change over time, even in the absence of new issuance. Therefore the breakeven AP to maintain the covered bond rating cannot be assumed to remain stable.

DATE OF RELEVANT COMMITTEE

30-Nov-2018

The source of information used to assess these ratings was BLH.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Additional information is available on www.fitchratings.com

Applicable Criteria

Latin America RMBS Rating Criteria (pub. 07 Dec 2017) (/site/re/907206)
Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 01 Aug 2018) (/site/re/10039504)
Bank Rating Criteria (pub. 12 Oct 2018) (/site/re/10044408)
Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 23 Oct 2018) (/site/re/10047041)
Covered Bonds Rating Criteria (pub. 08 Oct 2018) (/site/re/10047240)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (/site/dodd-frank-disclosure/10054160)
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