Covered Bonds

January 2014

Analysts

Covadonga Aybar
Senior Financial Analyst
+44 (0)207 855 6662
caybar@dbrs.com

Vito Natale
Senior Vice President
+44 (0)207 855 6649
vnatale@dbrs.com

Claire Mezzanotte
Group Managing Director
+44 (0) 20 7855 6672
cmezzanotte@dbrs.com

Recent Actions

December 23, 2013
DBRS Assigns BBB Rating to Caja Rural de Granada Cedulas Hipotecarias

Table of Contents

Caja Rural de Granada Cedulas Hipotecarias

Ratings

Series	DBRS Rating
Cedulas Hipotecarias	BBB

See appendix A for full list of Cedulas.

Rating Rationale

The ‘BBB’ rating assigned by DBRS Ratings Limited (DBRS) to the cedulas hipotecarias (CH, the Spanish legislative mortgage covered bonds) issued by Caja Rural de Granada (CRG or “the issuer”) is based on: the issuer rating of BBB (low); DBRS Legal and Structuring Framework assessment of “Modest” associated with Spanish CH; the cover pool credit assessment of ‘BBB (low)‘; and CRG’s capabilities with respect to origination and servicing of the cover pool assets.

Caja Rural de Granada issued its first single stand-alone CH on 16th December 2013, a EUR600mln issuance maturing in 2018. The DBRS rating of CRG CH addresses the timely payment of interest and full repayment of principal by the legal final maturity date. It also factors in an assessment of the cover pool substantial support in case of the issuer defaulting.

All else equal, a downgrade of the issuer rating would lead to a downgrade of the covered bonds by an equal number of notches.

Notable Features
Following the issuance, the total outstanding amount of CH is EUR0.6bn while the aggregate balance of mortgages in the cover pool is EUR1.576 bn. This provides for an available over-collateralisation (OC) of 162%.

The cover pool is composed of 43% residential and 57% non-residential mortgage loans. This is a common feature among Spanish covered bonds as CH are backed by the entire mortgage book of the bank, except for those mortgage loans pledged to securitisations and bonos hipotecarios. This is a 65-month seasoned pool geographically concentrated in the Autonomous Community of Andalusia (96%).

The CH has a bullet maturity with a weighted average life (WAL) of 5 years, while the cover assets are amortising with a WAL of 10.6 years. Spanish CH do not benefit from any maturity extension or pre-funding mechanism. The Spanish CH law allows for the possibility of setting aside liquid assets up to 5% of each CH (this 5% liquid assets could only be used to support the CH to which they refer), however as customary in the Spanish market, this is not put in place. The wide asset-liability mismatch can only be partly mitigated by the substantial amount of OC, therefore leaving a considerable risk of interruption of payments on the CH in a post issuer-insolvency scenario.

A large portion of the assets in the cover pool (98.5%) are floating rate, indexed to different basis, while the CH issued pay a fixed rate of interest. As customary in the Spanish market, the CH do not benefit from any hedging agreement to address such interest rate mismatch. This risk is mitigated by the substantial amount of OC available and has been accounted for in DBRS cash flow modelling.

CRG Cedulas Hipotecarias

Report Date
January 31, 2014

Transaction Summary

CRG CH are issued under the Spanish Covered Bond Law. As of December 2013, the volume of outstanding CRG's CH is EUR 0.6 bn. DBRS understands that CRG is required to pay interest and principal on the CH, and in case of issuer default, the CH do not accelerate and the entire mortgage book of the bank, except for those loans backing securitisations or bonos hipotecarios, is available to repay principal and interest on the Covered Bonds. The CH are directly issued by CRG with the cover pool remaining on CRG's balance sheet.

DBRS understands that the Spanish legislation gives the CH holders a special privileged claim to the cover pool. DBRS also recognizes the uniqueness of the CH holders claim to all of the mortgage assets of a Spanish issuer versus other jurisdictions where a defined pool is backing the covered bonds.

The Minimum Mandatory OC level for Spanish CH is 25% on the eligible pool. The eligible pool is calculated based on the eligibility criteria summarised under "Spanish Legislation Summary". The OC currently available is 83% based on the eligible pool and 162% based on the entire mortgage book.

Strengths

- CRG capabilities with respect to origination and servicing of the cover pool assets.
- Spanish CH legislation gives covered bond holders a preferential claim to the cover pool assets upon the insolvency of the issuer. DBRS also recognize the uniqueness of the CH holders claim to Issuer's entire mortgage book versus other jurisdictions.
- High level of OC available (162%).

Challenges and Mitigating Factors

- Continued weakness in the Spanish banking sector and prolonged economic slowdown in the property market. This is mitigated by DBRS MVD assumptions taken under DBRS analysis and OC available.
- CH are exposed to material issuer risk as CRG is the originator and servicer of the mortgages, which is a common characteristic in the Spanish market. This is mitigated by the supervision by the Bank of Spain (BoS).
- Liquidity gap between the bullet payments of the CH and the amortisation profile of the cover pool assets. Maturity mismatches between the principal bullet payments of the covered bonds (WAL 5 years) and the amortization profile of the loans (WAL 10.6 years). Moreover, Spanish CH do not benefit from any maturity extension. This is mitigated in part by the OC available and the "Modest" LSF Assessment.
- CH do not benefit from hedging agreements to cover the mismatch between the interest paid by the cover pool (98.5% floating rate) and the interest paid to the covered bond holders (100% fixed rates). This risk is mitigated by the OC available.
- 57% of the cover pool is formed by non-residential assets, having non-residential assets is a common feature among Spanish issuer and the cover pool eligibility criteria are set by law.
- The historical performance of non-residential assets is worse than its peers and arrears ratios are above the average observed in the Spanish market. According to CRG and in line with their Risk Distribution Statements, potential risky loans have been already identified and classified as non-performing. DBRS has taken into account CRG delinquency data to derive the cover pool LGD assumptions.
- DBRS concerns regarding CH structural features and the Spanish legal framework. This risk is accounted for in the "Modest" LSF Assessment.

Transaction Parties

Transaction Parties	Name	DBRS rating
Issuer	Caja Rural de Granada	BBB (low) Negative Trend
Originator	Caja Rural de Granada	BBB (low) Negative Trend
Servicer	Caja Rural de Granada	BBB (low) Negative Trend
Account Bank	Caja Rural de Granada	BBB (low) Negative Trend
Paying Agent	Banco Cooperativo Español	BBB (high) Negative Trend

Legal and Structuring Framework

DBRS has assessed the LSF related to the Spanish CH as "Modest" according to its rating methodology. DBRS understands that the Spanish legislation gives the CH holders a special privileged claim to the cover pool and recognizes the uniqueness of Spanish CH where the total mortgage book of the issuer, except for those loans backing securitisations or bonos hipotecarios, will be available to satisfy the claims of CH holders in case of an issuer default versus other jurisdictions where covered bond holders have a privileged claim to a designated pool of assets. However, DBRS believes that there are other considerable risks related to specific characteristics of the Spanish CH and the legislation and regulations applicable to the Spanish CH.

The LSF assessment of "Modest" reflects DBRS concern regarding (1) the lack of ring-fencing of collections from the cover pool prior to issuer insolvency; (2) the considerable risk of interruption of payments on the CH following an issuer's insolvency; and, (3) the lack of contingency plans set out in the legislation to protect CH holders from payment disruptions after an Issuer's insolvency.

More specifically, DBRS believes that there are other risk related to a potential short-term disruption of payments on CH (particularly interest due and payable) following an issuer's insolvency given that prior to issuer insolvency the cash flows of the cover pool are not segregated from other sources of operating funds, there are no pre-appointed cover pool administrator and there is a lack of liquidity test for CH issuers.

Additionally, DBRS has concerns regarding the management of the cover pool due to the lack of an independent cover pool monitor or contingency plans pre-insolvency of the issuer and no requirements to update property valuations.

For more information, please refer to "DBRS Commentary on Spanish Cedulas Hipotecarias Legal and Structuring Framework", available at www.dbrs.com

Issuer

DBRS conducted an operational review of Caja Rural de Granada's (CRG) mortgage loan and cover pool management operations in November 2012 and August 2013 respectively. DBRS considers the originations and servicing practices of CRG to be fairly consistent with other small Spanish banks.

The Caja Rural network was established in 1989 with 41 rural banks and has since expanded to include 73 banks and nearly the entire network excluding the roughly 10 banks that have merged with Cajamar to form Cajas Rurales Unidas. Excluding Cajamar, the average asset size for a caja is less than €2bn and at least four cajas have balance sheets exceeding €5bn including CRG with total assets of just over €6bn as of December 2012. Banco Cooperativo Espanol S.A. (BCE) was created in 1990 to serve as a central bank for the CRs which are also BCE's shareholders. BCE provides various services to the cajas including a share IT system provided by Rural Servicios Informaticos (RSI).

CRG, headquartered in Granada, was founded in 1969 in the region of Andalusia. The bank as a provincial institution linked to the agricultural sector and has more recently become a universal banking entity serving all sectors of the economy. CRG does not have any territorial limitation and has branches located outside its home province and maintains a significant market share in Granada.

Origination

All originations for CRG are internally sourced through their respective branch networks with oversight and support from the regional or territory offices particularly for the larger cajas. The branches are responsible for managing the relationship with the borrower as well as collecting data and the required documentation and inputting the information into the respective credit scoring system and rating model, where applicable.

CRG offer the standard mortgage products common in the Spanish market and such loans are generally capped at an 80% LTV although higher LTVs are possible with additional guarantees and approval outside the branch office. The maximum lending amount for non-owner occupied residential assets is typically below 80% including new builds and commercial properties. Variable and fixed rates are available and nearly all loans are on monthly payment schedules.

Underwriting

The underwriting and loan approval process is generally consistent across CRG and performed at the branch level. The overall underwriting process at all CRG includes an analysis of financial statements, historical analysis of the debtor's exposure to each bank and the wider Spanish banking system and valuations for secured loans. As consistent with the overall Spanish market, full income verification is conducted on all customers including collection of pay stubs, review of bank accounts as well as last two years' audited financial statements, tax returns, acts of incorporation and lists of outstanding loans for self-employed borrowers.

The caja employs credit scoring and rating models that incorporate credit bureau data, sector data, financial statements and qualitative elements although such models are somewhat less developed at the smaller banks and may, for instance, lack the qualitative component. The internal ratings apply mainly to SMEs and corporates and some self-employed borrowers. Ratings are based on a standard probability of default calculation and have been reviewed and approved by the Bank of Spain. The internal rating systems are also regularly back-tested and validated. The ratings (and credit scores for individual borrowers) are mainly used for assessing the borrower's creditworthiness and overall risk profile and are used as an on-going monitoring tool including some behavioural scoring functionality with monthly or quarterly updates of credit bureau data.

CRG' approval authority limits are fairly conservative with branch approval limited to around €50,000 for mortgage (secured) loans and only €10,000 for unsecured products. Dual approval is required for all loans and various committees are in place to review loans over €50,000. The risk committee approval is capped at €500,000. As with all Spanish banks, approval levels are set according to competency and size, particularly branch level authority as well as the risk profile of the borrower and the complexity of the loan driven by LTV and property type.

Real estate valuations are carried out for all secured loans. All appraisals are performed by external valuers and comply with Bank of Spain regulatory guidelines.

Servicing

Across CRG, servicing activities are fairly consistent with some centralisation of administrative functions in the respective bank's head office and primary borrower contact including collections and early arrears management activities managed with the local branches. Payments are primarily made through direct debit as most of the borrowers have current accounts with the caja.

CRG follows standard collections and arrears management strategies including compliance with regulatory guidelines surrounding delinquency, watch list and default definitions. Automated, standard letters are generated through the servicing system and sent to the borrower around day 15 and day 30. The internal rating system is used to monitor the loan including updates to the rating and helps to set the appropriate workout strategy. Once legal proceedings are initiated generally after a loan is officially classified as a default and all previous attempts at an out-of-court resolution have been exhausted.

Timelines and recovery rates are consistent across CRG as well as with the overall Spanish banking sector.

Collateral Analysis Details

Data Quality

The sources of information used for this rating include loan by loan data on their mortgage book split into residential and non-residential loans, and dynamic performance data spanning from 2010 to 2013. DBRS considers the information available to it for the purposes of providing this rating was of satisfactory quality.

Collateral Analysis

As of 30 October 2013, the cover pool assets amounted to EUR 1.576bn bn split 43% residential and 57% non-residential. The cover pool was composed OF mortgage loans with a low weighted average loan-to-value ratio (WALTV of 49%). This is a 65-month seasoned pool that is geographically concentrated in the Autonomous Community of Andalucia (96%) and in in particular Caja Rural de Granada home region (81%).

The cover pool is formed by residential mortgage loans (43%), commercial (35%), land loans (21%) and other type of loans (1%). Although common in the Spanish market, the substantial concentration in the non-residential mortgage loans (57%) impacts negatively DBRS default and recovery analysis.

The residential sub-pool is formed by mortgages with a low weighted average unindexed current LTV (51.5%). 12% of the loans were originated with an LTV above 80% and, currently, only 3.2% are above that level. The remaining term to maturity is 23 years and the WA seasoning is 58.5 months, being 19% of the residential loans originated before 2006. Almost all the loans are French amortising mortgages

CRG Cedulas Hipotecarias

Report Date
January 31, 2014

(99%) indexed to floating rates (99%) with monthly instalments (95%). 9% of the outstanding balance are second lien loans and 4% of the loans were granted to foreigners.

In analysing the residential mortgage book, based on performance data provided, DBRS has calculated a benchmark 2-year PD of 2.38%. DBRS also applied a sovereign risk adjustment to the 2-year PD, which result in an adjusted two-year PD of 3.21%. DBRS has used its 2yrPD assumption and loan-by-loan data information for the purpose of obtaining rating-specific portfolio expected loss rates in accordance with Master European Residential Mortgage-Backed Securities Rating Methodology and Jurisdictional Addenda.

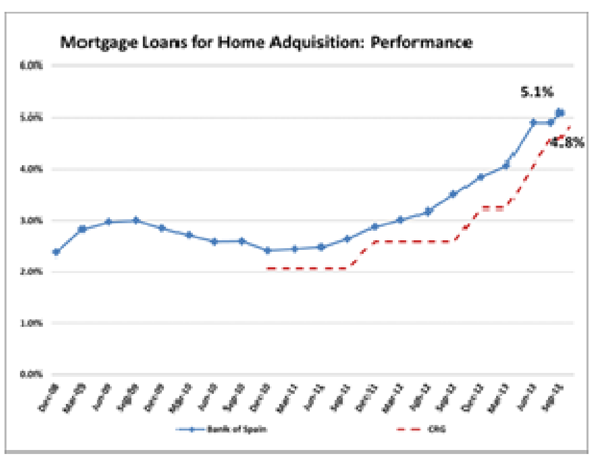
The non-residential pool represents 57% of the total cover pool, being 26% loans granted to individuals and 74% to companies. The sub-pool has deleveraged substantially since origination, the original WALTV was 77% while the current WALTV is 47%. The seasoning and the WA term to maturity are 5.8 and 13.5 years respectively. The non-residential pool is well diversified among industry groups and benefits from a low exposure to construction (21% of the sub-pool); however, DBRS regards loans granted to borrowers in the construction sector as most risky and has increased their PD assumption. The sub-pool is well diversified across borrowers (the largest borrower represents 1.9% of the sub-pool and the top twenty obligors represent 13%).

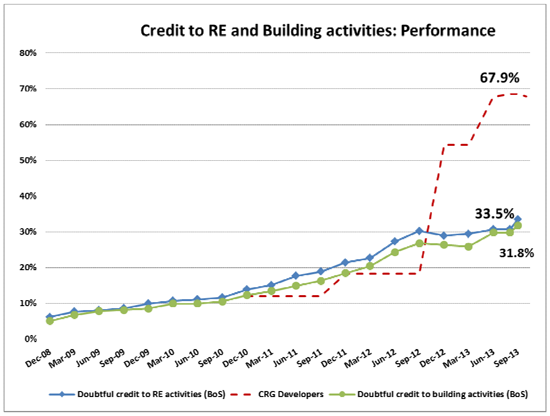
DBRS used its SME Diversity Model to determine a lifetime default rate at the target rating level based on the characteristics of the non-residential cover pool, as well as the issuer's performance data in line with Rating CLOs Baked by Loans to European Small and Medium-Sized Enerprises (SMEs). DBRS has used a base case 1-year PD assumption of 10% and loan by loan data on the cover pool for the purpose of obtaining CRG non-residential expected loss.

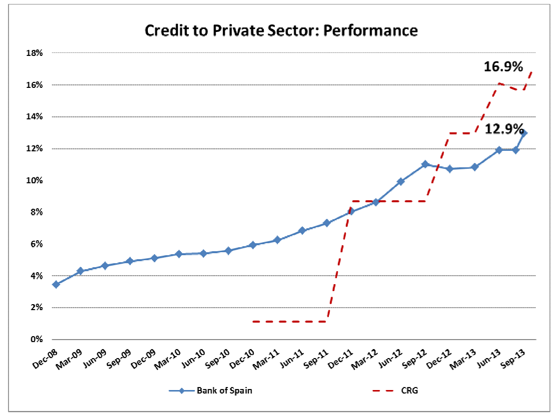
The combined expected loss for the entire cover pool in a stress scenario in line with the cover pool credit assessment of 'BBB (Low)' is 40%.

Historical Performance

DBRS received dynamic performance data on CRG mortgage book spanning from 2010 to 2013







Spanish Legislation Summary

DBRS understands that CH is special secured bonds issued by Spanish Financial Institutions. Under the Spanish law, DBRS understands that the principal and interest due under the CH are specially secured by all the issuer's mortgage assets (except those that are backing a securitisation or a bono hipotecario), and any substitution assets or derivatives cash flows dedicated to any specific CH issuance.

Spanish cover pools are dynamic and are composed by the entire mortgage pool of the issuer. There are no specific requirements for the mortgage loans to be part of the cover pool; however, the law states the characteristics of the eligible assets that are taken into account to set the maximum number of covered bonds that can be issued by a financial entity at any time. For issuances purposes the law establishes a limit of 80% of the eligible cover pool. DBRS understands that fulfilment of the CH eligibility criteria is assessed on an on-going basis by the issuer under the supervision of the Bank of Spain, although there is not a third independent party responsible for monitoring or auditing the information.

The legislation also sets out specific "eligibility criteria" for the cover pool assets that can be used to secure the CHs. The eligible assets are first lien mortgage loans backed by properties located in the European Union; however, the two main drivers of the "eligible loans" are the loan to value ratio and the performance status. The LTV threshold for residential loans is 80%, and 60% for commercial, developers and land; however, residential mortgage loans with LTV up to 90% could be considered eligible assets if they are secured by a qualified direct guarantee. The legislation also sets a performance threshold, only loans which are not already due and payable or the part of the relevant loan which is not due and payable are considered part of the eligible pool.

It is DBRS understanding that cover pool assets are appraised at the time of origination by independent valuation firms in accordance with the relevant valuation regulations. However, it is DBRS understanding that issuers are not required to update valuations in order for eligible loans to remain eligible cover pool assets.

The legislation permits substitution assets to also be included in the cover pool up to 5% of the outstanding CH issued and indicates that the following are considered qualified substitution assets: fixed income securities issued by the Kingdom of Spain or other EU states, CH, mortgage bonds, and other fixed income securities issued by others with a rating at least equivalent to the Kingdom of Spain.

There are not specific provisions in the Spanish law regarding hedging interest rates or foreign exchange risk, however the legislation establish that the issuers shall adopt the necessary measures to avoid inappropriate imbalances between the flows from the cover pool and those derived from CH payments. For more information, please refer to "DBRS Commentary on Spanish Cedulas Hipotecarias Legal and Structuring Framework", available at www.dbrs.com

Methodologies Applied

The following are the primary methodologies DBRS applied to assign a rating to the above referenced transaction, which can be found on www.dbrs.com under the heading Methodologies. Alternatively, please contact info@dbrs.com, or contact the primary analysts whose information is listed in this report:

- Rating European Covered Bonds
- Global Methodology for Rating Banks & Banking Organisations
- Master European Residential Mortgage-Backed Securities Rating Methodology and Jurisdictional Addenda
- Rating CLOs Baked by Loans to European Small and Medium-Sized Enerprises (SMEs)
- Legal Criteria for European Structured Finance Transactions
- Operational Risk Assessment for European Structured Finance Servicers
- Unified Interest Rate Model for European Securitisations

Monitoring and Surveillance

The transaction will be monitored in accordance with Master European Structured Finance Surveillance Methodology, available at www.dbrs.com

CRG Cedulas Hipotecarias

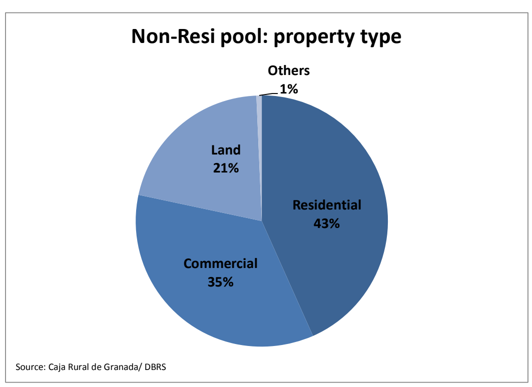
Report Date
January 31, 2014

Appendix A – Liabilities Summary

Name	ISIN	Outstanding balance	Crncy	Issue date	Interest Rate (F/V)	Coupon	Coupon Payment Frequency	Maturity Date
CR Granada 1CH	ES0415143009	600,000,000	EUR	16-Dec-13	Fixed	3.00%	Annual	30-Dec-18

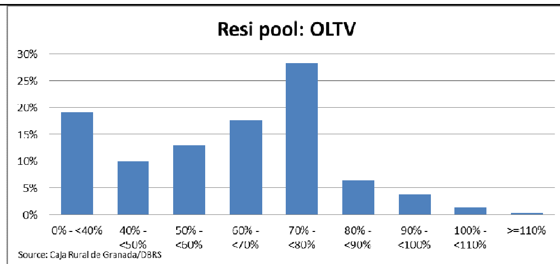
Appendix B – Assets Summary

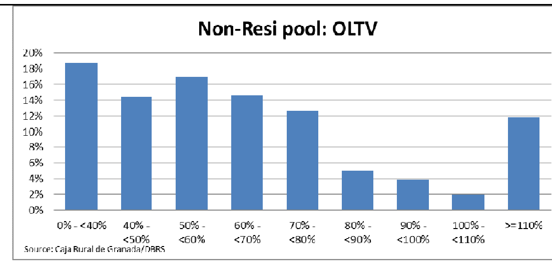
	Cover pool	Residential sub-pool	Commercial sub-pool
	100%	43%	57%
WA OLTV	70%	60%	77%
WA CLTV	49%	52%	47%
WA seasoning (months)	65	59	69
WA RTM (months)	224	280	181
Fixed rate	1.5%	0.5%	2.3%
Floating rate	98.5%	99.5%	97.7%
Total IR cover pool	3.52%	3.21%	3.76%
Avg Fixed rate	4.00%	6.15%	2.36%
Avg Floating rate	3.53%	3.19%	3.79%
Avg Spread	1.17%	0.98%	1.32%
Frequency Payment Interest			
Monthly	83.1%	95.4%	73.6%
Quarterly	3.4%	0.5%	5.7%
Semi-annual	4.4%	2.3%	5.9%
Annual	7.3%	1.8%	11.5%
Other (IO)	1.9%	0.0%	3.3%
Amortiztion method			
French	96.7%	99.9%	94.3%
Installment built-up	1.6%	0.1%	2.7%
Bullet	1.4%	0.0%	2.4%
Other	0.3%	0.0%	0.6%
Rank			
First lien	91.2%	91.3%	91.2%
Second lien	8.8%	8.7%	8.8%

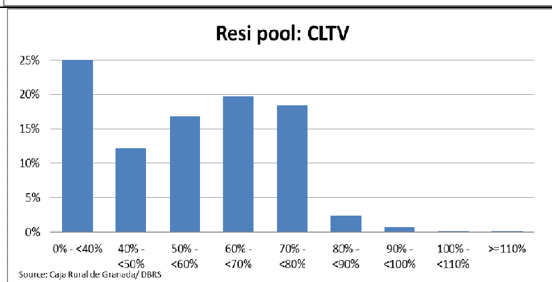


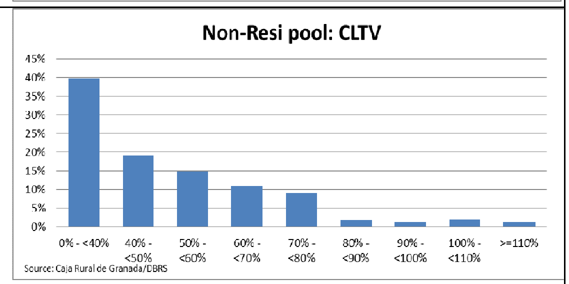
CRG Cedulas Hipotecarias

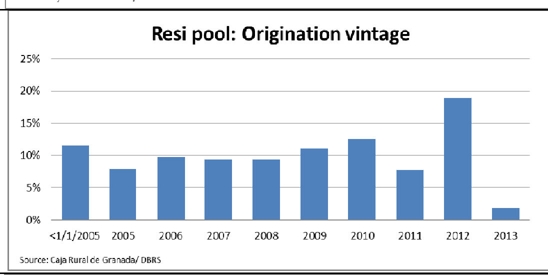
Report Date
January 31, 2014

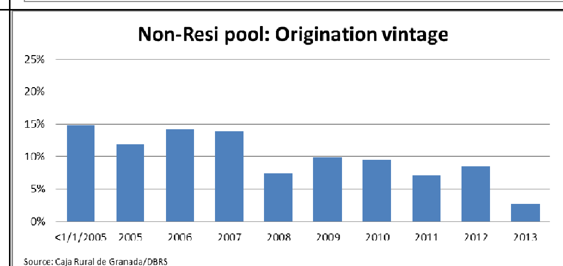


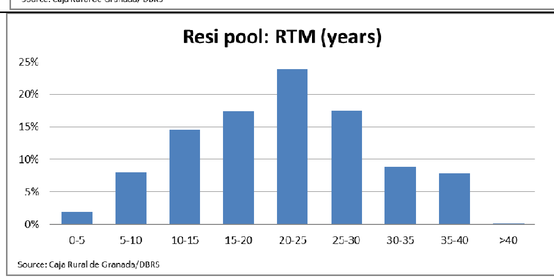


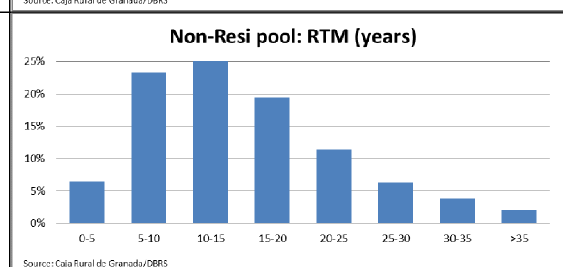


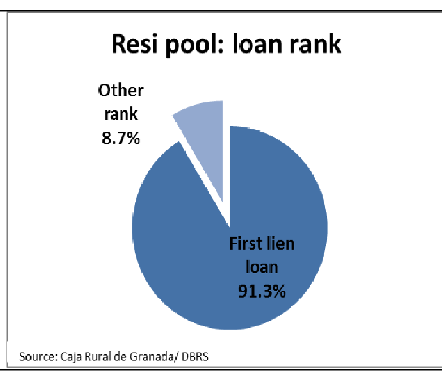


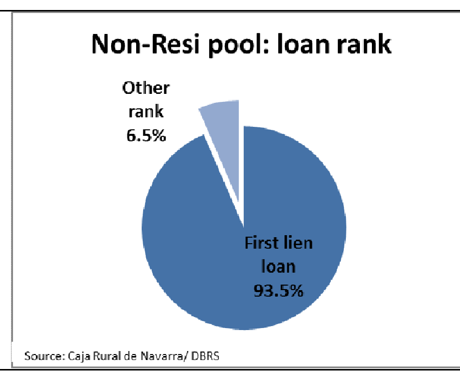






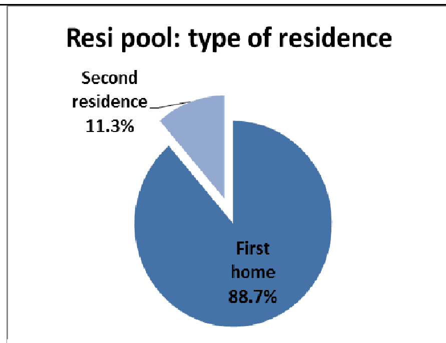




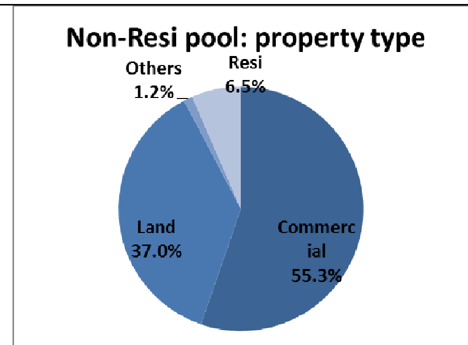


CRG Cedulas Hipotecarias

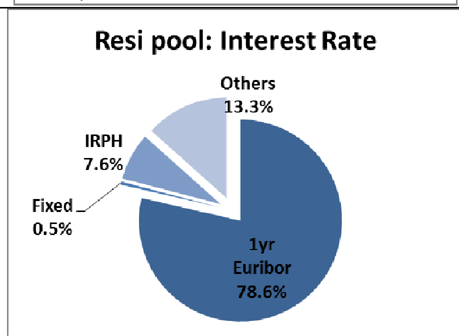
Report Date
January 31, 2014



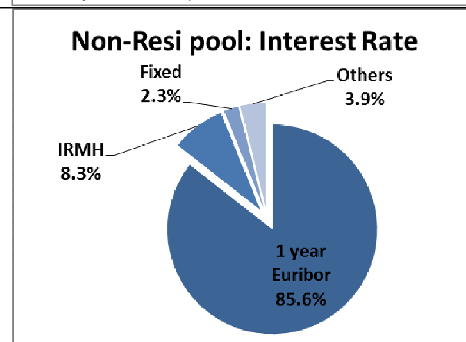
Source: Caja Rural de Granada/ DBRS



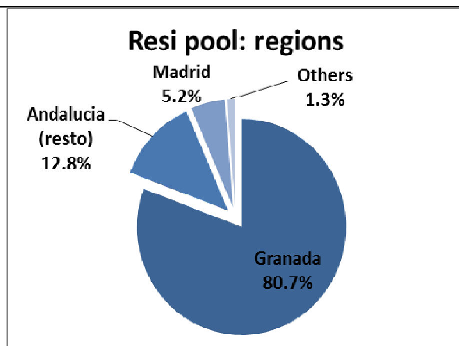
Source: Caja Rural de Granada/ DBRS



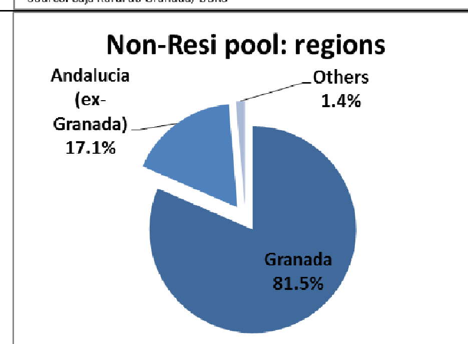
Source: Caja Rural de Granada/ DBRS



Source: Caja Rural de Granada/ DBRS



Source: Caja Rural de Granada/ DBRS



Source: Caja Rural de Granada/ DBRS

Note:
All figures are in Euro unless otherwise noted.

This report is based on information as of August and October 2013, unless otherwise noted. Subsequent information may result in material changes to the rating assigned herein and/or the contents of this report.