Surveillance Report

Caja Rural de Granada S.C.C. Covered Bonds (Cédulas Hipotecarias - Mortgages)

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Ratings

Rating Pillars	
CH Rating	A (high), 20 December 2016
CBAP	BBB
LSF Assessment	Average
CPCA	BBB (low)
LSF-Implied Likelihood	A (low)
Recovery Notches	2

Overcollateralisation	
Current OC	156%
Committed OC	NA
OC DBRS Gives Credit To	124%
Minimum Legal OC	25%
OC Basis	Nominal

Programme Overview	
Issuer Name	Caja Rural de Granada, Sociedad Cooperativa de Crédito
Issuer LT Debt Rating	BBB (low), Stable, 22 November 2016
Issuer LT Critical Obligations Rating	NA
Host Sovereign	Kingdom of Spain, A (low), Stable, 7 October 2016
Domicile Sovereign	Kingdom of Spain, A (low), Stable, 7 October 2016
Main Collateral Type	Mortgage
Subject to Legal Framework	Yes
Total Cover Assets (EUR Billion)	1.54
Total Covered Bonds (EUR Billion)	0.60
Maturity Type of Covered Bonds	Bullet
Maturity Extension	None

Rating Rationale

The A (high) rating currently assigned to the Cédulas Hipotecarias (CH; the Spanish legislative mortgage covered bonds) outstanding under the Caja Rural de Granada, Sociedad Cooperativa de Crédito's (CRG or the Issuer) Covered Bond Programme (CRG CH or the Programme) reflects the following analytical considerations:

- A Covered Bonds Attachment Point (CBAP) of BBB. CRG is the Issuer and Reference Entity (RE) for the Programme.
- A Legal and Structuring Framework (LSF) Assessment of Average associated with CRG CH.
- A Cover Pool Credit Assessment (CPCA) of BBB (low), which is the lowest CPCA in line with the LSF-Implied Likelihood (LSF-L).
- An LSF-L of A (low).
- A two-notch uplift for high recovery prospects.
- A level of overcollateralisation (OC) of 124% to which DBRS gives credit and which is the minimum observed OC level during the past 12 months adjusted by a scaling factor of 0.90.

The transaction was modelled using the DBRS European Covered Bond Cash Flow Model. The main assumptions focused on the timing of defaults and recoveries of the assets, interest rate stresses and market value spreads to calculate liquidation values on the cover pool (CP).

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Rating Sensitivity

Everything else being equal, a downgrade of the CBAP by one notch would lead to a downgrade of the LSF-L by one notch, resulting in a downgrade of the covered bonds rating by one notch.

In addition, everything else being equal, the CH rating would be downgraded if any of the following occurred: (1) the CPCA were downgraded below BBB (low); (2) the sovereign rating of the Kingdom of Spain (Spain) were downgraded below A (low); (3) the LSF Assessment associated with the Programme were downgraded; (4) the quality and consistency of the CP were no longer sufficient to support a two-notch uplift for high recovery prospects; or (5) volatility in the financial markets were to cause the currently estimated market value spreads to increase.

Notable Events over the Review Period

Over the review period, DBRS updated its *Rating European Covered Bonds* methodology to take into account the effects of the EU Bank Recovery and Resolution Directive by incorporating DBRS's Critical Obligations Rating (COR), if available, in its CBAP. CRG was not assigned a COR; consequently, this update had a neutral impact on the rating of the Programme.

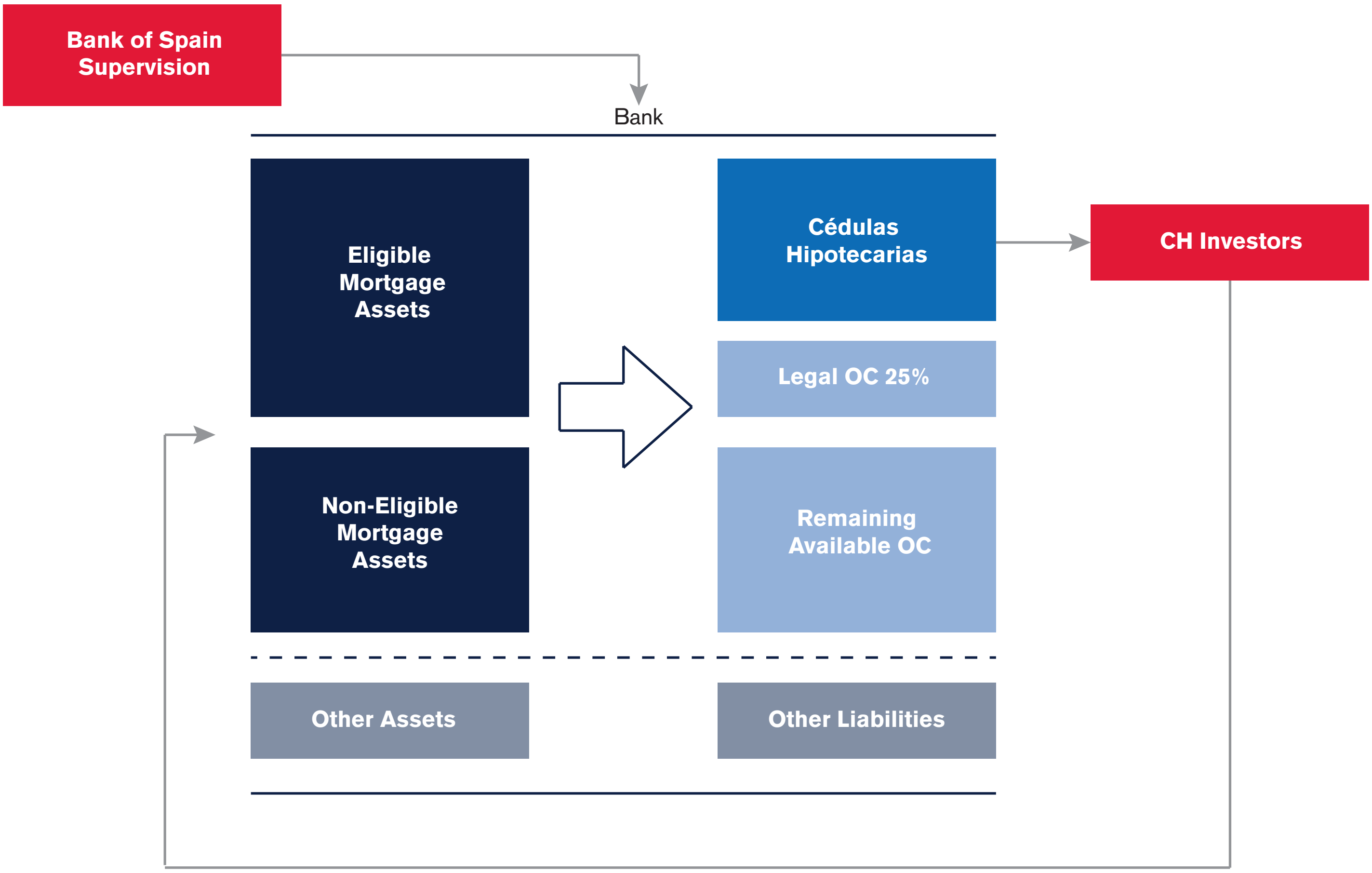
The July 2016 update of the above-mentioned CB methodology took into account the new *European RMBS Insight Methodology*, published on 17 May 2016, as part of its asset analysis. This update had a neutral impact on the rating of the Programme.

Major Events	
Sovereign Rating	The long-term rating of Spain was confirmed at A (low) with a Stable trend on 7 October 2016. This had no impact on the rating of the CH.
RE Rating	The Issuer and Senior Debt & Deposit rating of CRG was confirmed at BBB (low) with a Stable trend on 22 November 2016. This had no impact on the rating of the CH as the CBAP remained unchanged.
Origination and Servicing	No significant changes were made to the origination and servicing practices of CRG since the previous annual review.
Other	The most recent version of the *Rating European Covered Bonds methodology* was published on 6 December 2016. The last versions of the *European RMBS Insight Methodology* and *European RMBS Insight: Spanish Addendum* were published on 17 May 2016. The last version of the *Rating CLOs Backed by Loans to European SMEs* methodology was published on 19 July 2016.

Transaction Structure

The Programme is set up under the Spanish legal framework for CH.

Exhibit 1



Preferential Claim of CH Investors (Eligible and Non-Eligible Assets)

For more information on Spanish CH, please see *Spanish Mortgage Covered Bonds: Legal and Structuring Framework Review*, which can be found on www.dbrs.com.

Sovereign Assessment

DBRS confirmed Spain at A (low) with a Stable trend in October 2016.

The confirmation of the Stable trend reflects DBRS's view that the robust economic recovery and gradual correction of Spain's macroeconomic imbalances are offsetting the risks arising from higher uncertainty and a slower fiscal consolidation path. The forceful policy response to the crisis, lower energy prices and the European Central Bank's easier monetary policy have resulted in a job-rich economic recovery and higher confidence. These benign economic conditions have underpinned the rebalancing process and moderated the vulnerabilities stemming from the still high public and external debt ratios. The recovery is expected to continue at a strong, albeit slower, pace. The political stalemate in Spain and the inability of its political parties to form a new government have increased uncertainty over the future course of economic policy. Although this has not dented growth materially so far, a protracted period of political deadlock could delay the implementation of additional measures to continue with the structural reforms and fiscal consolidation process.

For more information on Spain, please refer to the most recently published press release by DBRS.

Legislation Overview

Covered bonds in the form of CH are regulated by (1) Law 2/1981, dated 25 March, which regulates the mortgage market, and (2) Royal Decree 716/2009, dated 24 April, which develops certain aspects of Law 2/1981 (collectively, the CH Regulation). These set forth, among other things, the types of issuers of covered bonds and of eligible cover assets, the CH holders' preferential right and the maximum issuance ratio.

DBRS understands that the legislation currently in place gives CH holders a preferential right to the cash flows derived from the mortgage credits and loans on the Issuer's balance sheet (except those backing securitisations or Bonos Hipotecarios) as well as those cash flows derived from Replacement Assets and Hedging Instruments specifically flagged for this purpose, if any.

In DBRS's view, this provides CH holders with strong protection; however, there is a risk that the rights backing the CH may not ensure timely payments on the CH immediately following the insolvency of the Issuer, based on DBRS's understanding of the following features:

- There is no requirement in the CH Regulation for a minimum liquidity buffer or any equivalent regulatory or contractual mitigant to cover temporary liquidity constraints.
- No contingency plans are set out in the CH Regulation that allow for the appointment of an alternative manager ahead of the Issuer's insolvency. Liquidation of the CP assets may be implemented after the appointment of an insolvency administrator, who would at the same time look after the contrasting interests of CH holders and unsecured creditors.
- No independent CP monitor is required by the CH Regulation. Rather, the Issuer is responsible to abide by the CH Regulation requirement under the general oversight of the Bank of Spain. However, the vast majority of the mortgage assets of the issuing entity is (by operation of law) pledged in priority to CH holders.

For further information on DBRS's understanding of the set of rules applicable to Spanish CB, please refer to the commentary *Spanish Mortgage Covered Bonds: Legal and Structuring Framework Review,* which can be found on www.dbrs.com.

CBAP

CRG is the Issuer and RE for the Programme. CRG's Issuer and Senior Debt & Deposit rating is currently BBB (low) with a Stable trend. CRG does not have a COR assigned.

DBRS has taken the view that Spain is one of those jurisdictions for which CB are a particularly important financing tool (for more information, see the commentary *DBRS's Assessment of European Jurisdictions for Which Covered Bonds Are Systemically Important*).

According to the European CB methodology, in such jurisdictions, the CBAP can be set up to one notch above the RE long-term (LT) rating when a COR is not available.

Therefore, for CRG CH, the CBAP is set at BBB, which is equal to CRG LT Rating plus one notch.

LSF Assessment

The LSF Assessment is one of the four pillars of DBRS's *Rating European Covered Bonds* methodology and expresses DBRS's view on the likelihood that payment obligations under the CB could be smoothly and efficiently transferred from a troubled bank to another bank or the CP administered by a third party.

DBRS has assigned an LSF Assessment of Average to CRG CH, which is line with the LSF Assessment of other Spanish CH programmes.

The Average LSF Assessment associated with each of the CH programmes reflect DBRS's view of

1. The satisfactory level of segregation provided by the CH legal framework and the CH holders' first-priority right on the entire mortgage book of the Issuer, in combination with a residual commingling risk that DBRS considers to be limited.
2. The absence of specific provisions and the uncertainty surrounding the timely liquidation of the CP to meet maturing CH in an assumed insolvency of the Issuer as well as the lack of any short-term liquidity support, balanced by DBRS's expectation of forthcoming regulator support and an ability to support the CB instrument in line with a host sovereign that is rated A (low) with a Stable trend.
3. The role of the Bank of Spain, which oversees the banking business and the CH business of the Issuer as a sole entity, in the supervision of the Spanish CH combined with the absence of contingency plans specific to the continuation of the CH, high penetration of the CH as a funding tool for Spanish banks and a history of regulatory intervention in the re-arrestment of financial institutions during the last years, which, in DBRS's view, benefit CH holders because of the structural nature of Spanish CH.

A potential downgrade of the sovereign rating of Spain below A (low) may cause the LSF Assessment to be reduced to the Modest category.

DBRS acknowledges the requests for comment on proposed amendments to Spanish law issued by the Spanish Treasury and understands the preliminary stage of the potential changes. A specific review of the LSF Assessments would take place once the legislation and any secondary regulation are clarified and enacted.

For more information, please refer to the commentary *Spanish Mortgage Covered Bonds: Legal and Structuring Framework Review*, which can be found on www.dbrs.com.

CPCA

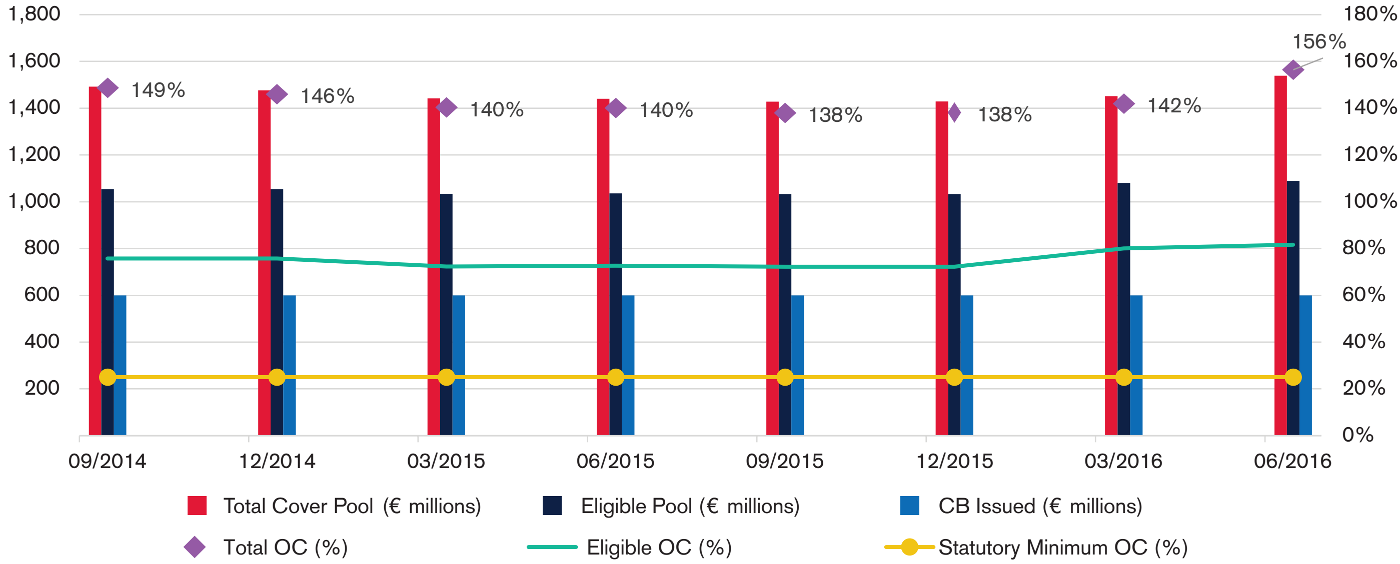
DBRS has assigned a CPCA of BBB (low) to the Programme, which is the lowest CPCA in line with the assigned LSF-L of A (low).

CP and CB

The total outstanding amount of CH is EUR 600 million, while the aggregate balance of the mortgages in the CP is EUR 1.54 billion (as at June 2016), resulting in a total OC of 156.4%. The eligible CP stands at EUR 1.09 billion, resulting in an eligible OC of 81.6%.

As at 30 June 2016, the CP amounts to EUR 1.54 billion split into 53% residential and 47% commercial loans with a low weighted-average loan-to-value ratio of 51.3%. This is an 80-month seasoned CP that is geographically concentrated in the Autonomous Community of Andalusia (95%).

Exhibit 2: CRG CH



Sources: CRG and DBRS. Note: Assets and liabilities as at June 2016.

Cover Assets Analysis

Residential CP

DBRS has run the RMBS Insight Default Model based on loan-by-loan data as at 30 June 2016 provided by the Issuer.

Given that Spanish CB pools are composed of the whole mortgage books of the issuers (excluding loans segregated for securitisation), the CP reflects the strategy of the bank and its approach to the market in relation to underwriting criteria. For this reason, an Underwriting Score of 3 has been applied in line with the other Spanish CB.

The Underwriting Score assumes values from 1 to 6, where 1 is considered the least risky and 6 is considered the riskiest.

All other assumptions are in line with the ones described in *European RMBS Insight: Spanish Addendum*.

The Expected Loss assumption for the Residential CP in the base-case (B) scenario is 3.71%.

Non-Residential CP

DBRS has run the Diversity Model in line with *Rating CLOs Backed by Loans to European SMEs* methodology published on 19 July 2016, based on loan-by-loan data as at June 2016 provided by the Issuer.

The Diversity Model was run with a one-year probability of default (1yr PD) of 12% and a weighted-average life of 7.0 years. All other assumptions are in line with the standard assumptions for Spanish small and medium-sized enterprise pools described in *Rating CLOs Backed by Loans to European SMEs* and *Rating CLOs and CDOs of Large Corporate Credit*. For second-lien loans, DBRS applied the unsecured recovery rate assumption for Spain.

The 1yr PD assumed for the Non-Residential CP was a conservative assumption based on arrears over 90 days and doubtful loans' dynamic data provided by the Issuer spanning from 2010 to 2016.

The Expected Loss assumption for the Non-Residential CP in the base-case (B) scenario is 13.17%.

Refinancing and Market Risk

The weighted-average life of the assets is roughly ten years, while that of the covered bonds is roughly two years. This generates an asset-liability mismatch that is partly mitigated by the available OC.

As customary in the Spanish market, CH holders do not receive the benefit of any swap contract to hedge the mismatches between the interest yield by the CP (99% floating rate linked to different indices and reset dates) and the interest due on the CH (100% fixed-rate bonds). This been accounted for in DBRS cash flow modelling.

All assets and liabilities are denominated in euros.

Cash Flow Analysis

The transaction was modelled using the *DBRS European Covered Bond Cash Flow Model*. The main assumptions focused on the timing of defaults, recoveries of the assets and interest rate stresses.

DBRS used the following assumptions for its cash flow modelling:

- Default curves that take into account the seasoning of the cover assets to test the cash flows of the CB.
- Forty-eight months' time span from the point of first arrears, which is necessary to take possession of and sell and realise the cash from the sale of a residential property in Spain. This is in line with the Spanish foreclosure timing assumptions described in DBRS's *European RMBS Insight: Spanish Addendum*.
- In line with its *Rating European Covered Bonds* methodology, DBRS has assumed a prepayment scenario of 1%.
- Interest rate stresses as per the DBRS Unified Interest Rate Model, which includes upward and downward interest rate curves.
- CRG's CP is formed by assets that are standard in its market. DBRS applied Tier 2 market value spreads[1] for the purpose of calculating the liquidation value of the CP; market value spread curves are applied in full during the first 18 months and to a reduced extent afterward.
- DBRS has analysed CRG CH claw-back, commingling and set-off risks in line with the Spanish CB LSF review (published in December 2014). For this transaction, these risks are considered to be in line with the Spanish legal framework commentary published. DBRS understands that commingling, set-off and claw-back risks are residual in Spanish CH.

OC to Which DBRS Gives Credit

The minimum level of OC required by legislation is 25% of the eligible pool. As customary in Spain, the Issuer does not commit to any higher level.

The minimum level of OC observed over the last 12 months ended 30 June 2016 is 138.0%. According to DBRS's *Rating European Covered Bonds* methodology, this level is then adjusted by a scaling factor of 0.9, yielding a level of 124.2% to which DBRS gives credit.

LSF-L

DBRS has assigned an LSF-L of A (low) to the Programme.

Credit for Recovery Prospects

DBRS has run a wind-down cash flow simulation aimed at covering the cost of funding under a stress scenario in line with the CB rating. According to its *Rating European Covered Bonds* methodology, DBRS has assigned an uplift of two notches from the LSF-L in consideration of the strong recovery prospects of the CH.

Eligibility Criteria

Legislative Criteria

For a summary of the eligibility criteria for CB under the Spanish legislative framework, please refer to the commentary *Spanish Mortgage Covered Bonds: Legal and Structuring Framework Review*, which can be found on www.dbrs.com.

Data Sources

The sources of information used for this report include historical dynamic performance data and loan-by-loan data on the whole CP provided by CRG.

1. See *Rating European Covered Bonds Addendum: Market Value Spreads Range (Midpoints)* available on www.dbrs.com.

List of CH Outstanding under the Programme

Series	Outstanding Amount	Currency	Issue date	Maturity	IR Type	Coupon	Rated by DBRS
CR Granada 1CH – ES0415143009	600,000,000	EUR	16-Dec-13	30-Dec-18	Fixed	3.00%	Y

Note: CH as at date of publication.

Key Credit Metrics

	30/9/2015	31/12/2015	31/3/2016	30/6/2016
Total Mortgage Pool (€)	1,427,899,767	1,428,782,744	1,451,181,590	1,538,258,949
Eligible Mortgage Pool (€)	1,033,442,044	1,033,442,044	1,080,321,600	1,089,586,602
Outstanding Covered Bonds (€)	600,000,000	600,000,000	600,000,000	600,000,000
Nominal OC %	138.0%	138.1%	141.9%	156.4%
Eligible OC %	72.2%	72.2%	80.1%	81.6%
Legal OC	25.0%	25.0%	25.0%	25.0%
Cover Pool				
Total Mortgage Pool (€)	1,427,899,767	1,428,782,744	1,451,181,590	1,538,258,949
Residential %	50.2%	51.6%	52.2%	52.3%
Commercial %	49.8%	48.4%	47.8%	47.7%
Total – WA Seasoning (Mon)	75	75	81	80
Total – WA RTM (Mon)	210	211	212	216
Total – WA CLTV %	50.3%	50.5%	50.8%	51.3%
Interest Rate				
Fixed Rate %	0.6%	0.6%	0.5%	0.5%
Floating Rate %	99.4%	99.4%	99.5%	99.5%
Total – Fixed Coupon	4.83%	4.52%	4.44%	4.31%
Total – Floating Coupon	3.21%	3.58%	3.43%	2.63%
Total – WA Margin	1.55%	1.55%	2.08%	1.54%
Performance				
Total Portfolio – DQ > 90 Days %	12.4%	11.1%	11.0%	11.7%
Resi – DQ > 90 Days %	6.1%	5.8%	5.8%	5.5%
Comm – DQ > 90 Days %	27.1%	23.8%	23.4%	24.2%
Residential Cover Pool				
Residential Mortgage Balance (€)	762,314,018.13	780,237,541.62	797,796,619.87	814,069,377.10
Resi – WA Seasoning (Mon)	67	67	68	65
Resi – WA RTM (Mon)	256	257	256	259
Resi – WA CLTV %	53.9%	54.3%	54.6%	54.9%
Commercial Cover Pool				
Commercial Mortgage Balance (€)	755,656,707.13	730,401,263.08	731,200,324.84	743,640,187.40
Comm – WA Seasoning (Mon)	84	84	96	97
Comm – WA RTM (Mon)	163	163	163	167
Comm – WA CLTV %	46.7%	46.4%	46.6%	47.3%

Counterparties

Transaction Parties	Entity	Legal Entity Identifier	LT Rating	LT Rating Date	LT COR	LT COR Date
Issuer	Caja Rural de Granada, Sociedad Cooperativa de Crédito	95980020140005220135	BBB (low), Stable	22 November 2016	NA	NA
Originator	Caja Rural de Granada, Sociedad Cooperativa de Crédito	95980020140005220135	BBB (low), Stable	22 November 2016	NA	NA
Servicer	Caja Rural de Granada, Sociedad Cooperativa de Crédito	95980020140005220135	BBB (low), Stable	22 November 2016	NA	NA
Paying Agent	Banco Cooperativo Español S.A.	549300LYFYVPUC-G6SY25	BBB, Stable	12 December 2016	NA	NA

Related Research

The rating methodologies and criteria used in the analysis of this transaction can be found at http://www.dbrs.com/about/methodologies:

- *Rating European Covered Bonds*
- *Rating European Covered Bonds Addendum: Market Value Spreads Range (Midpoints)*
- *Critical Obligations Rating Criteria*
- *Global Methodology for Rating Banks and Banking Organisations*
- *DBRS Criteria: Support Assessments for Banks and Banking Organisations*
- *Legal Criteria for European Structured Finance Transactions*
- *Derivative Criteria for European Structured Finance Transactions*
- *Unified Interest Rate Model for European Securitisations*
- *European RMBS Insight Methodology*
- *European RMBS Insight: Spanish Addendum*
- *Rating CLOs and CDOs of Large Corporate Credit*
- *Rating CLOs Backed by Loans to European SMEs*
- *Operational Risk Assessment for European Structured Finance Originators*
- *Operational Risk Assessment for European Structured Finance Servicers*
- *The Effect of Sovereign Risk on Securitisations in the Euro Area*
- *Sovereign Ratings Provide a Benchmark for other DBRS Credit Ratings*

A description of how DBRS methodologies are collectively applied can be found at http://www.dbrs.com/research/278375.

Note:
All figures are euros unless otherwise noted.

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