SCOPE | Ratings

# Covered Bond Outlook 2025

Credit stability at times of increasing uncertainty

16 January 2025

## Executive summary

We remain constructive on European covered bond ratings for 2025. All of Scope's covered bonds are currently rated AAA with a stable outlook. European banks entered the year in solid shape, while the broadly stable economic outlooks that we anticipate across Europe will also support rating levels. But even though our broad outlook is favourable, investors will need to remain vigilant against headline risk that could catch the market off guard.

We expect covered bond issuance volumes and spreads to move sideways in 2025. Our forecast for euro benchmark covered bond issuance is EUR 155bn, basically unchanged from 2024 (EUR 153bn), which was 10% below our expectations but still the third highest volume in a decade.

Covered bond spreads widened throughout 2024 and were trading close to 50bp on 10 January, the highest in a decade. But this was driven by technical factors rather than any perception of increased risk by investors, so is not a concern from a rating perspective. On the plus side, wider spreads attracted real money investors back to the covered bond market.

For issuers, senior unsecured spread levels in both preferred and non-preferred buckets suggest it currently makes more sense to fund unsecured and keep collateral unencumbered. This also supports our view of a sideways move in issuance volumes in 2025.

A quarter of euro benchmark covered bonds last year came from French issuers, allowing France to retain pole position for the fifth year in a row. This year, Denmark is likely to regain its global top position, although issuance will continue to be predominantly in DKK. In the euro market, we expect a gradual expansion of activity from CEE issuers and smaller, infrequent and private placement-focused issuers. This will add further diversification to the market.

**No regulatory drivers to impact ratings in 2025**

Neither the final Basel III transposition into CRR3 nor the upcoming review of the European Covered Bond Directive, including topics such as European Secured Notes and third-country equivalence, have implications for the credit quality of covered bonds. Nor will evergreen topics such as ESG-labelled covered bonds or digitalised/blockchain covered bonds be credit drivers, although both topics will provide food for thought in upcoming months.

In fact, no significant regulatory changes are pending that would require amendments to covered bond frameworks. The European Commission report on ESNs has been delayed until at least mid-2025, coinciding with the European Banking Authority's timing to provide feedback following the Commission's call for advice. EBA feedback on third party equivalence is expected by mid-September 2025. That could see preferential treatment extended to non-EU covered bonds.

**Risk factors for covered bond collateral remains manageable**

As for covered bond collateral performance, lower interest rates and an expectation of further rate cuts in 2025 will continue to lower risk for commercial real estate exposures, revive growth in residential house prices and improve affordability for homeowners. But while our outlook generally remains stable, political tensions and economic turmoil may impact covered bonds in 2025.

The credit quality of European public-sector collateral could face risks stemming from sovereign rating deterioration, residential mortgage pools could be exposed to higher defaults driven by rising unemployment and/or inflation, while commercial real estate may suffer from weakening demand and headline risk, particularly in light of ongoing economic uncertainty. But even if credit risk were to increase, we do not expect it to negatively affect covered bond ratings.

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## 1. Watch out for headline risk but credit quality remains well supported

We remain constructive on European covered bond ratings and expect rating stability throughout 2025. Both issuance volumes and spreads are expected to move sideways, with a gradual expansion mainly of issuance from CEE countries and from smaller, infrequent and private placement-focused issuers that will add further diversification to the market.

Lower interest rates than 2024 and an expectation of further rate cuts in 2025 will continue to lower risk for commercial real estate exposures, revive growth in residential house prices and improve affordability for homeowners.

No significant regulatory changes are pending that would require amendments to existing covered bond frameworks. Nor will the implementation of CRR3 create challenges for stakeholders. But while all of the above factors paint a favourable outlook, investors will need to remain vigilant against headline risk that could catch the market off guard.

## 2. Market sentiment

### 2.1 Resilient bank ratings in a stable macro environment

European banks entered 2025 in solid shape. The soft landing of the global economy that we expect, and broadly stable economic outlooks across Europe will be supportive of current rating levels. We do not expect our baseline covered bond ratings to be challenged, also because most ratings have ample buffers and only a few rely on cover-pool support.

Bank rating changes in 2025 will likely be driven by idiosyncratic events as well as management of excess reserves resulting in some M&A. Investors need to be vigilant in 2025 as pockets of risk have built up that could become credit relevant.

Geopolitical developments, political instability, policy changes in major economies (tariffs and interest-rate developments) and the potential for asset-price corrections have the potential to become rating drivers in 2025.

We expect bank profitability to start normalising in 2025. Most banks have so far been able to moderate the negative impact of reduced rates on profitability. In our baseline scenario, the impact of further rate cuts can largely be offset by increased lending volumes (partially on the back of looser underwriting standards) but also by growth in non-interest income.

Cost management will remain high on the agenda as cost inflation will challenge efficiency metrics in the next few years. Banks will have to create efficiency improvements including investing in digitalisation as well as cost-cuttings measures.

Asset quality is expected to deteriorate at a controlled pace, amid moderate economic growth and robust labour markets. Even as defaults increase their impact on banks, profitability will be supported by general reserves built up in recent years.

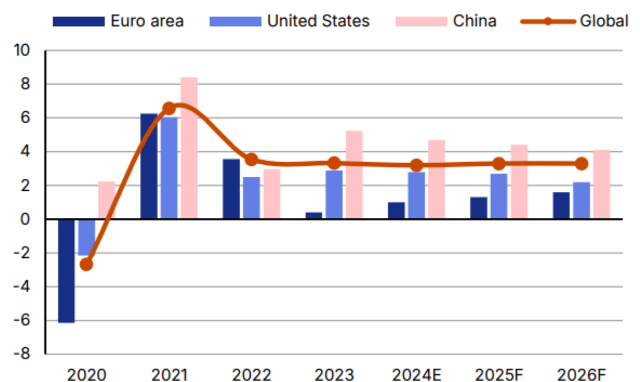
Capitalisation for most banks is well above regulatory requirements and average buffers of around 4% will help to lessen the impact of Basel III-driven increases in risk-weight intensity. At the same time, excess capital is prompting bank management to find solutions for its efficient deployment. Dividend increases and a rise in M&A aimed at achieving scale and addressing cost inflation will be high on the agenda.

### Macro environment provides stability for banks and support the performance of cover assets

European economies are expected to grow at a slower pace than their global counterparts. We expect European GDP to only grow by around 1.3% in 2025 and 1.6% in 2026. We expect growth will be driven by euro-area periphery economies. Germany, France and Italy are expected to underperform.

Medium-term downside risks have increased, particularly for Europe's largest export-oriented countries, which are most exposed to tariffs and protectionist measures from the US. These could constrain the free flow of trade, a key driver of their past economic growth.

**Figure 1: Global growth %, 2021-2026**




Source: Eurostat, national statistical agencies, Scope Ratings forecasts

Central banks are unlikely to ease monetary policy to the same extent as before the pandemic. However, the ECB may be compelled to implement further interest-rates cuts given Europe's weaker economic outlook and structurally lower rates of inflation in the euro area.

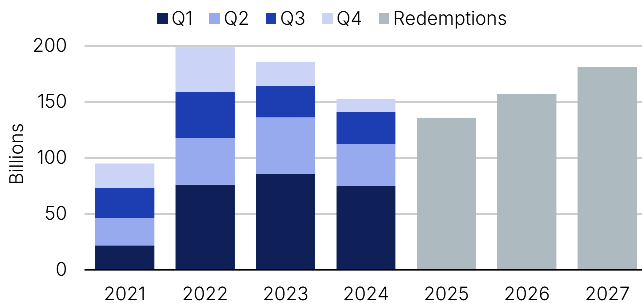
For more, see Scope's 2025 Sovereign Outlook.

### 2.2 2024 issuance volumes below expectations

Covered bond issuance volumes in 2024 saw three phases: record or above-average monthly volumes between January and May, an indecisive summer and a disappointing fourth quarter with volumes falling.

The EUR 153bn of EUR benchmark covered bond issuance was 10% below our expectations but all-in annual issuance volumes are still significant, marking for the third highest volume in a decade.

**Figure 2: EUR benchmark issuance volumes**




Source: Eurostat , Scope Ratings forecasts

New covered bond issuance in 2024 was not materially impacted by the unwinding of TLTROs or refinancing in the capital markets via public issuance. The roughly EUR 400bn of TLTRO repayments were a non-event. TLTRO repayments without new covered bond issuance showed that most banks used TLTRO for carry trades to aid profitability rather than a source of additional mortgage lending.

Markets were not impacted either by the roughly EUR 250bn of covered bond redemptions still held as part of CBPP3. Scheduled redemptions for 2025 amount to EUR 43bn but will likely not add to additional funding requirements.

**French covered bond issuers take the pole position – again**

In 2024, with 25% of total EUR benchmark issuance, French covered bond issuers retained their pole position for the fifth year in a row. The top three issuing countries (including French, German and Canadian issuers) accounted for more than half of global issuance of EUR benchmark covered bonds.

While the pecking order in the benchmark segment is not expected to change significantly, Denmark is likely to regain its global top position when it comes to new issuance. However, Danish covered bonds are mostly issued in DKK and placed in the domestic market. Danish issuers are seen much less frequently in the EUR benchmark segment.

## 2.3 2025 issuance volumes to move sideways

Our expectation for 2025 issuance is EUR 155bn, a sideways move. We do not expect a repeat of the traditional January frenzy, when traditionally there is almost no day without a new covered bond issue. Indeed, as of 13 January only EUR 10.4bn new covered bonds priced, compared to EUR 20.1bn in 2024

Most European countries have fully transposed the European covered bond directive. Increasing issuance from CEE or smaller issuers are not expected to push up issuance expectations as most will only issue in sub-benchmark format but they will add some more colour to the issuing universe.

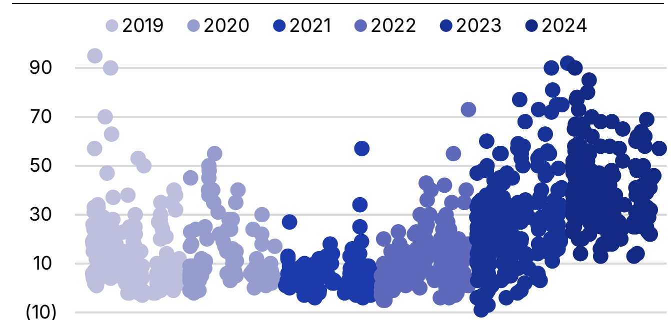
Covered bonds are currently an expensive funding option relative to preferred and non-preferred senior unsecured bonds. Plus, banks can access abundant and rising deposit volumes that easily allow to refinance lending volumes that are only increasing slowly.

## 2.4 Current spread levels do not reflect increased risk

The fact that the core reference index (EUR iboxx covereds) widened throughout 2024 and was trading close to 50bp on 10 January, the highest level for a decade, is not worrying from a rating perspective.

This does not reflect an increased perception of risk by covered bond investors. High and stable covered bond ratings and very resilient bank fundamentals across Europe have firmly placed covered bonds in the rates segment of the market rather than the credit segment.

**Figure 3: Spread variance EUR benchmarks**




Source: Bond Radar, Scope Ratings

The increase in covered bond spreads is mostly driven by technical factors: the increase in sovereign credit spreads (particularly Germany), which are used as a reference for gauging the relative value of covered bonds in the rates segment.

Widening spreads present both opportunities and challenges. With negative spreads a thing of the past, real-money investors came back to the covered bond market in 2024 which is positive. At the same time, the relative value covered bonds can provide to bank treasuries is currently limited and market expectations suggest that structurally, spreads will not significantly tighten.

Comparing covered bond spreads with preferred or non-preferred senior unsecured bonds shows that from a cost-benefit perspective, it makes more sense to fund unsecured and keep collateral unencumbered. This supports our view of a sideways movement of issuance volumes for 2025.

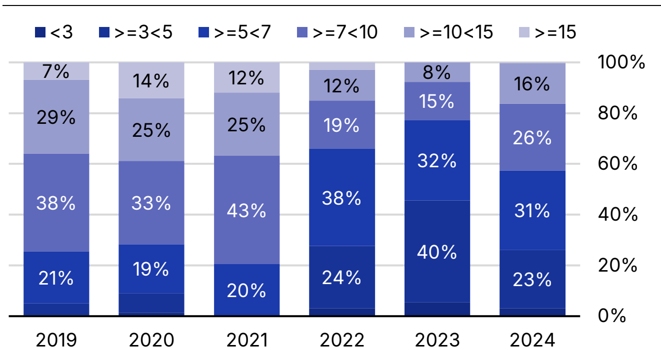
French issuers had to pay a premium in the last quarter of 2024, reflecting deteriorating economic conditions and political turmoil and now issue at 50bp or even more. Last year reminded investors that they need to watch out not only for sovereign developments, as is typical for rates products, but also for credit-related factors that can also become pertinent and become spread as well as rating drivers. Covered bond issuers with significant CRE exposures and which were in the limelight in early 2024 still have to pay a premium.

We do not expect the trend for spreads to change materially over the next 12 months. Credit dispersion will persist. French covered bonds or more generally covered bond spreads in countries with deteriorating economic fundamentals will remain under pressure.

### 2.5 Shorter maturities to accommodate market appetite increasing ALM risk

The current inverted forward curve and market expectations have led both issuers and investors to increasingly favour shorter maturities. For the whole of 2024, the average maturity of new issues reduced to five years, down from about 6.7 years in the first and second quarters of 2024. Bonds with 3-5-year maturities dominated in the second half of 2024. We expect short tenors to be the maturity of choice in the first half of 2025.

**Figure 4: Issuance split by maturity bucket**




Source: Bond Radar, Scope Ratings

Preference for shorter maturities also comes from bank treasuries keen to avoid a repeat of 2024. Long covered bond maturities in some bank treasury portfolios translated into revaluation requirements when rates were cut in 2024.

Demand for shorter maturities will persist until rates find their floor, which we expect to be 2.25% at the end of 2025. Demand for longer-dated covered bonds, which should be the natural choice for refinancing long-term assets, will also hinge on a nomalisation of the forward rate curve. This also means maturity mismatch risks are (slowly) increasing.

## 3. Structural developments of relevance

The final Basel III transposition into CRR3 as well as the upcoming review of the European Covered bond Directive, including topics such as European Secured Notes (ESNs) and third-country equivalence, will not have implications relevant to the credit quality of covered bonds. Neither will evergreen topics such as ESG-labelled covered bonds or digitalised/blockchain covered bonds be credit drivers. But they will provide food for thought in the upcoming months.

### 3.1 Increasing CRR output floors are credit neutral...

While CRR3 does not directly impact covered bonds, it may affect the capital costs of covered bond issuers. Mortgage lenders applying the internal ratings-based approach (IRB banks) will see the risk-weight intensity of their assets increase. The output floor for risk weights will gradually increase from 50% in 2025 to its target level of 72.5% in 2030, effectively providing a backstop to modelled risk weights that better reflect economic realities. Most banks are well capitalised, which means that the capital impacts will be easily absorbed while impacts on profitability could be mitigated by adjusting lending margins.

### 3.2 ...which also holds true for changed valuation requirements

CRR3-induced changes to the valuation approach for real estate could in principle impact average LTVs of cover pools and reduce the volume of covered bond refinancing.

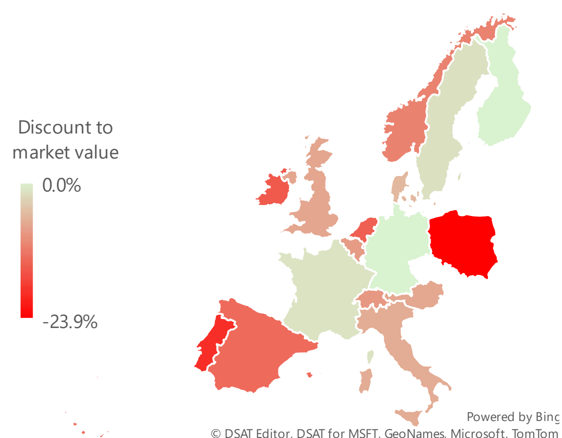
From January 2025, eligibility of cover-pool assets can no longer be determined by the current market value of a property. According to article 229 of the CRR, the value must be one that "excludes expectations on price increases" and must be "sustainable over the life of the loan".

Even more, the regulatory property value cannot exceed the lower of the current market value or the average market value over the last six years for residential and eight years for commercial property.

Covered bond legislation constrains asset-eligibility criteria for cover assets to loans with maximum loan to (property) values of 80% for residential and 60% for commercial mortgage loans.

Because valuations, the denominator for the LTV calculation will change, the volume of new cover-pool additions could reduce in countries where the market value of the securing property is primarily used for the eligibility test. Also, countries that have or are seeing strong house-price appreciation will likely be impacted.

**Figure 5: CRR could impact new cover-pool additions**




Source: Eurostat, Scope Ratings

In Poland for example, house prices have soared by 70% over the past six years. The regulatory requirement that valuations should not exceed the six-year average for residential mortgages means that new property valuations in Poland would have to be discounted by 24% from the latest market values.

By contrast, countries that have seen contractions in house prices will be less impacted and no discount will have to be applied (for example in Germany and Finland).

The new CRR valuation requirement will not materially impact existing covered pools. For their existing mortgage books, lenders can continue to rely on current property valuations until 31 December 2027 or until a review of the property value is required. In addition, competent authorities may allow real estate cover assets to continue to be valued at or at less than the Market Value or at the Mortgage Lending Value by way of a derogation from Article 229 of the CRR. In late December, Germany's BaFin made use of its waiver option. Instead of capping, the (conservative) principles of the German lending value prevail.

From a credit rating perspective, the valuation changes are credit neutral. Even if the new property valuation concept were fully applicable and LTVs increase, there would only a limited impact on the cover pools in our coverage.

Price increases over the last two years have been small in core covered bond markets and few covered bond issuers have exhausted their issuance limits so can cope with some valuation declines by adding new collateral. In our recovery analysis, we already adjust current market valuations for over-valuations and apply additional value decline assumptions. See our research on Property value in CRR3 (see Property value in CRR3).

### 3.3 European Secured Notes on backburner

The European Commission had been scheduled to write a report on European Secured Notes (ESNs) or even propose a legislative initiative by July 2024, but this was delayed until at least mid-2025. This will coincide with the European Banking Authority's timing to provide the Commission with feedback on its call for advice on the subject.

The slow pace of legislative developments prompted the ESN taskforce of the European Mortgage Federation-European Covered Bond Council to update its ESN Blueprint in 2024 to spark discussions. We agree with the taskforce that a supportive legislative ESN framework is needed to allow the instrument to positively support SME financing. Market participants have also called for preferential regulatory treatment of ESNs plus capital relief as a possible add-on and potentially equivalence to regulated covered bonds.

We do not expect such additional support to materialise any time soon, unless a political comprise is reached. SMEs are systemically relevant but as long as ESNs remain a niche, there will be little appetite to keep them as going concerns in (re-)solution. Governance support and the willingness to resolve the product (e.g. specific ESN issuers) in case of need only gain momentums where a common market and investor base has developed. Regulators have not been constructive to-date. ESNs have no track record of sound performance, unlike SME ABS.

We would only provide a similarly high, governance-supported credit uplift to ESNs as we provide for regulated mortgage covered bonds if they can demonstrate such a track record and relevance. This will likely be the argument we hear from the Commission or ECB when preferential treatment is questioned.

### 3.4 Third country equivalence

The Commission also expects feedback from the EBA by mid-September 2025 following its call for advice on third party equivalence and the potential extension of preferential treatment to non-EU covered bonds.

Since the European covered bond directive has been fully transposed across EU member states, it has also harmonised regulatory treatment of covered bonds. This includes preferential treatment under the Liquidity Coverage Ratio; eligibility rules as collateral in central bank liquidity schemes and exemption from bail-in. However, covered bonds issued by credit institutions outside the EEA and purchased by European investors still receive less favourable regulatory treatment.

We believe that third party equivalence could be a lever to promote European covered bonds as a global standard. Other countries may be incentivised to implement (copy) features that have been proven to sustain high quality and liquidity for the instrument in Europe.

Harmonised standards will offer European investors the ability to increase diversification, and foster trust in non-European covered bonds. Ultimately, equivalence should not be a one-way street allowing non-European issuers to generate higher demand from European investors. It also should support and increase foreign demand for European covered bonds.

Even though some significant third countries such as the UK, Canada, and Australia have adopted European quality standards, their track record as well as systemic, domestic relevance cannot compete. The EBA is expected to provide its comments by mid-2025 but we will likely only comment on any tangible proposals from the Commission in our 2026 outlook.

### 3.5 Green covered bonds – slow momentum

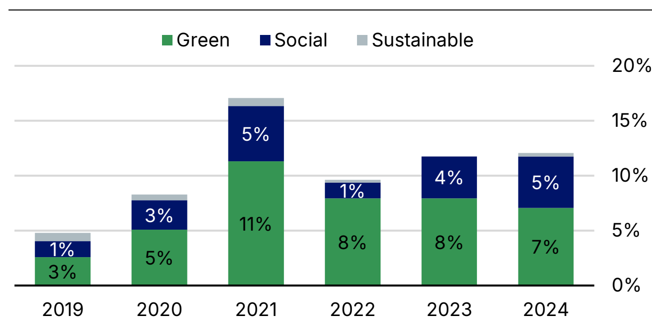
We do not expect ESG volumes to significantly change in 2025. However, the target of reducing net greenhouse gas emissions by at least 55% by 2030 and to achieve zero net emissions by 2050 appears to be an unstoppable trend that sooner or later will also require more emphasis by covered bond issuers.

For now, however, Green and other ESG-themed covered bonds remain a niche segment and those that have been calling for preferential treatment to boost their relevance will need to be patient.

Covered bond issuers are between a rock and a hard place. They are constantly flooded with new ESG initiatives, new regulation and reporting requirements. The application of eligibility criteria to the definition of green loans, particularly those complying with the EU Taxonomy, is complex, time-consuming and costly. Gathering relevant information is also time consuming but not incentivised by cheaper funding costs. The spread benefit for green covered bonds (greenium), if any, is very low. On average we calculate 1bp since 2019.

On a positive note, 2024 ESG issuance did not fall behind 2023 in relative terms and labelled issuance has become standard in the covered bond market. However, looking at nominal issuance volumes of EUR 18.4bn, ESG covered bond issuance fell by 16%.

**Figure 6: ESG labelled covered bond issuance (% of total)**




Source: Bond Radar, Scope Ratings

2025 Issuance volumes will likely be at similar levels, eventually normalising at slightly lower levels as issuers prepare to comply with the EU Green bond standard. In the medium term, volumes will need to increase as the transition needs to be financed.

### 3.6 Blockchain is here to stay

Distributed ledger and blockchain based covered bonds resurfaced in 2024 but remain proofs of concept rather than a valid choice for issuers when thinking about the format they want to issue. Following French forays into blockchain based issuance in 2019/20, the German covered bond community tipped its toes into the water. Berlin Hyp issued a digital Mortgage Pfandbrief based on the German Electronic Securities Act and used blockchain technology. In August also Natixis Pfandbriefbank issued its first digital registered covered bond.

Both Pfandbriefe were standardised and used a private, permissioned and Basel-compliant blockchain as a settlement network. From a rating perspective, the transition from pen and paper to more digitalised processes raises no concerns. The underlying product is well established and tested, the parties involved are of high credit quality, technical set-ups are externally vetted, and supervisors and regulators are actively engaged. Furthermore, a significant number of legal opinions were provided to ensure legal certainty. Additional operational risk for this new documentation type was negligible and thus rating neutral.

However, while blockchain platforms address most of the key challenges for tokenised bond issuance, they may also hinder scalability. By design, blockchains are restricted to members, which limits the number of market participants. This limitation could hinder one of the key benefits to covered bonds: liquidity. Also, to achieve end-to-end digitalisation a digital euro for settlement remains essential to increase efficiency but also to help foster acceptance and trust in the technology.

Ultimately, the decision to implement a digital euro lies with EU member states and the European Parliament, which is currently negotiating the European Commission's proposal. Any resolution let alone implementation is several years away.

The time might be well spent removing other missing elements, such as acceptance by the ECB within the Eurosystem collateral framework but also more digital and blockchain-based collateral aka cover pools and collateral management.

We expect to see more blockchain based covered bond issuance, which will hopefully help to establish a common (open?) platform using standardised and machine-readable information.

## 4. Credit themes to watch for in 2025

Our outlook on core asset classes underlying covered bonds remains stable, but vagaries stemming from political tensions and macroeconomic turmoil may impact covered bonds in 2025. The credit quality of European public-sector collateral could face risks stemming from sovereign rating deterioration, which could have a contagion effect on sub-sovereign exposures.

Additionally, residential mortgage pools could be exposed to higher defaults driven by rising unemployment and/or inflation. Commercial real estate may further suffer from weakening demand and headline risk particularly in light of ongoing economic uncertainty.

Even if credit risk were to increase, we do not expect it to negatively impact covered bond ratings, because of their strong protection as a dual-recourse instrument benefiting from strict asset eligibility criteria and replacement mechanisms. In addition, issuers are well capitalised so should be able to weather turbulence in 2025. (See Covered bond rating stability to persist).

### 4.1 European public-sector credit quality needs to be monitored for core countries

The majority of Scope's sovereign outlooks are Stable, which underscores a balanced overall sovereign sector outlook for 2025 (see Sovereign outlook 2025: Normalising economic fundamentals, rising fiscal pressures and geopolitical uncertainty balance the sovereign outlook). At year end, Scope had just one European sovereign on a Negative Outlook (Belgium) and five sovereigns on Positive Outlook: Bulgaria, Greece, Lithuania, Serbia and Türkiye. This represents a significant shift compared with the previous year, where 10 sovereigns were on Negative Outlook against only two on Positive.

Public-sector covered bonds are mostly issued in core euro area countries where sovereign credit quality has traditionally been strong. While we have seen positive credit rating actions in lower-investment-grade-rated euro-area sovereigns, some selective negative rating actions on highly rated core euro-area sovereigns took place, most notably France.

The capacity of sovereigns and sub-sovereigns to navigate rising debt-servicing costs, implement structural policy reform, and prioritise investment balancing short-run stability with longer-term challenges will be key themes for the credit outlook of public-sector collateral in covered bonds.

Countries with stable parliamentary majorities and strong reform mandates will be well positioned to address sustained fiscal imbalances and maintain sovereign credit quality. For others, the credit trajectory and the quality of public-sector collateral in covered bonds will be more uncertain.

## 4.2 Commercial real estate risk reducing

For 2025, we expect headline risk to reduce for cover pools with significant commercial real estate exposures. More liquidity from debt and equity investors is expected to alleviate some refinancing pressures throughout 2025, but banks will continue to be more selective about the CRE assets they choose to finance.

Performance on CRE collateral in early 2024 was driven by fears about over-valuation, repricing and refinancing risk. Since then, the sector has benefited from lower rates while inflation has boosted rental income, compensating for some increases in capitalisation rates. (see 2025 Outlook European CRE & CMBS: cautiously optimistic)

Commercial real estate as covered bond collateral typically comprises office buildings, followed by retail and industrial properties. The credit performance of loans backed by offices remains bifurcated. Prime properties in good locations will continue to attract strong tenants and achieve stable valuations – even more so when assets have strong ESG standards. This is also valid for US exposures (though this is limited in cover pools).

Valuations of loans secured on office properties in secondary locations are unlikely to revert to pre-Covid occupancy levels. Obsolescence of some buildings and high repurposing costs weigh on net operating income and valuations, effectively challenging refinancing.

The performance in retail property will be driven by location and the quality of management hence it remains very bespoke. Diverging European growth and inflation will continue to weigh on household spending and may also lead to increasing tenant bankruptcies, impacting loans backed by retail properties.

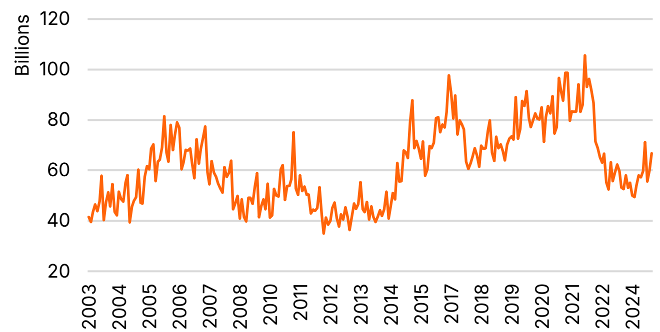
## 4.3 European residential house prices back to a normal trajectory in most countries

We expect mortgage demand and house prices to rebound in 2025, as stable unemployment levels and declining interest rates in Europe mean that household affordability will remain resilient, allowing banks to provide credit for housing.

Financing costs have become more manageable for borrowers, and inflation has started to weigh less on prices, which means that price corrections of 10% since mid-2022 in major European countries have started to reverse. France and Belgium are still seeing house prices moderate but we expect the trend to reverse in 2025.

Mortgage demand in Europe halved from its peak over EUR 100bn in March 2022 to EUR 50bn five months later. Although the 2024 interest-rate reductions have helped to reverse the trend, demand is still far away from earlier levels.

**Figure 7: European Housing loan demand**



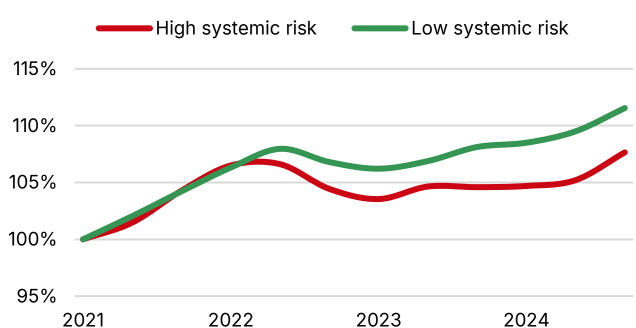

Source: ECB, Scope Ratings

## 4.4 Vulnerability of European residential mortgage markets differs

Vulnerabilities in European residential mortgage markets continue to differ, partly because of different growth potential (0%-2% for the larger euro area economies in 2025) but also due to the very diverse structure of European mortgage markets. Households in some countries voluntarily take or are more exposed to interest-rate risks than others.

Our mortgage market systemic risk score shows that the countries with a high score experienced more severe house-price changes when short-term European interest rates started to increase in the second half of 2022 through 2023.

**Figure 8: House prices more sensitive in countries with high mortgage market systemic risk scores**




Source: Scope Ratings

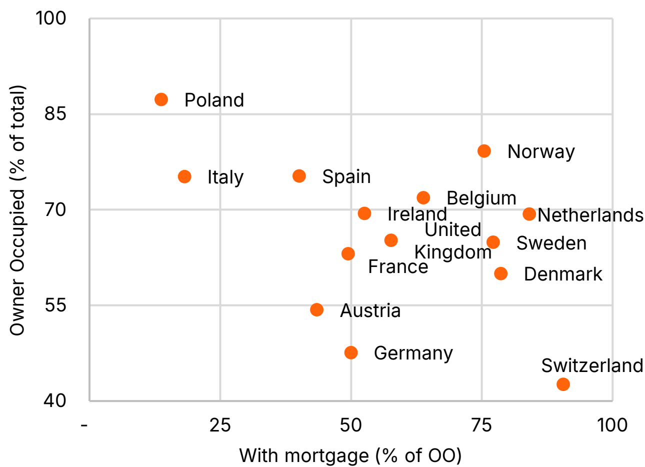
Higher systemic risks (50% quantile) in a mortgage market can introduce higher house-price volatility during times of stress. Consequently, property values can decline more strongly and over a longer period of time in countries where systemic mortgage risks are high. Systemic risk also impacts household default rates. We have calculated that default rates on mortgages in countries with high systemic risks since 2021 increased twice as much as in countries with low systemic risks scores.

### Introducing the mortgage market systemic risk score

To establish the scoring, we identified three drivers that can make household affordability more exposed to sudden changes in interest rates. In the first step, we compare household occupancy status and mortgage exposure.

On average, 70% of European households live in their own houses but only 36% have a mortgage. We see very high shares for debt-financed households in Northern European countries and Switzerland. Housing is debt-financed to a lesser extent in Central, Southern and Eastern European countries.

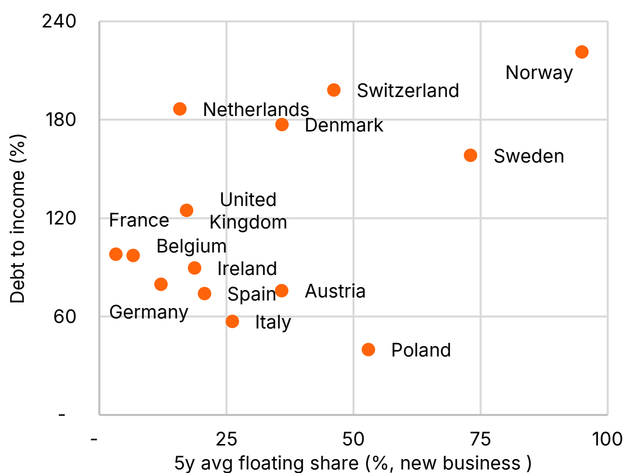
**Figure 9: Home ownership rates and mortgage financing**




Source: Eurostat, Statistics Norway, Bank of England, SNB, Scope Ratings

In our second step, we plot debt-to-income levels and the share of floating-rate mortgages (the average from new business over the last five years as a proxy for the total stock of mortgages). It shows that European households are exposed in different ways to affordability shocks. Swedish and Norwegian borrowers are the most leveraged and have a substantial share of floating-rate mortgages.

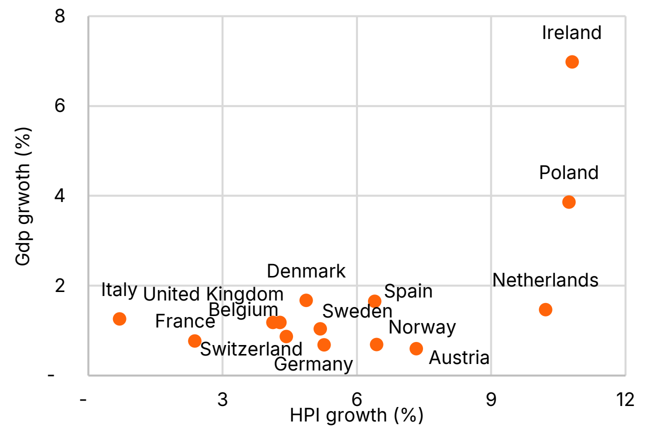
**Figure 10: Debt to income vs floating rate loans (originated during the last 5 years)**




Source: Eurostat, ECB, Statistics Norway, Bank of England, SNB,, Scope Ratings

Third, we compare long-term (10 years) nominal house-price growth relative to long term economic growth. Most economies show low 10-year average economic growth of 1%. Residential house prices grew on average by about 5% annually.

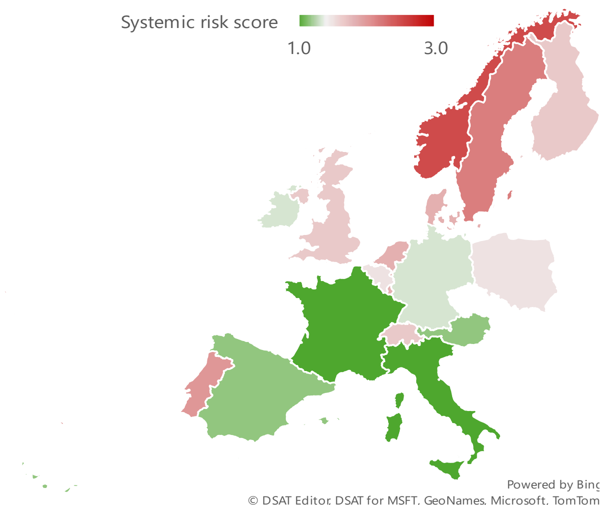
**Figure 11: Economic vs residential house price growth**




Source: Eurostat, ECB, Statistics Norway, Bank of England, SNB,, Scope Ratings

In some countries, house-price growth has significantly decoupled from economic growth, indicating a growing risk of a correction. By combining these risk factors into an equally weighted score, we conclude, unchanged from our earlier assessments, that the Nordic countries are more leveraged, more exposed to interest-rate risks, and HPI growth is exceeding long-term economic growth.

**Figure 12: European mortgage market systemic risk scores**




Source: Eurostat, ECB, Statistics Norway, Bank of England, SNB, Scope Ratings

These factors appear to rank countries in terms of house-price volatility, as countries with a higher score have experienced larger house price decrease since 2022 than the countries with a lower score (see also Figure 8). Countries with a high score also experienced more significant house price increases before 2021.

## 5. Covered bond rating stability to persist

In 2025, we expect covered bond ratings to remain stable, with limited changes to relevant risk factors. The over-collateralisation needed to mitigate identified risks is expected to remain steady.

Covered bond ratings remain underpinned by

1.) Banks' current strong capital buffers and sound profitability, resulting in a stable outlook for Scope-rated covered bond issuers[1],

2.) Unwavering governance support for covered bonds from existing and tested statutory provisions, including legal frameworks,

3.) The strength of underlying loan collateral, where applicable and needed.

### 5.1 Covered bond ratings remain well supported

Dual recourse is commonly quoted as the key differentiating factor for the high credit quality of covered bonds. It reflects the recourse to the issuer as well as recourse to the cover pool.

From a rating perspective, high credit quality is also supported by very strong and product specific governance, which also needs to be looked at when assessing rating stability.

**Figure 13: Sources of covered bond rating support**

| LEVEL OF RECOURSE | TYPE OF RECOURSE | SCOPE RATING UPLIFT |
| --- | --- | --- |
| 3rd recourse | Contractual payments under loan collateral & recourse from security | Cover pool uplift + 3 |
| | | Cover pool uplift + 2 |
| | | Cover pool uplift + 1 |
| 2nd recourse | Legal framework and resolution regime | Resolution regime +4 |
| | | Resolution regime +3 |
| | | Resolution regime +2 |
| | | Resolution regime +1 |
| | | Legal framework +2 |
| | | Legal framework +1 |
| 1st recourse | Issuer creditworthiness | Issuer rating |

Source: Scope Ratings

The first and often strongest support comes from the credit quality of the issuer. With the introduction of the Bank Recovery and Resolution Directive, directly switching to full recourse to the cover pool has been aided by an interim step: resolution.

The resolution of a bank might result in a going concern outcome for covered bonds or the (orderly) wind-down of the issuer. Under these scenarios, the potential transition (if any) of recourse to the cover pool will be postponed. The assessment, or the impact of a resolution scenario is therefore also a relevant support factor on top of the creditworthiness of the issuer.

In the EU, the Single Resolution Board (SRB) and national resolution authorities are tasked with the resolving banks and credit institutions. To date, the SRB has only reported two cases where a resolution decision has been made. One of these involved Banco Popular, a covered bond issuer. In this case Banco Santander stepped into all covered bonds issued by Banco Popular and their credit quality has remained untarnished.

While different in several aspects and not within the realm of the SRB, the Credit Suisse resolution did not impact CS's outstanding covered bonds, highlighting cohesiveness among authorities, regulators and other market participants when push comes to shove.

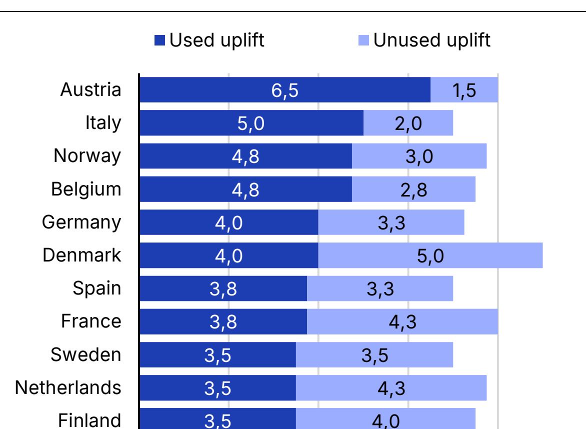
The third support pillar is only of relevance after a chain of events that ultimately leads an issuer in resolution to default with the consequence that payment obligations under its covered bonds are borne by the cover pool only.

Payment obligations under the covered bonds would have to be satisfied using cover-pool assets. Here contractual or regulated covered bonds typically benefit from a dedicated framework that ensures a smooth transition from the defaulted obligor to the cover pool. Even where cover assets become distressed, covered bond holders have recourse to the loans securing the collateral.

### 5.2 Scope's covered bond universe

All of Scope's covered bonds are currently rated AAA with a stable outlook (see here). Danish, French, Dutch, and Finnish covered bond are the least sensitive to issuer downgrades thanks to the combination of their banks' higher average credit quality as well as the transaction-specific interplay between complexity and transparency.

**Figure 14: Downgrade sensitivity Covered bonds**



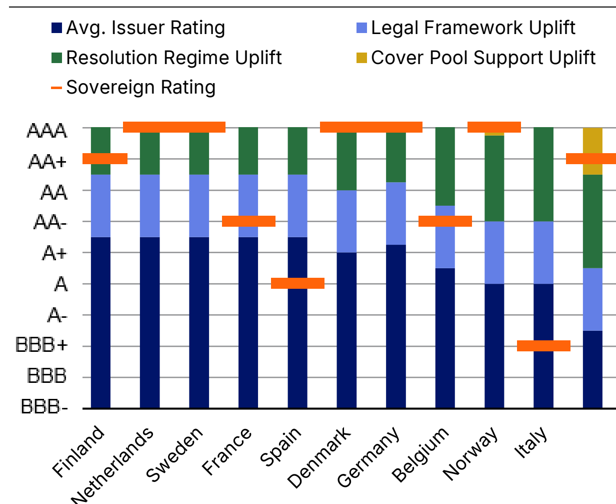

Source: Scope Ratings

Strong bank ratings and supportive legal and resolution frameworks allow 89% of our rated covered bond programmes to achieve the highest ratings without additional cover-pool support.

[1] see Scopes 2025 Bank outlook: ...available here

The strength of the cover pool does provide additional rating stability, however. On average, Scope-rated covered bond programmes can withstand issuer downgrades of up to three notches. That is unchanged from last year, on condition that the programmes' risk characteristics and protection provided through over-collateralisation (OC) do not materially change.

**Figure 15: Rating constructs by country**




Source: Scope Ratings

At the same time, the dual recourse of covered bonds allows the other 11% of covered bond programmes to support the highest ratings on the basis of cover-pool support. Notably, covered bonds in Austria and Norway achieve AAA ratings with the help of this credit support.

The buffer against issuer downgrades is lower for such programmes. For all, strong cover-pool support can mitigate a downgrade of the issuer rating of at least one notch.

We do not expect rating-supporting OC to constrain ratings in the short to medium term, either through increased issuance activity or through a deterioration in cover-pool quality (including a drop in eligible assets from value depreciation).

## Appendix 1. Scope 2025 outlooks

### Bank outlooks

Spanish banks 2025 outlook: strong economy supports loan growth; tax extension could erode profits

French banks outlook: Fundamentals support profitability; political uncertainty clouds loan growth

Norway: positive credit implications from banking sector consolidation

### Public Finance and sovereign outlooks

Sovereign Outlook 2025: robust fundamentals, rising fiscal pressures and geopolitical uncertainty

CEE Sovereign Outlook 2025: risk balance to ratings broadly neutral for 2025

### Other relevant outlooks

Structured finance monitoring report and 2025 rating outlook

European Commercial Real Estate loan/CMBS 2025 Outlook: cautiously optimistic

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