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Eiendoms kreditt AS

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Eiendomskreditt AS

SACP	bbb		+	Support	0	+	Additional Factors	0
Anchor	a-			ALAC Support	0		Issuer Credit Rating BBB/Negative/A-2	
Business Position	Weak	-2		GRE Support	0			
Capital and Earnings	Very Strong	+2		Group Support	0			
Risk Position	Moderate	-1		Sovereign Support	0			
Funding	Below Average	-1						
Liquidity	Adequate							

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Very high capital levels. • Conservative approach to risk underlined by high collateral values. • No credit losses since establishment in 1998. 	<ul style="list-style-type: none"> • Reliant on the Norwegian covered bond market for funding and lacking direct access to central bank. • Concentration of the business model on commercial real estate (CRE) in Norway. • Small size and very low market shares.

Outlook : Negative

The negative outlook on Norway-based mortgage company Eiendoms kreditt AS indicates that we could lower the ratings on within our two-year outlook horizon if the negative trend we see for Norwegian economic risk causes us to revise down our anchor for banks operating in Norway to 'bbb+' from 'a-'. The negative trend is primarily driven by the increasing economic risk we perceive in Norway's banking system in general, and in western Norway in particular, based on growing imbalances and low oil prices. In addition, continued deterioration in oil-related industries could hurt asset quality and result in credit losses for Eiendoms kreditt, which has meaningful exposures to CRE loans in southern and western Norway.

We could also lower the rating if Eiendoms kreditt's growth strategy results in a material change in risk appetite, loan concentrations, or increased operational risks, or if we see early signs of asset quality deterioration.

We could revise the outlook to stable if we were to observe an improvement in economic conditions, with slowing development in household debt and house prices, as well as improved conditions for the oil industry.

Rationale

Eiendoms kreditt's stand-alone credit profile (SACP) is 'bbb', reflecting the anchor of 'a-' we assign to financial institutions operating in Norway, Eiendoms kreditt's weak business position, its very strong capital and earnings, moderate risk position, below average funding, and adequate liquidity. We consider Eiendoms kreditt to be of low systemic importance and consequently do not factor any extraordinary government support into the ratings.

Anchor: 'a-' for financial institutions operating only in Norway

Our bank criteria use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for a commercial bank operating only in Norway is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

Our assessment of low economic risk in Norway is supported by the country's wealthy government, which is supported by returns from its global investment fund, and a predictable political environment. The Norwegian economy is undergoing a structural transformation as a result of the contraction in oil prices. As a result, the krone has weakened and the depreciation has helped increase competitiveness for Norwegian exports. This has buoyed mainland GDP growth in particular, and has meant headline GDP growth has remained positive.

The Norwegian central bank has maintained an expansive monetary policy stance to support the country's structural shift. Low interest rates and competition among banks for mortgage loans, in addition to a shortage of housing in the greater Oslo region, has meant house prices in the area have increased at an accelerated pace. However, in the oil-concentrated Rogaland and Vestland regions real estate prices have been much more subdued, underscoring the diverging regional developments and making targeted monetary policy difficult. Increasing asset values have led to further household debt growth, which continues to outpace disposable income growth and poses mounting risks for

the economy, in our view. Bank losses, meanwhile, have been amplified over the past year as a result of the reduced level of investment in oil and oil-related sectors. That said, we believe the rise in credit losses will remain manageable for banks with diverse national exposures, given low levels of unemployment, the government's fiscal stimulus initiatives, and strong social safety nets.

Our view of industry risk is supported by Norway's banking regulator, which has been proactive in implementing relatively high capital requirements, in addition to improving banks' liquidity. Steps have also been taken to introduce banking crisis legislation over 2017-2018. We furthermore note the government's track record and ability to provide impartial liquidity support to the sector. The market is dominated by DNB Bank, other Scandinavian banks, and domestic savings bank alliances, although we observe intense competition for mortgage-loan market share, which has depressed lending margins in recent years. Tentative signs of improved margins are now there, as banks look to increase lending margins and their funding costs improve. Restrictions on domestic investments by Norway's Government Pension Fund Global (GPF) result in a sizable outflow of capital, some of which is repatriated through banks' use of international wholesale funding. However, Norway's expanding bond market, banks' receipt of funding from foreign parent companies, and likely liquidity support from the government help offset some of the risks from what we see as a structural lack of deposits.

Table 1

Eiendomskreditt AS Key Figures					
	--Year-ended Dec. 31--				
(Mil. NOK)	2017*	2016	2015	2014	2013
Adjusted assets	4,599.5	4,605.8	4,682.2	4,870.1	4,877.7
Customer loans (gross)	3,556.7	3,599.1	3,794.2	4,019.0	4,125.5
Adjusted common equity	575.4	438.2	425.5	404.1	380.3
Operating revenues	15.5	58.2	47.1	61.2	62.5
Noninterest expenses	4.5	15.9	19.2	18.7	18.9
Core earnings	9.1	31.9	20.2	31.6	31.4

*As of March 31. NOK--Norwegian krone.

Business position: Weak, due to very low market shares and a concentrated business model

We consider Eiendomskreditt's business position to be weak, due to its small size--total assets stood at Norwegian krone (NOK) 4.6 billion (€507 million at 9.08 NOK/€) at March 31, 2017--very low market shares in Norway's residential and CRE markets, and geographic and sector concentration. Eiendomskreditt is owned by two investment companies and 79 savings banks, for which Eiendomskreditt functions as a covered bond funding vehicle. As such, a large share of Eiendomskreditt's loans are originated by the owners. While this supports Eiendomskreditt's loan and income generation somewhat, we also consider the reliance on the owners for loan generation a risk as it exposes Eiendomskreditt to the owner banks' strategic choices to increase or decrease the volumes of transferred loans.

The owner banks cover the cooperations of Frende (16.18% ownership share), Eika (23.47%), Sparebank (4.16%), and unaligned savings banks (10.25%). In the beginning of 2017, the two Norwegian family-owned investment companies R Transit AS and Meteva AS acquired 22.66% ownership each in Eiendomskreditt, contributing new capital worth NOK122 million, which we believe Eiendomskreditt will use to considerably grow their loan book in 2017, taking off in

the second quarter.

Eiendomskreditt is mainly focused on CRE loans to customers in the five-largest counties of southern and western Norway. These are relatively wealthy areas, but the western regions are reliant on the oil sector, which is currently under pressure. This has led to falling house prices locally and increased unemployment. So far, we have not seen a negative impact on Eiendomskreditt's revenues, but we continue considering the concentrations a vulnerability that may result in fluctuations in the company's revenue generation. In addition, the concentration to CRE lending makes Eiendomskreditt sensitive to the competitive environment within this sector.

Table 2

Eiendomskreditt AS Business Position					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Total revenues from business line (mil. NOK)	15.5	58.2	47.1	61.2	62.5
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on equity	7.1	7.3	4.9	8.1	9.1

*As of March 31. NOK--Norwegian krone.

Capital and earnings: Very strong due to very high and rising capital levels

We assess Eiendomskreditt's capital and earnings as very strong, based on a risk-adjusted capital (RAC) ratio of 22.3% at end-2016 and our projected RAC ratio in the 21%-22% range over the next 18-24 months. Our calculation of Eiendomskreditt's RAC ratio includes two additional tier 1 hybrid instruments totaling NOK75 million, which we include in our measure of total adjusted capital. The forecast incorporates a NOK122 million equity contribution made in early 2017 by the new owners, R Transit AS and AS Meteva, and 50% dividend payout ratio on income from 2017 onward.

We anticipate that Eiendomskreditt will increase its loan book by about 20% in 2017, entirely within CRE, slowing down to 5%-10% annually in 2018-2019. The growth is enabled by the recent capital contribution and increased loan transfers from owner banks. However, Eiendomskreditt will need significantly higher lending margins or new equity contributions to maintain the relatively aggressive loan growth beyond 2019. While we expected increased net interest margins (NIM) and cost-efficient operations, we forecast a slight decrease in RAC over the next 18-24 months.

We consider the quality of Eiendomskreditt's capital and earnings to be low, constrained by its small absolute size of the capital base (about \$60 million). In our view, this weakness is more than offset by the very high RAC ratio and 120 basis point earnings buffer, which measures the capacity for earnings to cover normalized losses.

Table 3

Eiendomskreditt AS Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Tier 1 capital ratio	19.2	15.8	14.9	13.9	12.2
S&P Global Ratings RAC ratio before diversification	N.M.	22.3	20.2	18.3	16.2
S&P Global Ratings RAC ratio after diversification	N.M.	11.9	11.4	10.3	9.6
Adjusted common equity/total adjusted capital	88.5	85.4	85.0	84.3	90.5

Table 3

Eiendoms kreditt AS Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Net interest income/operating revenues	93.6	90.0	107.3	96.2	96.7
Fee income/operating revenues	1.0	1.0	0.7	0.5	0.5
Market-sensitive income/operating revenues	4.1	7.8	(9.3)	2.0	1.4
Noninterest expenses/operating revenues	29.0	27.4	40.7	30.5	30.2
Provision operating income/average assets	1.0	0.9	0.6	0.9	0.9
Core earnings/average managed assets	0.8	0.7	0.4	0.6	0.7

*As of March 31. RAC--Risk-adjusted ratio. N.M.--Not meaningful.

Table 4

Eiendoms kreditt AS Risk-Adjusted Capital Framework Data					
(NOK 000s)	Exposure at default	Basel II RWA	Average Basel II RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government and central banks	40,081	0	0	1,202	3
Institutions	959,010	176,382	18	146,287	15
Corporate	2,268,157	2,268,157	100	1,645,494	73
Retail	1,370,229	702,088	51	328,855	24
Of which mortgage	1,370,229	702,088	51	328,855	24
Securitization*	0	0	0	0	0
Other assets	20,416	18,852	92	20,197	99
Total credit risk	4,657,893	3,165,479	68	2,142,035	46
Market risk					
Equity in the banking book§	5,617	5,613	100	45,076	802
Trading book market risk	--	0	--	0	--
Total market risk	--	5,613	--	45,076	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	104,225	--	115,071	--
		Basel II RWA		S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification		3,291,929		2,302,181	100
Total diversification/concentration adjustments		--		2,006,913	87
RWA after diversification		3,291,929		4,309,095	187

Table 4

Eiendomskreditt AS Risk-Adjusted Capital Framework Data (cont.)				
	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	520,273	15.8	513,163	22.3
Capital ratio after adjustments†	520,273	15.8	513,163	11.9

*Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. §Exposure and Standard & Poor's risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. †Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. NOK--Norwegian krone. Sources: Company data as of Dec. 31, 2016, Standard & Poor's.

Risk position: Moderate, reflecting concentrations in commercial real estate in Norway

We assess Eiendomskreditt's risk position as moderate, reflecting its increasing concentration in the CRE sector, single-name concentration, and exposure to the oil-reliant western regions of Norway. This is partly counterbalanced by Eiendomskreditt's conservative underwriting standards and historical lack of loan losses.

The share of CRE lending within total customer loans has increased steadily to about 78% at end-2016, from about 40% in 2009, and we expect the share of CRE will continue increasing given a reduced focus on the direct residential mortgage lending and our expectations that owner banks will be able to optimize their balance sheets by using Eiendomskreditt as a funding vehicle.

About 74% of the lending is in the counties of Oslo, Akershus, Hordaland, and Rogaland. This coincides with areas of high economic activity and liquid real estate markets, but provides some concentration risks. We believe that the liquidity of the Norwegian CRE market and the valuations of associated collateral could come under pressure during a period of stress, which could result in more substantial credit losses in the future, given Eiendomskreditt's concentration on a historically volatile segment.

In our view, these risks are somewhat counterbalanced by Eiendomskreditt's conservative underwriting process, underscored by loan-to-value (LTV) limits of 65% of collateral values for residential and 55% for commercial loans, as well as average LTV of 40%, and the absence of credit losses since the company started operations in 1998. While Eiendomskreditt has had some defaults, the entity's high collaterals and priority position has led to full recovery thus far in its history.

Table 5

Eiendomskreditt AS Risk Position					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Growth in customer loans	(4.7)	(5.1)	(5.6)	(2.6)	9.4
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N.M.	87.2	76.6	77.9	69.3
Total managed assets/adjusted common equity (x)	8.0	10.5	11.0	12.1	12.8
Gross nonperforming assets/customer loans + other real estate owned	0.3	0.7	1.9	2.1	3.8
Loan loss reserves/gross nonperforming assets	9.6	4.6	1.6	1.4	0.8

*As of March 31. RWA--Risk-weighted assets. N.M.--Not meaningful.

Funding and liquidity: Concentrated funding base with a dependence on wholesale funding, in particular Norwegian covered bonds

We consider Eiendomskreditt's funding to be below average, incorporating its predominantly wholesale funding profile, and regard its liquidity position as adequate

The below-average funding assessment reflects Eiendomskreditt's reliance on wholesale funding, particularly the rather fragmented domestic covered bond market, making it susceptible to erosion of market confidence in turbulent economic conditions, in our view. In addition, our assessment also considers the lack of direct access to the central bank. We do not consider potential support from the owner banks in our funding assessment. Eiendomskreditt's stable funding ratio, as measured by S&P Global Ratings, stood at 98.9% at end-2016, and is gradually extending maturity profile, partly by increasing the share of commercial covered bonds funding.

We assess Eiendomskreditt's liquidity as adequate, with a ratio of broad liquid assets to short-term wholesale funding at 0.99x at end-2016. We expect that these ratios will remain volatile, yet comfortable, due to the impact of debt falling due within one year, given the small number of outstanding issues.

Table 6

Eiendomskreditt AS Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2017*	2016	2015	2014	2013
Core deposits/funding base	0.0	0.0	0.0	0.0	0.0
Long-term funding ratio	N.M.	79.5	83.2	96.6	87.4
Stable funding ratio	N.M.	98.9	99.5	113.7	98.8
Short-term wholesale funding/funding base	N.M.	23.2	18.8	3.8	13.8
Broad liquid assets/short-term wholesale funding (x)	N.M.	1.0	1.0	4.6	1.0
Short-term wholesale funding/total wholesale funding	N.M.	22.7	18.5	3.7	13.7
Narrow liquid assets/3-month wholesale funding (x)	N.M.	44.2	57.3	52.4	6.9

*As of March 31. N.M.--Not meaningful.

Support: No notches of uplift to the SACP

We consider Eiendomskreditt to be of low systemic importance and consequently do not factor any extraordinary government support into the ratings. We do not include any group support in the ratings, despite the company's ownership by 79 domestic savings banks.

Additional rating factors: None

No additional factors affect this rating

Related Criteria And Research

Related Criteria

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And

Assumptions, July 17, 2013

- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Norway, March 14, 2017

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of May 17, 2017)

Eiendomskreditt AS

Counterparty Credit Rating	BBB/Negative/A-2
Senior Secured	AA+/Negative
Senior Unsecured	BBB

Counterparty Credit Ratings History

01-Jul-2014	BBB/Negative/A-2
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Sovereign Rating

Norway (Kingdom of)	AAA/Stable/A-1+
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*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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