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Eiendomskreditt AS

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Table Of Contents

Eiendomskreditt AS

SACP	bbb

Anchor	a-	
Business Position	Weak	-2
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Below Average	-1
Liquidity	Adequate	

\+

Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

\+

Additional Factors	0

Issuer Credit Rating
BBB/Negative/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Very high and rising capital levels. • Conservative approach to risk underlined by high collateral values. • No credit losses since establishment in 1998.	• Small size and very low market shares. • Business model concentrated on commercial real estate in southern Norway. • Confidence sensitive due to dependence on wholesale funding, particularly from the Norwegian covered bond market.

Outlook: Negative

The outlook on Norway-based mortgage provider Eiendomskreditt AS is negative, reflecting the negative trend of economic risk we perceive in Norway's banking system, and our view that a deterioration of economic conditions in Norway could have negative repercussions for Eiendomskreditt's operating performance and the Norwegian real estate markets in general.

Within our outlook horizon of 18-24 months, we could take a negative rating action if Eiendomskreditt made changes to its current lending policies, by compromising its loan-to-value limits or otherwise relaxing its underwriting process, which could lead to weakening asset quality and credit losses. We could also take a negative rating action if Eiendomskreditt failed to maintain its capital at a level commensurate with a "very strong" assessment. We view the company's current capital as an important buffer, preventing a reduction in market confidence and reduced access to the Norwegian debt capital markets.

A negative adjustment of our Banking Industry Country Risk Assessment (BICRA) of Norway's banking industry would reduce Eiendomskreditt's anchor score by one notch and result in a sharp decline of up to 260 basis points in our calculation of the company's risk-adjusted capital (RAC) ratio. However, in view of Eiendomskreditt's high and rising capital levels, such a decline in the RAC ratio would not affect our assessment of the company's capital and earnings. Accordingly, the likely impact of a negative revision of Norway's BICRA score would be limited to one rating notch.

We could revise the outlook to stable if we saw an improvement in economic conditions and a reduction in the developing economic imbalances in Norway. In addition, we could review the role of Eiendomskreditt or the support available from its owner banks if a support agreement became a more formal and consistent part of the funding strategy of its owner banks, which could lead us to reassess the company's business position or funding.

Rationale

Eiendomskreditt's stand-alone credit profile (SACP) is 'bbb', reflecting the 'a-' anchor we assign to financial institutions operating in Norway, as well as the company's "weak" business position, "very strong" capital and earnings, "moderate" risk position, "below average" funding, and "adequate" liquidity, as our criteria define these terms. We consider Eiendomskreditt 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 criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine an institution's anchor, the starting point in assigning an issuer credit rating. The anchor for a financial institution operating only in Norway is 'a-', based on an economic risk score of '2' and an industry risk score of '3'.

In our view, Norway has a wealthy economy, supported by its large oil fund, steady oil revenues, and predictable political environment. We believe that Norway is entering a correction phase after credit-led asset price inflation in recent years. However, given low interest rates, low unemployment, and strong social safety nets, we anticipate generally low credit losses.

In terms of industry risk, the Norwegian banking system comprises primarily stable Scandinavian banks and domestic savings bank alliances. We regard the regulator as proactive, and note that the government has a history of successful intervention in the system. Moreover, the expanding domestic bond market and the likelihood of liquidity support from the government help offset some of the risks from what we see as a structural lack of deposits and reliance on international wholesale funding.

Table 1

Eiendomskreditt AS Key Figures					
		--Year-ended Dec. 31--			
(Mil. NOK)	**2014***	**2013**	**2012**	**2011**	**2010**
Adjusted assets	4,913.6	4,877.7	4,498.3	3,918.4	3,898.3
Customer loans (gross)	4,041.7	4,125.5	3,772.7	3,168.1	2,869.2
Adjusted common equity	396.1	380.3	299.1	261.4	210.2
Operating revenues	32.9	62.5	46.4	34.8	40.4
Noninterest expenses	8.4	18.9	15.9	15.0	14.2
Core earnings	17.9	31.4	22.0	14.3	18.9

*Data as of June 30. 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 about Norwegian krone (NOK) 5 billion (€600 million) at mid-2014--very low market shares in Norway's residential and commercial real estate markets, and geographic and sector concentration.

Eiendomskreditt provides residential mortgages and commercial real estate loans, mainly to customers in the five largest counties of southern Norway. In addition to its geographic concentration, Eiendomskreditt is concentrated in the commercial real estate sector and has the highest share of loans to this sector among domestic Norwegian banks. Loans to the commercial real estate sector and residential mortgages, respectively, accounted for 70% and 26% of total lending as of mid-2014. We expect an increase in the relative share of commercial real estate loans transferred to Eiendomskreditt from its owner banks.

In spite of its concentrations, we consider that Eiendomskreditt's management has a conservative approach to risk. This is underlined, in our view, by the company's priority of providing its owner banks with cost-effective real estate financing with high collateral values at the expense of its own growth and financial targets. We assess Eiendomskreditt's cooperation with its owner banks as supportive of its business stability, and consider that the provision of loans from the owners will continue to contribute to Eiendomskreditt's fairly stable revenues. We view the company's operations as efficient, but believe this is largely due to the small number of full-time employees--13--which leads to key-man risk.

Table 2

Eiendomskreditt AS Business Position					
		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Total revenues from business line (currency in millions)	32.9	62.5	46.4	34.8	40.4
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on equity	9.2	9.1	7.6	5.8	8.7

*Data as of June 30.

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 the company's RAC ratio of 21.5% at mid-2014 and its projected RAC ratio of 22%-23% for 2015. We note that the Norwegian Financial Supervisory Authority is requiring financial institutions to increase their capital buffers to comply with higher capital requirements through 2016. We believe that, to comply with these capital requirements, Eiendomskreditt will reduce lending growth and retain dividends to increase its Tier 1 ratio. Despite an increase from 12.2% at year-end 2013, Eiendomskreditt's Tier 1 ratio was only 13.3% at mid-2014 due to the relatively high standardized risk weights in its regulatory capital. This figure includes two Tier 1 hybrid instruments totaling NOK75 million which we include in our measure of total adjusted capital. We believe Eiendomskreditt's capital levels will be supported by the continuing impact of increased margins as of mid-2013, a lack of dividend payouts, and its cost-efficient operations.

Table 3

Eiendomskreditt AS Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Tier 1 capital ratio	13.3	12.2	9.8	10.1	9.4
S&P RAC ratio before diversification	N.M.	19.0	N.M.	N.M.	N.M.
S&P RAC ratio after diversification	N.M.	10.7	N.M.	N.M.	N.M.
Adjusted common equity/total adjusted capital	84.1	90.5	100.0	100.0	100.0
Net interest income/operating revenues	97.6	96.7	89.5	96.8	94.9
Fee income/operating revenues	0.4	0.5	0.9	1.0	0.3
Market-sensitive income/operating revenues	0.8	1.4	7.5	(0.4)	2.3
Noninterest expenses/operating revenues	25.6	30.2	34.2	43.0	35.2
Preprovision operating income/average assets	1.0	0.9	0.7	0.5	0.7
Core earnings/average managed assets	0.7	0.7	0.5	0.4	0.5

*Data as of June 30. N.M.--Not meaningful.

Table 4

Eiendomskreditt AS Risk-Adjusted Capital Framework Data

(NOK 000s)	**Exposure***	**Basel II RWA**	**Average Basel II RW (%)**	**Standard & Poor's RWA**	**Average Standard & Poor's RW (%)**
Credit risk					
Government and central banks	0	0	0	0	0
Institutions	164,819	169,988	103	26,903	16
Corporate	2,581,705	2,581,710	100	1,872,966	73
Retail	534,151	534,147	100	135,770	25
Of which mortgage	516,097	516,097	100	123,863	24
Securitization§	0	0	0	0	0
Other assets	0	0	0	0	0
Total credit risk	3,280,675	3,285,844	100	2,035,638	62
Market risk					
Equity in the banking book†	5,167	0	0	41,982	813
Trading book market risk	--	0	--	0	--

Table 4

Eiendomskreditt AS Risk-Adjusted Capital Framework Data (cont.)					
Total market risk	--	0	--	41,982	--
Insurance risk					
Total insurance risk	--	--	--	0	--
Operational risk					
Total operational risk	--	90,088	--	117,392	--
(NOK 000s)		**Basel II RWA**		**Standard & Poor's RWA**	**% of Standard & Poor's RWA**
Diversification adjustments					
RWA before diversification		3,375,932		2,195,012	100
Total Diversification/Concentration Adjustments		--		1,717,507	78
RWA after diversification		3,375,932		3,912,519	178
(NOK 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**Standard & Poor's RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		554,530	16.4	471,111	21.5
Capital ratio after adjustments‡		554,530	16.4	471,111	12.0

*Exposure at default. §Securitization exposure includes 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--Norway krone. Sources: Company data as of June. 30, 2014, Standard & Poor's.

Risk position: Moderate due to concentrations in commercial real estate in southern Norway

We consider Eiendomskreditt's risk position to be "moderate," reflecting its concentration in southern Norway, increasing concentration in the commercial real estate sector, and single-name concentration.

Eiendomskreditt will continue to increase its share of commercial real estate lending as it increases its role as a commercial real estate mortgage financier for its owner banks. The share of commercial real estate lending within total customer loans has grown steadily from about 40% in 2009 to about 70% at mid-2014, and loans to the sector have been the main driver of loan growth since 2009. The increase in commercial real estate lending will continue to increase the relative size of the company's exposures, despite some diversification from the residential mortgage book.

Despite its concentration in a volatile sector, we consider Eiendomskreditt's underwriting process to be conservative. Our view is underscored by loan-to-value limits of 65% and 55% of collateral values for residential and commercial loans, respectively, both of which are below the regulatory requirements for inclusion in the company's covered bond pool. In our view, this has contributed to strong asset quality, best demonstrated by an absence of credit losses since the company started operations in 1998. We also note that Eiendomskreditt performs its own credit analysis on loans transferred from its owners, ensuring that such loans fit the company's risk profile. At mid-2014, loans totalling NOK76 million were considered to be in default but had collateral values exceeding the claims, underscoring the low risk in Eiendomskreditt's lending book, in our view. However, we believe that the liquidity of the Norwegian commercial real estate market and the valuations of associated collateral could come under pressure during a period of stress, and lead to more substantial credit losses in the future.

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Table 5

Eiendomskreditt AS Risk Position					
		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Growth in customer loans	(4.1)	9.4	19.1	10.4	6.1
Total diversification adjustment / S&P RWA before diversification	N.M.	76.8	N.M.	N.M.	N.M.
Total managed assets/adjusted common equity (x)	12.4	12.8	15.0	15.0	18.5
Gross nonperforming assets/customer loans + other real estate owned	1.9	3.8	2.1	0.5	0.6
Loan loss reserves/gross nonperforming assets	1.5	0.8	1.5	6.9	6.5

*Data as of June 30. N.M.--Not meaningful.

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

We assess Eiendomskreditt's funding as "below average." The company is dependent on wholesale funding, particularly domestic covered bonds, making it susceptible to erosion of market confidence in turbulent economic conditions, in our view. We do not consider measures available to the owner banks to provide funding support in our funding assessment, and note the correlation between the credit risk and the asset valuations used in the company's covered bond pool.

We understand that Eiendomskreditt is seeking to extend its funding maturity profile and, as part of this strategy, we believe it will replace outstanding commercial paper with longer-term senior and covered bonds. Eiendomskreditt's stable funding ratio, as measured by Standard & Poor's, stood at 90% at mid-2014, down from 98.8% at end-2013. At year-end 2014, we expect the stable funding ratio to be 97%-100%--a level comparable with the corresponding ratios of the company's Norwegian peers-- reflecting our expectation that short-term debt maturing within one year will be pre-paid and replaced by longer-term issuance. While we believe that the reduction of short-term wholesale funding will bring improvements in Eiendomskreditt's stable funding ratio over the coming two years, we expect that the ratio will remain volatile due to maturing debt with short durations and the relatively small number of outstanding issues.

We assess Eiendomskreditt's liquidity as "adequate." At end-2013, the company's liquidity portfolio stood at NOK423 million, comprising mainly highly rated Norwegian covered bonds and senior unsecured debt issued by domestic financial institutions, in addition to NOK242 million in demand deposits with domestic Norwegian banks. The company's liquidity ratio as measured by Standard & Poor's (broad liquid assets to short-term wholesale funding) declined to 0.65x at mid-2014 compared with 0.99x at end-2013 due to an increase in short-term debt maturing within one year. As with the stable funding ratio, we expect maturing debt to cause volatility in the liquidity ratio. We anticipate that Eiendomskreditt's strategy of extending the duration of its total funding will continue to reduce the share of short-term funding and have a positive effect on the liquidity ratio in the coming 18-24 months. We believe these actions will improve Eiendomskreditt's liquidity ratio to 0.9x-0.99x by end-2014.

Table 6

Eiendomskreditt AS Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2014***	**2013**	**2012**	**2011**	**2010**
Long term funding ratio	76.5	87.4	76.1	77.7	71.4

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Table 6

Eiendomskreditt AS Funding And Liquidity (cont.)					
Stable funding ratio	89.6	98.8	86.0	88.2	85.8
Short-term wholesale funding/funding base	26.1	13.8	25.6	24.0	30.3
Broad liquid assets/short-term wholesale funding (x)	0.6	1.0	0.5	0.7	0.7
Short-term wholesale funding/total wholesale funding	25.6	13.7	25.6	24.0	30.3
Narrow liquid assets/3-month wholesale funding (x)	10.4	6.9	2.1	3.9	1.9

*Data as of June 30.

External 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 into the ratings, despite the company's ownership by 85 domestic savings banks.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria And Research

Related Criteria

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Norwegian Mortgage Company Eiendomskreditt Assigned 'BBB/A-2' Ratings; Outlook Negative, July 1, 2014
- Banking Industry Country Risk Assessment: Norway, Nov. 26, 2013

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-

1365737 | 301941160

Ratings Detail (As Of October 24, 2014)	
Eiendomskreditt AS	
Counterparty Credit Rating	BBB/Negative/A-2
Senior Secured	AA/Negative
Counterparty Credit Ratings History	
01-Jul-2014	BBB/Negative/A-2
Sovereign Rating	
Norway (Kingdom of)	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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