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Research Update:

Norwegian Mortgage Company Eiendomskreditt Assigned 'BBB/A-2' Ratings; Outlook Negative

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Overview

- Eiendoms kreditt AS is a Norwegian mortgage company owned by 85 savings banks based in Norway.
- The ratings on Eiendoms kreditt reflect our view of its "weak" business position, "very strong" capital and earnings, "moderate" risk position, "below average" funding, and "adequate" liquidity, as our criteria define these terms.
- We are assigning our 'BBB/A-2' long- and short-term counterparty credit ratings to Eiendoms kreditt.
- The negative outlook reflects our view that increasing economic risks and a potentially deteriorating economic environment in Norway could have negative repercussions for Eiendoms kreditt's operating performance.

Rating Action

On July 1, 2014, Standard & Poor's Ratings Services assigned its 'BBB/A-2' long- and short-term counterparty credit ratings to Norwegian mortgage company Eiendoms kreditt AS. The outlook is negative.

Rationale

The ratings on Eiendoms kreditt reflect the bank's 'bbb' stand-alone credit profile. This is based on the 'a-' anchor we assign to banks operating in Norway, as well as Eiendoms kreditt'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 see Eiendoms kreditt as being of "low" systemic importance and factor no potential extraordinary government support into the ratings.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) 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'.

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.

With regard to industry risk, the Norwegian banking system comprises primarily stable Scandinavian banks and domestic savings bank alliances. We regard the regulator as proactive, and 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 banks' reliance on international wholesale funding.

We consider Eiendoms kreditt's business position to be "weak," due to its small size--total assets were about Norwegian krone (NOK) 5 billion (€600 million) at the end of the first quarter in 2014--very low market shares in Norway's residential and commercial real estate market, and geographic and sector concentration.

Eiendoms kreditt 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, Eiendoms kreditt is concentrated in the commercial real estate sector and has the highest share of loans to this sector among domestic Norwegian banks. Loans to commercial real estate and residential mortgages respectively accounted for 69% and 26% of total lending as of the first quarter of 2014. We do not expect geographic or sector concentrations to change significantly, although we expect an increase in the relative share of commercial real estate loans transferred from Eiendoms kreditt's owner banks.

In spite of its concentrations, we consider that Eiendoms kreditt's management has a conservative approach to risk. This is underlined, in our view, by the bank's priority of providing owner banks with cost-effective real estate financing with high collateral values over its own growth and financial targets. We assess Eiendoms kreditt'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 Eiendoms kreditt's fairly stable revenues. We view the bank'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" among its experienced top management.

We assess Eiendoms kreditt's capital and earnings as "very strong," based on our risk-adjusted capital (RAC) ratio for the bank of 19% at end-2013 and our projected RAC ratio of 21% for 2014. We note that the Norwegian Financial Services Authority (FSA) is requiring financial institutions to increase their capital buffers to comply with higher capital requirements through 2016. We believe that, in order to comply with the FSA's capital requirements, Eiendoms kreditt will reduce lending growth and retain dividends to increase its Tier 1 ratio, which stood at 12.15% at the end of first-quarter 2014. We believe Eiendoms kreditt's capital levels will be supported by the remaining impact of increased margins from mid-year 2013, no dividend payouts, and its cost efficient operations.

We consider Eiendoms kreditt's risk position to be "moderate," reflecting its

concentration on Southern Norway, an increasing concentration on the commercial real estate sector, and single-name concentration. Eiendoms kreditt will continue to increase its share of commercial real estate as it increases its role as a commercial real estate mortgage financier for its owner banks. The share of commercial real estate to total customer loans has grown steadily from about 40% in 2009 to about 69% in first-quarter 2014, and loans to the sector were the main driver of loan growth in 2013. The increase in commercial real estate will continue to increase the relative size of the exposures, despite the bank maintaining some diversification from its residential mortgage book.

Despite its concentration on a volatile sector, we consider Eiendoms kreditt'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 covered pool. In our view, this has contributed to strong asset quality, best demonstrated by an absence of credit losses since the bank started operations in 1998. We also note that Eiendoms kreditt performs its own credit analysis on transferred loans from its owners, ensuring that loans fit their risk profile. At the end of first-quarter 2014, loans totalling NOK124 million were considered to be in default but had collateral values exceeding the claims, underscoring the low risk in Eiendoms kreditt's lending book, in our view.

We assess Eiendoms kreditt's funding as "below average." By virtue of its position as a covered bond company, Eiendoms kreditt is dependent on wholesale funding, making it susceptible to a potential erosion of market confidence in turbulent economic conditions, in our view. We do not consider available measures of owner banks to provide funding support, and note the correlation between the credit risk and the asset valuations used in the covered pool.

We understand that Eiendoms kreditt is pursuing a strategy to extend the maturity profile of its funding and, as part of this strategy, we believe it will replace the outstanding commercial paper with longer-term senior and covered bonds. Eiendoms kreditt's stable funding ratio, as measured by us, stood at 99.6% at the end of first-quarter 2014, from 98.8% at end-2013, comparable with that of Norwegian peers. However, we expect the reduction of short-term wholesale funding to bring further improvements in its stable funding ratio over the coming two years.

We assess Eiendoms kreditt's liquidity as "adequate." At end-2013, its liquidity portfolio stood at NOK423 million, comprised mainly of 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. Our liquidity ratio--broad liquid assets to short-term wholesale funding--stood at 0.99x at end-2013 and 1.04x at first-quarter 2014, a significant improvement from 0.52x at end-2012. The liquidity ratio has been somewhat volatile due to Eiendoms kreditt's maturing debt with short durations and its relatively small number of outstanding issues. We expect Eiendoms kreditt's strategy of extending the duration of its total funding, as

mentioned above, to continue reducing the share of short-term funding and to have a positive effect on its liquidity ratio in the coming 18-24 months.

We consider Eiendoms kreditt to be of "low" systemic importance and consequently do not factor any extraordinary government support into the ratings.

Outlook

The negative outlook reflects the negative trend we have assigned for economic risks in Norway's banking system, and our view that a potentially deteriorating economic environment in Norway could have negative repercussions on the operating performance of Eiendoms kreditt and Norwegian real estate markets in general.

Within our outlook horizon of 18-24 months, we could take a negative rating action if Eiendoms kreditt made changes to its current lending policies, by compromising the loan-to-value limits or otherwise relaxing its underwriting process, which could lead to weakening asset quality and ensuing credit losses. We could also take a negative rating action if Eiendoms kreditt failed to maintain its capital commensurate with our "very strong" assessment, which we view as an important buffer preventing a reduction in market confidence and reduced access to the Norwegian debt capital markets. A negative adjustment of our country risk assessment for Norway's banking industry to BICRA group '3' from group '2' would reduce Eiendoms kreditt's anchor to 'bbb+' from 'a-' and result in a decline of the RAC ratio by nearly 250 basis points. Given the high and growing capital levels, the likely effect of a negative BICRA economic risk revision in Norway would lead us to lower the rating by one notch.

We might revise the outlook to stable if we saw an improvement in the economic environment and a reduction in the developing economic imbalances in Norway. In addition, we could review the role of Eiendoms kreditt or the support available from its owner banks if this became a more formal and consistent part of the funding strategy of its owner banks, which could lead to a review of our assessment of business position or funding.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Negative/A-2
SACP	bbb
Anchor	a-
Business Position	Weak (-2)

Capital and Earnings	Very Strong (+2)
Risk Position	Moderate (-1)
Funding and Liquidity	Below Average and Adequate (-1)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

- Banking Industry Country Risk Assessment: Norway, Nov. 26, 2013
- 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

Ratings List

New Rating

Eiendoms kreditt AS

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

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