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Ratings

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Eiendomskreditt AS

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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

ALAC 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 capital levels that we expect to remain very strong over the next few years. • Conservative underwriting standards and strong risk management, supporting traditionally good asset quality. • Established links with partner banks support new business generation.	• Reliance on the Norwegian covered bond market for funding and lack of direct access to the central bank. • Concentration of the business model on commercial real estate (CRE) in Norway. • Small size and very low market share.

Outlook : Negative

S&P Global Ratings' negative outlook on Norway-based Eiendomskreditt reflects that although economic risks in Norway have stabilized, we could lower the ratings on the company within our two-year outlook horizon if its growth strategy resulted in a material change in its risk appetite, a significant increase in loan concentrations, or increased operational risks, or if we saw early signs of asset quality deterioration.

We could revise the outlook to stable if Eiendomskreditt successfully continued its new business growth without compromising asset quality, while maintaining its solid capitalization and solid operational performance.

Rationale

Our 'BBB/A-2' ratings on Eiendomskreditt incorporate our view of the Norwegian banking industry as whole and Eiendomskreditt's very strong capitalization. Offsetting these factors are the company's limited market share and concentrated business model, and in particular, exposure to concentrations in the Norwegian CRE market. Eiendomskreditt's reliance on wholesale funding and the lack of direct access to central bank funding also constrain the ratings. 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 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 reflects the high level of wealth--including the government--which is supported by returns from its global investment fund and a predictable political environment. The contraction in oil prices over 2014-2015 has seen loose monetary policy prevail in the years that followed. Coupled with a competitive mortgage market, this has triggered an increase in property valuations and household debt and contributed to higher imbalances. Although household debt growth has slowed down in recent few years, debt to disposable income in Norway exceeded 230% at end-2018. This is high compared with other European countries. The residential mortgage portfolio accounts for about 60% of total bank loans and has been performing well.

We have seen a reduction in house prices in 2017 because of stricter macro-prudential regulations and increased housing supply. Many of the regulations introduced in 2017 were carried forward, which supported the stability of the banking sector. However, after some correction in 2017, housing prices continued moderately increasing and returned to almost the same levels in 2019. Bank losses related to oil and oil-related sector investment have been decreasing from a peak in 2016, against a positive economic backdrop, and we expect that asset quality will continue to improve.

Norway's banking regulator has been proactive in maintaining solid capital and liquidity requirements over the years, which supports our view of industry risk. Interest margins have improved over the past two years and now appear to be stabilizing at a slightly higher level. This, in turn, supports solid profitability and strong capitalization of Norwegian banks.

Restrictions on domestic investments by Norway's Government Pension Fund Global have resulted in a sizable outflow of capital, some of which the banks are repatriating through 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)	**2019***	**2018**	**2017**	**2016**	**2015**
Adjusted assets	5,863.4	5,263.3	5,081.3	4,605.8	4,682.2
Customer loans (gross)	5,099.8	4,414.6	4,302.3	3,599.1	3,794.2
Adjusted common equity	790.0	761.5	587.6	438.2	425.5
Operating revenues	49.3	92.0	69.7	58.2	47.1
Noninterest expenses	12.3	20.4	17.5	15.9	19.2
Core earnings	28.5	54.0	39.3	31.9	20.2

*Data as of June 30. NOK--Norwegian krone.

Business position: Very low market shares and a concentrated business model

Eiendomskreditt's small size--total assets stood at Norwegian krone (NOK) 5.3 billion (€530 million) at Dec. 31, 2018--weighs on its business position. It has a very low market share in Norway's residential and CRE markets, and rather high geographic and sector concentration. Eiendomskreditt is owned by two investment companies, 65 Norwegian savings banks--for which Eiendomskreditt functions as a covered bond funding vehicle--and several other investors.

The savings bank owners have traditionally originated a high proportion of Eiendomskreditt's loans, supporting Eiendomskreditt's loan growth and income generation. However, since 2017, Eiendomskreditt has been significantly increasing its in-house loan generation; loans originated in-house accounted for about 31% of total loan origination in 2018. This led to a decreased dependence on the partner banks.

Eiendomskreditt's expansion strategy focuses on the well-managed growth of good-quality exposure in the CRE segment, the area where Eiendomskreditt has traditionally had good expertise. This strategy acknowledges the very high competition in the mortgage market in Norway, which prompted Eiendomskreditt to gradually exit the retail loans segment and shift its focus to CRE instead. Eiendomskreditt aims to position itself as an important provider of loans to the CRE segment using a combination of in-house expertise and established cooperation with its shareholders, the savings banks.

Geographically, Eiendomskreditt focuses its efforts on the five largest counties of southern and western Norway. These are relatively wealthy areas, although the western regions are reliant on the oil sector, which could be vulnerable to oil price volatility. We note that despite the turmoil in 2014-2015, Eiendomskreditt's asset quality has been good in the years that followed. The rebound in oil prices should further support strong asset quality in Eiendomskreditt's portfolio because it should have a positive effect on employment and income in the oil-dependent regions. At the same time, we continue to view the concentrations in the CRE segment as a vulnerability that may result in fluctuations in Eiendomskreditt's revenue generation.

In 2017, investment companies R Transit AS and Meteva AS became new shareholders in Eiendomskreditt. In 2018, these shareholders increased their market share to 30% each. We note that R Transit AS and Meteva AS were incorporated well into the shareholder structure and are supportive of Eiendomskreditt's growth strategy. Eiendomskreditt's other major shareholders are Sparebanken Sogn og Fjordane (6.51%), Voss Sparebank (3.64%), and

Luster Sparebank (1.85%). Other shareholders own less than 2% each.

We consider that Eiendomskreditt's management team is stable and very experienced in the business on which the company focuses. That said, we also note that Eiendomskreditt is subject to key-person risk regarding its management team, since it is a relatively small company. Eiendomskreditt addresses this risk by promoting a multi-functional focus among the management team members.

Table 2

Eiendomskreditt AS Business Position

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Total revenues from business line (mil. NOK)	49.3	92.0	69.7	58.2	47.1
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	7.4	7.9	7.4	7.3	4.9

*Data as of June 30. NOK--Norwegian krone.

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

We expect Eiendomskreditt's capital and earnings to remain very strong, based on a risk-adjusted capital (RAC) ratio of 23.9% at end-2018 and our projected RAC ratio in the 20.0%-22.5% range over the next 18-24 months, well above 15%. These metrics, together with Eiendomskreditt's very good cost efficiency over the past few years and stable earning profile, support our very strong capital assessment.

We anticipate that Eiendomskreditt will maintain its focus on the CRE segment given its expertise in this area, but new lending growth rates could slow down in 2019-2020 compared to 2017-2018. The capital provided by new shareholders in 2017-2018 supported asset growth and helped Eiendomskreditt maintain its very strong RAC ratio. However, the company will need to either improve lending margins or receive new equity contributions to maintain the relatively aggressive loan growth beyond 2020. Our forecasts currently incorporate the assumptions that Eiendomskreditt will be able to maintain its net interest margins at about 1.7% and that it will receive an additional equity contribution of about NOK30 million from shareholders before year-end 2019.

We consider Eiendomskreditt's quality of capital to be adequate. Core capital comprised 90% of total adjusted capital at end-2018 (88% at end-2017). Moreover, the company's earnings capacity is reasonably strong, with an earnings buffer of about 1.0%-1.5% both historically and forecasted.

Table 3

Eiendomskreditt AS Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Tier 1 capital ratio	16.1	17.8	16.8	15.8	14.9
S&P Global Ratings' RAC ratio before diversification	N/A	23.9	23.3	22.3	20.2
S&P Global Ratings' RAC ratio after diversification	N/A	11.1	11.8	11.9	11.4
Adjusted common equity/total adjusted capital	90.3	91.0	88.7	85.4	85.0
Net interest income/operating revenues	95.0	89.3	95.2	90.0	107.3
Fee income/operating revenues	3.3	2.4	2.7	1.0	0.7

Table 3

Eiendomskreditt AS Capital And Earnings (cont.)

	--Year-ended Dec. 31--				
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Market-sensitive income/operating revenues	1.1	0.5	1.2	7.8	(9.3)
Noninterest expenses/operating revenues	25.1	22.2	25.1	27.4	40.7
Preprovision operating income/average assets	1.3	1.4	1.1	0.9	0.6
Core earnings/average managed assets	1.0	1.0	0.8	0.7	0.4

*Data as of June 30. N/A--Not applicable. RAC--Risk-adjusted capital.

Table 4

Eiendomskreditt AS S&P Global Ratings Risk-Adjusted Capital Framework

(Thousand NOK)	**EAD**	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Institutions and CCPs	827,418	129,013	16	121,087	15
Corporate	4,054,643	3,754,550	93	2,941,547	73
Retail	800,348	632,563	79	185,601	23
Of which mortgage	800,348	632,563	79	185,601	23
Securitization*	0	0	0	0	0
Other assets§	24,442	24,438	100	24,180	99
Total credit risk	5,706,851	4,540,563	80	3,272,415	57
Total credit valuation adjustment	--	7,063	--	0	--
Equity in the banking book	5,617	5,613	100	55,608	990
Total market risk	--	5,613	--	55,608	--
Total operational risk	--	136,663	--	172,359	--
RWA before diversification	--	4,689,900	--	3,500,382	100
Total diversification/concentration adjustments	--	--	--	4,009,490	115
RWA after diversification	--	4,689,900	--	7,509,872	215
(Thousand NOK)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio before adjustments		959,198	20.5	836,470	23.9
Capital ratio after adjustments†		959,198	20.4	836,470	11.1

*Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. §Other assets includes deferred tax assets (DTAs) not deducted from ACE. †For Tier 1 ratio, adjustments are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). CCP--Central counterparty. EAD--Exposure at default. NOK--Norwegian krone. RW--Risk weight. RWA--Risk-weighted assets.

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

We expect Eiendomskreditt's risk position to remain moderate, reflecting its concentration in the CRE sector, sizable single-name concentrations, and exposure to the oil-reliant western regions of Norway. This is partly counterbalanced by Eiendomskreditt's conservative underwriting standards and good asset quality track record.

The share of CRE lending within total customer loans has increased steadily to above 85% at end-2018, from about 40% in 2009, and we expect the share of CRE will continue increasing, given the company's limited appetite for direct residential mortgage lending and its new strategic focus on the CRE segment, where it has good expertise.

About 70% of the lending is in the counties of Oslo, Akershus, Hordaland, and Rogaland. Although these are areas of high economic activity that have liquid real estate markets, the concentration carries some risks. In our view, the liquidity of the Norwegian CRE market and the value of the associated collateral could come under pressure during a period of stress. Nevertheless, we think that this risk is stabilizing. Due to the stabilizing macroeconomic environment, housing prices started to ease from the beginning of 2017, after the Norwegian Financial Supervisory Authority introduced a number of macroprudential measures that seem to be successfully limiting household debt growth.

Moreover, Eiendomskreditt has a conservative underwriting process, underscored by loan-to-value (LTV) limits of 65% of collateral values for residential and 55% for commercial loans, and an average LTV ratio of less than 43% as of end-2018. These factors mitigate concentration risks, to some extent. We also view positively that the company's operations in the CRE segment mainly focus on cash generating projects, with no significant exposure to high-risk construction and development projects. The quality of the portfolio has been very good: loan losses were close to zero in 2018, an improvement from the NOK1.2 million loan loss that the company reported in 2017. We incorporate in our base-case scenario the expectation that in the company could incur loan-loss provisions in 2019-2020, at a level no higher than that of 2017. However, we think that tight underwriting criteria, including low LTV values and good risk management systems, should support Eiendomskreditt's solid asset quality and gradually improving profitability.

Table 5

Eiendomskreditt AS Risk Position

		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	31.0	2.6	19.5	(5.1)	(5.6)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	114.5	98.0	87.2	76.6
Total managed assets/adjusted common equity (x)	7.4	6.9	8.6	10.5	11.0
New loan loss provisions/average customer loans	(0.0)	0.0	0.0	N.M.	N.M.
Gross nonperforming assets/customer loans + other real estate owned	1.4	0.6	0.2	0.7	1.9
Loan loss reserves/gross nonperforming assets	2.3	5.9	18.0	4.6	1.6

*Data as of June 30. N/A--Not applicable. N.M.--Not meaningful. RWA--Risk-weighted assets.

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

We expect Eiendomskreditt's funding to be below average over the next few years, underpinned by its predominantly wholesale funding profile. We also expect its liquidity position to remain adequate.

The below-average funding assessment reflects Eiendomskreditt's reliance on wholesale funding, particularly the rather fragmented domestic covered bond market. This makes it susceptible to the erosion of market confidence in turbulent economic conditions, in our view. Our assessment also considers the lack of direct access to the central bank. We do not consider potential support from the shareholders in our funding assessment. Eiendomskreditt's stable funding ratio, as measured by S&P Global Ratings, stood at 101.4% at end-2018. Its maturity profile has been gradually extending, partly because it has increased the share of commercial covered bonds in its funding.

We assess Eiendomskreditt's liquidity as adequate. As of end-2018, its ratio of broad liquid assets to short-term wholesale funding was 1.1x (1.4x as of end-2017). We expect that these ratios will remain volatile, yet comfortable, due to the impact of debt falling due within one year.

Table 6

Eiendomskreditt AS Funding And Liquidity					
		--Year-ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	0.0	0.0	0.0	0.0	0.0
Long-term funding ratio	85.4	87.4	90.6	79.5	83.2
Stable funding ratio	96.5	101.4	104.1	98.9	99.5
Short-term wholesale funding/funding base	17.1	15.0	10.9	23.2	18.8
Broad liquid assets/short-term wholesale funding (x)	0.8	1.1	1.4	1.0	1.0
Short-term wholesale funding/total wholesale funding	16.9	14.7	10.7	22.7	18.5
Narrow liquid assets/three-month wholesale funding (x)	3.5	10.0	3.7	44.2	57.3

*Data as of June 30. 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. Equally, we do not include group support from any of the shareholders in the ratings.

We do not add any support uplift to Eiendomskreditt ratings under our "Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity," published April 27, 2015. We think it is unlikely that Eiendomskreditt would be subject to a well-defined bail-in resolution process, given its small size, limited complexity, and low systemic importance.

Additional rating factors: None

No additional factors affect this rating.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment Update: July 2019, July 30, 2019
- Nordic Banks' Strong Capital Will Cushion Them From The Challenges Ahead, March 28, 2019
- Nordic Banks Sport Strong Capital--And It's Not Likely To Soften, Oct. 17, 2018
- Nordic Bank Ratings Continue To Stand Tall, Aug. 16, 2018
- Banking Industry Country Risk Assessment: Norway, May 11, 2018

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 September 18, 2019)*

Eiendomskreditt AS	
Issuer Credit Rating	BBB/Negative/A-2
Senior Secured	AAA/Stable
Issuer Credit Ratings History	
01-Jul-2014	BBB/Negative/A-2
Sovereign Rating	
Norway	AAA/Stable/A-1+

*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.