

Research Update:

# Eiendomskreditt AS Long-Term Ratings Lowered To 'BBB-'; Outlook Stable

March 31, 2020

## Overview

- We now expect that the fall in oil prices and ongoing threat of COVID-19 will have substantial negative implications for the Norwegian economy.
- We also believe that these factors will likely have a longer-term negative impact on the commercial real estate (CRE) segment, among other vulnerable sectors.
- We believe that the above factors will place increased pressure on Eiendomskreditt's revenues and business position.
- We are therefore lowering the issuer credit ratings on Eiendomskreditt to 'BBB-/A-3' from 'BBB/A-2'.
- The stable outlook on Eiendomskreditt reflects our view that, despite the likely volatility in revenues, the company's very strong capital buffers will, to a large extent, help balance the potential deterioration in asset quality over the next 24 months.

### PRIMARY CREDIT ANALYST

**Natalia Yalovskaya**  
London  
(44) 20-7176-3407  
natalia.yalovskaya  
@spglobal.com

### SECONDARY CONTACT

**Erik Andersson**  
Stockholm  
+ 46 84 40 5915  
erik.andersson  
@spglobal.com

## Rating Action

On March 31, 2020, S&P Global Ratings lowered its long- and short-term issuer credit ratings on Norway-based Eiendomskreditt AS to 'BBB-/A-3' from 'BBB/A-2'. The outlook is stable.

## Rationale

The downgrade reflects our assessment that the fall in oil prices and ongoing threat of COVID-19 will have substantial negative implications for the Norwegian economy, particularly the CRE segment. We foresee weaker economic prospects and have therefore revised down our assumptions for new lending growth in the banking sector. At the same time, we consider that the Norwegian government has introduced ample efficient and timely measures to support the economy, banking sector, and households. We believe that this will help mitigate pressure on revenues of various businesses and individual borrowers' income. Nevertheless, we believe that the likely pressure on the CRE segment will strain Eiendomskreditt's revenues, mainly due to the

focus of its business on this segment, as well as individual name concentrations in its portfolio, compared with banks with more universal business profiles.

**CRE segment is likely to experience the combined effects of the coronavirus outbreak and lower oil price.** We believe that the effects of the COVID-19 outbreak and fall in oil price will likely have a more pronounced negative, and possibly longer-term, impact on certain business sectors, particularly the CRE segment. This is because we expect business revenues to be increasingly volatile, resulting in pressure in particular on various businesses that provide non-essential goods and services, such as non-food retail and hotels, which often make up a substantial share of revenues of businesses within the CRE segment. With increasing unemployment and weakening corporate sentiment, there is an increased risk of tenants defaulting, which would make it more difficult to negotiate new leases, raising the risk of vacancies for the CRE segment. We also think that, in the longer term, the current situation might result in many businesses switching to an online business model instead of actively developing a physical presence in urban centers.

The impact of the financial fallout from the pandemic on future property prices remains uncertain at this stage. Weaker cash flows and a decline in investment over coming quarters may result in negative revaluations and increased loan-to-value ratios by the end of the year.

**We consider Eiendomskreditt to be vulnerable to the challenging macroeconomic environment due to its limited market share and lack of business diversification** Although we note Eiendomskreditt's rigorous underwriting process and strong portfolio performance over the past few years (as evidenced by the loan-to-value on its portfolio of about 45% and good asset quality as reported as of end-2019), we consider that the challenging economic environment will constrain its revenues.

We expect that the company's focus on the CRE segment, with individual name concentrations in its portfolio, will make it vulnerable to the potential deterioration of some large exposures. We believe that this will result in notable pressure on the company's revenues and will likely require significant additional provisioning.

As a small company with a concentrated funding profile, Eiendomskreditt will likely be among those entities that find it more difficult to secure funding from the capital markets, which are very turbulent at the moment. However, we believe that the company's liquidity cushion will mitigate this to a large extent. In addition, over recent years we note that the company has managed to extend the maturity of its funding to about three years and we don't expect that it will need to access the capital markets until 2021, which is a strength given the current circumstances.

**Currently very strong capitalization largely mitigates the risks related to potential asset quality deterioration.** We still consider Eiendomskreditt's strong capitalization as a rating strength. Based on our capital assessment, the company's risk-adjusted capital (RAC) ratio before diversification was 24.7% as of end-2019. Despite potential asset quality deterioration, under our base case we assume that capitalization will remain above 15% over our forecast horizon. This means that the company will have sufficient capital buffers to absorb expected higher losses compared with the low levels observed in 2019.

However, we see downside risk to our projections owing to uncertainty around the potential impact of coronavirus on global economic growth that might have certain implications for Norway. If we need to revise our base-case assumptions, we'll also revise our assumptions underlying Eiendomskreditt's financial forecasts and RAC projections.

## Outlook

The stable outlook on Eiendomskreditt reflects our view that, despite the likely volatility in revenues, the company's very strong capital buffers will, to a large extent, help balance the potential deterioration in asset quality over the next 24 months.

## Downside scenario

We could consider revising the outlook on Eiendomskreditt to negative if we observed that the entity's risk profile indicators are not commensurate with a 'BBB-' rating on a sustained basis over the next 18-24 months. Specifically, we would revise our outlook to negative if the ongoing coronavirus outbreak, coupled with the oil price shock, leads to significant negative pressure on the performance of the CRE segment in Norway, resulting in substantially higher credit losses and additional provisioning needs than we currently expect. We consider that the company's funding profile might also become more vulnerable due to increased volatility of the covered bond markets.

## Upside scenario

Although we believe an upgrade is unlikely at present, if Eiendomskreditt is able to demonstrate stable, predictable revenue generation on a consistent basis and strong resilience of its asset quality to ongoing pressures, we could consider revising our outlook to positive.

We acknowledge a high degree of uncertainty about the rate of spread and peak of the coronavirus outbreak. Some government authorities estimate the pandemic will peak about midyear, and we are using this assumption in assessing the economic and credit implications. We believe the measures adopted to contain COVID-19 have pushed the global economy into recession (see our macroeconomic and credit updates here: [www.spglobal.com/ratings](http://www.spglobal.com/ratings)). As the situation evolves, we will update our assumptions and estimates accordingly.

## Ratings Score Snapshot

	To	From
SACP	bbb-	bbb
Anchor	a-	a-
Business Position	Weak (-3)	Weak (-2)
Capital and Earnings	Very Strong (+2)	Very Strong (+2)
Risk Position	Moderate (-1)	Moderate (-1)
Funding	Below Average and (-1)	Below Average and (-1)
Liquidity	Adequate	Adequate
Support	0	0
GRE Support	0	0
Group Support	0	0
ALAC Support	0	0

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	To	From
Sovereign Support	0	0
Additional Factors	0	0
Holding Co. Notching	None	None

## 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: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- 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

- Coronavirus Impact: Key Takeaways From Our Articles, March 25, 2020
- Global Covered Bonds: Assessing The Credit Effects Of COVID-19, March 25, 2020
- Global Macroeconomic Update, March 24: A Massive Hit To World Economic Growth, March 24, 2020
- Norway, March 13, 2020
- BICRA Norway, Jan. 7, 2020

## Ratings List

### Downgraded; CreditWatch/Outlook Action

	To	From
<b>Eiendomskreditt AS</b>		
Issuer Credit Rating	BBB-/Stable/A-3	BBB/Negative/A-2

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such

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criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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