S&P Global Ratings

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Eiendomskreditt AS

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Eiendomskreditt AS

SACP	bbb-	+	Support	0	+	Additional Factors	0

Anchor	a-	
Business Position	Weak	-3
Capital and Earnings	Very Strong	+2
Risk Position	Moderate	-1
Funding	Below Average	-1
Liquidity	Adequate	

ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
BBB-/Stable/A-3

Major Rating Factors

Strengths:	Weaknesses:
• Very high capital levels that we expect to remain over the next few years. • Conservative underwriting standards and strong risk management, which will support asset quality despite the more vulnerable environment. • Established links with partner banks support new business generation.	• Reliance on the Norwegian covered bond market for funding, and a lack of direct access to the central bank. • Concentration of the business model on commercial real estate (CRE) in Norway, which could be particularly vulnerable to the current stress. • Small size and very low market share.

Outlook: Stable

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 its risk profile indicators were 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 stress related to coronavirus outbreak, coupled with the oil price decline, leads to significant negative pressure on the performance of the CRE segment in Norway, resulting in substantially higher credit losses and additional provisioning needs, above what we currently expect. We consider that the company's funding profile might also become more vulnerable due to increased volatility in the covered bond markets.

Upside scenario

Although we believe an upgrade is unlikely at present, if Eiendomskreditt is able to consistently demonstrate stable, predictable revenue generation and show that its asset quality is resilient to ongoing pressures, we could consider revising our outlook to positive.

Rationale

Our 'BBB-/A-3' 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.

S&P Global Ratings acknowledges a high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

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 balances the rising stress for the banking sector from the COVID-19 pandemic with the high level of wealth, strong returns from the sovereign investment fund, and a predictable political environment. We expect government programs aimed at businesses and households to provide substantial offset against the dual pressures of a sharp decline in oil prices and a recessionary environment prompted by the COVID-19 pandemic. In our base case, we expect that the pandemic will cause GDP to contract by 2.2% in 2020, and will rebound to average 2.6% in 2021-2023. We believe the current macro stress will result in intensifying pressure for the banking sector asset quality, revenue, and profitability over the next two years. Specific segments of concern include the oil sector, small and midsize enterprises (SMEs), commercial real estate, and other cyclical sectors.

Authorities in Norway, and across many other European countries, have delivered unprecedented policy responses to the COVID-19 crisis in the form of monetary, fiscal, and regulatory support to their economies. Given the ample reserves in its sovereign wealth fund, we believe Norway enjoys a unique position with respect to its ability to fund its fiscal support programs. We consider that this, in turn, will largely stabilize the banking sector's asset quality. In addition, we consider that the accumulated earnings and capital buffers will allow banks in Norway to absorb the increase in credit losses in 2020-2021 related to the current stress, and will support their credit standing.

In our view, the residential mortgage portfolio--about half of total bank loans--will be more resilient to the present stress than the corporate sector exposure, due to various government employment and income support measures. That said, we recognize some latent risks to banks from structurally high household debt (227% of GDP at year-end 2019), driven by strong growth in house prices over the past decade, and banks' exposure to the cyclical commercial real estate segment.

Our assessment of industry risks for Norwegian banks incorporates an effective banking regulation, stable competitive environment, and strong banking sector capitalization in Norway. We consider that the government authorities, including the banking regulator, have been proactively addressing the difficulties related to the current situation, including introducing an unprecedented key policy rate cut and temporarily relaxing the countercyclical capital buffer requirements, as well as providing liquidity support to the banking sector.

Moreover, we consider that Norwegian banks have benefited from being at the forefront of digital transformation including mobile payments, investment solutions, and mortgages. A high digital-technology adoption rate, as well as the population's openness to sharing data, have helped drive this progress. Given social-distancing requirements, being digital frontrunners should enable banks to continue providing high-quality service to customers, as banks had already moved from branch-based operations into a predominantly digital environment a while ago. This will also help Norwegian banks keep their costs under control, which will support their profitability amid the revenue pressure we anticipate over the next two years. Although domestic deposits as a portion of the total funding base are lower in Norway than in many other European markets, we believe Norwegian banks will continue to have reliable access to domestic and international capital markets, in addition to deposits.

Table 1

Eiendomskreditt AS Key Figures

		--Year-ended Dec. 31--			
(Mil. NOK)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	5,746.8	5,775.0	5,263.3	5,081.3	4,605.8
Customer loans (gross)	4,878.0	4,973.1	4,414.6	4,302.3	3,599.1
Adjusted common equity	816.5	760.9	734.7	587.6	438.2

Table 1

Eiendomskreditt AS Key Figures (cont.)					
		--Year-ended Dec. 31--			
(Mil. NOK)	**2020***	**2019**	**2018**	**2017**	**2016**
Operating revenues	54.9	102.0	92.0	69.7	58.2
Noninterest expenses	10.1	23.1	20.4	17.5	15.9
Core earnings	29.8	60.0	54.0	39.3	31.9

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

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

Eiendomskreditt's small size--total assets stood at Norwegian krone (NOK) 5.7 billion (€527 million) at June 30, 2020--weighs on its business position. It has a very low market share in Norway's retail and CRE markets, and therefore high geographic and sector concentration and low diversification of revenue. We think that its predominant focus on CRE--the segment that we consider vulnerable to the current macroeconomic stress--could result in pressure on its new loans generation and revenues and could require additional provisioning. We also note that this is the area in which Eiendomskreditt has traditionally had good expertise, resulting in asset quality remaining reasonably resilient so far despite an increase in credit costs in 2020.

Eiendomskreditt has a stable shareholder structure. It is owned by two investment companies (holding 30% each), 65 Norwegian savings banks--for which Eiendomskreditt functions as a covered bond funding vehicle--and several other investors. In the past, the savings bank owners originated a high proportion of Eiendomskreditt's loans, supporting Eiendomskreditt's loan growth and income generation. However, since 2017, Eiendomskreditt has been successfully growing its in-house loan generation as well as deals originated in the transaction market; such loans accounted for about 24% and 53% of total loan origination respectively in 2019. This led to a decreased dependence on the partner banks' new business generation.

Geographically, Eiendomskreditt focuses its efforts on the five largest counties of southern and western Norway. These are relatively wealthy areas, although the western regions rely heavily on the oil sector and therefore could be vulnerable to oil price volatility in the current low-price environment.

We consider that Eiendomskreditt's management team is stable and very experienced in its areas of focus. Nevertheless, it is also subject to key-person risk regarding its management team, being a relatively small company. Eiendomskreditt addresses this risk by promoting a multi-functional focus among the management team.

Table 2

Eiendomskreditt AS Business Position					
		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (NOK millions)	54.9	102.0	92.0	69.7	58.2
Return on average common equity	7.4	7.7	7.9	7.4	7.3

*Data as of June 30.

Capital and earnings: Very strong, supported by shareholders' injections and internal capital generation in the past few years

We expect Eiendomskreditt's capital and earnings to remain its rating strength. Our view reflects Eiendomskreditt's risk-adjusted capital (RAC) ratio of 24.7% at end-2019 and our projected RAC ratio of about 25% over the next 18-24 months. Very high capitalization provides good buffers over the minimum capital requirements and compares well with domestic peers in Norway, where on average banks have higher capitalization compared with the European banks average. These metrics, together with Eiendomskreditt's good cost efficiency indicators could somewhat counterbalance potential volatility in revenues in the next two years.

As a result of higher market volatility and uncertainty related to COVID-19, we expect lending growth to slow down in 2020-2021, which will further support Eiendomskreditt's high capitalization indicators. We forecast the company will be able to maintain its net interest margins at about 1.6%-1.7% and roughly flat lending growth for the current year, increasing to 2%-3% in 2021-2022.

The company's earnings capacity is reasonably strong, with a three-year average earnings buffer of about 1.8% at year-end 2019, indicating good internal capital generation capacity. As of mid-year 2020, return on equity was 7.4% despite the turbulent macroeconomic environment. We, however, think that potential new provisions and a further increase in NPLs could put additional pressure on return on equity and margins for the full year.

We consider Eiendomskreditt's quality of capital to be adequate. Core capital comprised 91% of total adjusted capital at mid-year 2020. We expect the company to likely pay dividends of up to 50% of net income during the forecast horizon, in line with its historical track record.

Table 3

Eiendomskreditt AS Capital And Earnings					
		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	17.3	17.2	17.8	16.8	15.8
S&P Global Ratings’ RAC ratio before diversification	N/A	24.7	23.1	23.3	N/A
S&P Global Ratings’ RAC ratio after diversification	N/A	10.7	10.8	11.8	N/A
Adjusted common equity/total adjusted capital	90.6	90.0	90.7	88.7	85.4
Net interest income/operating revenues	93.1	95.5	89.3	95.2	90.0
Fee income/operating revenues	3.6	3.1	2.4	2.7	1.0
Market-sensitive income/operating revenues	2.9	0.9	0.5	1.2	7.8
Cost to income ratio	18.4	22.7	22.2	25.1	27.4
Preprovision operating income/average assets	1.6	1.4	1.4	1.1	0.9
Core earnings/average managed assets	1.0	1.1	1.0	0.8	0.7

*Data as of June 30.
N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

Eiendomskreditt AS RACF [Risk-Adjusted Capital Framework] Data

(NOK 000s)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global RWA	Average S&P Global RW (%)
Credit risk					
Government & central banks	0	0	0	0	0
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	828,871	121,138	15	122,210	14.74
Corporate	4,304,799	4,116,613	96	2,839,117	65.95
Retail	775,236	626,688	81	179,777	23.19
Of which mortgage	775,236	626,688	81	179,777	23.19
Securitization§	0	0	0	0	0.00
Other assets†	34,836	34,838	100	34,463	98.93
Total credit risk	5,943,742	4,899,275	82	3,175,567	53.43
Credit valuation adjustment					
Total credit valuation adjustment	--	14,675	--	0	--
Market Risk					
Equity in the banking book	5,617	5,613	100	55,608	989.99
Trading book market risk	--	0	--	0	--
Total market risk	--	5,612.5	--	55,607.5	--
Operational risk					
Total operational risk	--	164,887.5	--	191319.375	--
(NOK 000s)	**Exposure**	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	5,084,450.0	--	3,422,494.2	100.0
Total Diversification/ Concentration Adjustments	--	--	--	4,505,585.4	131.6
RWA after diversification	--	5,084,450.0	--	7,928,079.6	231.6
(NOK 000s)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		998,372.0	19.64	845,918.0	24.72
Capital ratio after adjustments‡		998,372.0	19.64	845,918.0	10.67

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' 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 'Dec. 31 2019', S&P Global Ratings.

Risk position: Concentrations in commercial real estate in Norway are somewhat balanced by a focus on cash-generating projects with good performance

We think that tight underwriting criteria and good risk management systems should support Eiendomskreditt's asset quality over the next two years despite the current stress. Asset quality has been rather resilient so far with cost of risk at 23 bps at mid-year 2020 (versus close to zero over 2018-2019). In our base-case scenario we expect that the company would see increasing credit costs of around 12-20bps in 2020-2021.

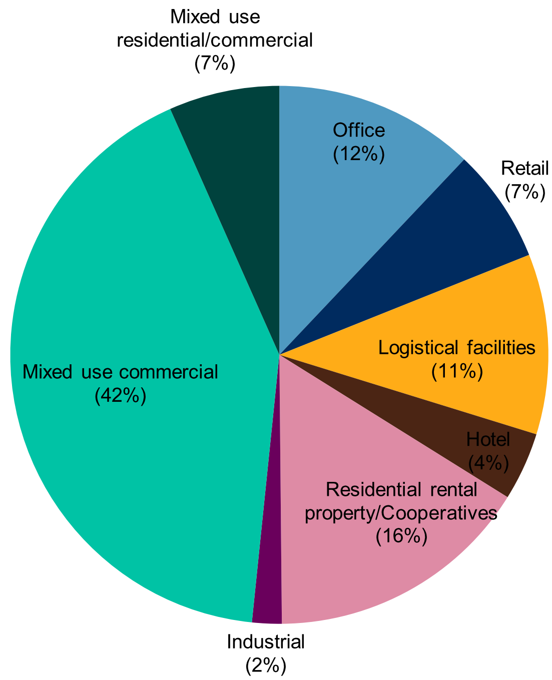
Eiendomskreditt's risk position will continue reflecting its concentration in the CRE sector and sizable single-name concentrations. We consider both the CRE segment and exposure to the oil-reliant western regions of Norway as potentially rather sensitive to stresses related to the COVID-19 pandemic. This might eventually lead to more volatile portfolio performance and the need to create additional provisions in 2020-2021. This is partly counterbalanced by Eiendomskreditt's conservative underwriting standards, the focus on cash-generating projects as opposite to more risky construction and development projects, and a good asset quality track record.

The share of CRE lending within total customer loans now dominates the loan book, reflecting its growth strategy and expertise in this segment. About 71% of lending is in the counties of Oslo, Viken, Vestland, and Rogaland. Although these are areas of high economic activity that have liquid real estate markets, the concentration carries risks. In addition, with 43.6% of loans comprised by top 20 exposures, single-name exposures are rather high.

At least 11% of the bank's exposures are either in retail or hotels, which are expected to be the most sensitive to the current market turbulence. Since the start of the pandemic, reported LTVs have remained quite stable, however. In our view, conservative underwriting processes counterbalance some of the risks reflected above, evidenced by LTV limits of 60% of collateral values for commercial residential and 55% for commercial loans, and an average LTV ratio of about 44% as of mid-year 2020.

Chart 1

Eiendomskreditt's Cover Pool Composition As Of June 2020



Source: Eiendomskreditt

Table 5

Eiendomskreditt AS Risk Position

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	(3.8)	12.7	2.6	19.5	(5.1)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	131.6	114.4	98.0	87.2
Total managed assets/adjusted common equity (x)	7.0	7.6	7.2	8.6	10.5
New loan loss provisions/average customer loans	0.2	(0.0)	0.0	0.0	N.M.
Gross nonperforming assets/customer loans + other real estate owned	2.4	1.6	0.6	0.2	0.7
Loan loss reserves/gross nonperforming assets	6.2	2.1	5.9	18.0	4.6

*Data as of June 30.
N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Funding and liquidity: The funding base is concentrated, with a dependence on wholesale funding, particularly domestic covered bonds

We expect Eiendomskreditt's funding to be below average over the next few years, underpinned by its predominantly wholesale funding profile. We anticipate its liquidity position will 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 97.6% at end-June 2020. Its maturity profile has been gradually extending to around three years and the bank targets 2.5-3 years average duration with covered bonds remaining the key funding source.

We assess Eiendomskreditt's liquidity as adequate. As of end-June 2020, its ratio of broad liquid assets to short-term wholesale funding was 0.85x (0.75x as of end-2019). Funding and liquidity ratios are expected to remain volatile, yet comfortable, due to the impact of debt repayments falling due within one year. The regulatory liquidity coverage ratio at 121% as of mid-year 2020 (115% at year-end 2019) was comfortably above the minimum of 100%.

Table 6

Eiendomskreditt AS Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Long-term funding ratio	84.1	84.0	87.4	90.6	79.5
Stable funding ratio	97.6	95.0	101.4	104.1	98.9
Short-term wholesale funding/funding base	18.9	18.9	15.0	10.9	23.2
Broad liquid assets/short-term wholesale funding (x)	0.9	0.8	1.1	1.4	1.0
Short-term wholesale funding/total wholesale funding	18.6	18.6	14.7	10.7	22.7
Narrow liquid assets/3-month wholesale funding (x)	1.6	1.4	10.0	3.7	44.2

*Data as of June 30.

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.

Environmental, Social, and Governance

We believe ESG credit factors are influencing Eiendomskreditt's credit quality similar to industry and local peers.

Social factors are important due to changing customer preferences and the increased regulatory focus on banks' business conduct in Norway and globally. The company has implemented a number of measures into its policies and procedures that cover know-your-customer (KYC) checks, anti-financial-crime controls, product design, and sales processes standards.

We believe that Eiendomskreditt's management team remains committed to its strong focus on customer relationship and risk awareness, and will exhibit disciplined execution. We consider the company's governance standards to be consistent with industry norms in Norway and the Nordic region overall.

Environmental factors, including climate change but also evolving regulations and norms, are relevant for our credit analysis of Eiendomskreditt in the same way it affects other banks involved in CRE lending, but we do not consider they are distinctive factors for Eiendomskreditt compared with peers.

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

Related Research

- Nordic Banks' Strong Capital Deflects COVID-19 Impact, Sept. 8, 2020
- COVID-19: Resilient Fundamentals And Assertive Policy Measures Will Buoy Nordic Banking Systems, June 16, 2020
- Tech Disruption In Retail Banking: Nordic Techies Make Mobile Banking Easy, Feb. 4, 2020

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 October 12, 2020)*

Eiendomskreditt AS	
Issuer Credit Rating	BBB-/Stable/A-3
Senior Secured	AAA/Stable
Issuer Credit Ratings History	
31-Mar-2020	BBB-/Stable/A-3
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.