

Research Update:

Eiendomskreditt AS Affirmed At 'BBB-' Amid Challenges From Norwegian Commercial Real Estate; Outlook Stable

July 4, 2024

Overview

- We expect Eiendomskreditt AS's conservative underwriting approach and strong risk-adjusted capitalization will enable it to weather challenges facing Norwegian commercial real estate (CRE) markets.
- Recent observed asset quality pressure is commensurate with our view of Eiendomskreditt's constrained risk position, highlighting the ramifications of certain sector concentrations.
- While we reflect risk concentrations as a structural weakness in our ratings, Eiendomskreditt's asset quality metrics remain stronger than international peers', which is supported by the bank's prudent approach to risk taking.
- We therefore affirmed our 'BBB-/A-3' long- and short-term issuer credit ratings on Eiendomskreditt.
- The stable outlook reflects our view that the bank will preserve its robust asset quality metrics and strong capital.

PRIMARY CREDIT ANALYST

Olivia K Grant
Dubai
+971 56 680 1008
olivia.grant
@spglobal.com

SECONDARY CONTACT

Salla von Steinaecker
Frankfurt
+ 49 693 399 9164
salla.vonsteinaecker
@spglobal.com

Rating Action

On July 4, 2024, S&P Global Ratings affirmed its 'BBB-/A-3' long- and short-term issuer credit ratings on Eiendomskreditt AS. The outlook remains stable.

Rationale

Eiendomskreditt is successfully navigating a challenging period for Norwegian CRE markets.

In our view, Eiendomskreditt's ongoing conservative underwriting approach shields it from more material risk costs during the downturn of the CRE sector. The bank's strong risk-adjusted capitalization will also help it to withstand the tougher environment. We note the bank's

concentration to the CRE sector, given that it serves as a platform to facilitate CRE loans for Norwegian savings banks and for itself.

The Norwegian CRE sector is facing headwinds, but to a lesser extent than in some peer markets. Over the past 18 months, the Norwegian CRE markets have grappled with higher financing rates, which have led to a correction in asset values and caused transaction volumes to decline markedly. At the same time, we note that the Norwegian CRE sector is faring better than some of its European peers. While conditions vary across CRE segments, office vacancy rates have not increased meaningfully given working patterns were less affected by the pandemic, and we believe Norway's macroeconomic conditions support the broader sector. This contrasts with the difficulties facing, for example the U.S. CRE sector and certain European markets, which are on course for major restructuring over the medium term.

Under our base case, we expect asset quality deterioration to moderate. We saw non-performing loans (NPLs) increase during 2023 driven by single cases. At the same time, asset quality metrics continued to outperform international peers, mainly reflecting the bank's prudent lending policy and expertise in the CRE business. As of year-end, stage 3 loans represented 3.3% as a share of net lending, which is above historical levels. In first quarter 2024, stage 3 loans receded to 1.2% since steps to restore cashflow repayment capacity for certain exposures have been taken. During 2024-2025, we expect cost of risk to remain elevated at about 6 basis points (bps)-8bps and NPLs at about 1%-2%. However, we anticipate these metrics will decline from early 2026, as conditions improve for the Norwegian CRE sector.

Eiendomskreditt's capitalization underpins its creditworthiness. We forecast a very strong risk-adjusted capital ratio of 22.5%-23.5% over 2024-2026 (22.8% at year-end 2023). In our view, this mitigates risks from Eiendomskreditt's concentration toward the CRE market. The bank's record-high 2023 earnings of Norwegian krone (NOK) 94 million, leading to return on equity of about 10.1%, further bolster its capitalization. We expect earnings to moderate over the next two years to NOK80 million-NOK85 million per year. We see this level as sufficiently supportive of capital build to ensure growth and coverage of elevated risk costs.

Funding markets continue to support both covered bond and unsecured issuance.

Eiendomskreditt relies on covered bond funding, which constitutes just over 85% of its funding base; we continue to see this as a structural weakness for the rating due to a confidence-sensitive funding profile. However, the bank has continued to access the covered bond market during recent stress times, despite some turmoil in the CRE sector, indicating that investors remain confident in Eiendomskreditt's prudent risk management approach. The bank's position is fortified by its liquidity reserve of about NOK883 million, as of first quarter 2024. This reserve ensures 180 days of net outflows are well-covered, and typically equates to broad liquid assets fully backing short-term wholesale funding.

Outlook

The stable outlook on Eiendomskreditt reflects our view that over the next 24 months, the bank will preserve its very strong capital buffers and asset quality, while navigating the challenging operating environment caused by the CRE sector downturn.

Downside scenario

We could take a negative rating action on Eiendomskreditt if we observed a further weakening in the Norwegian CRE market that led to significant pressure on the bank. Indications of this would include substantially higher credit losses than we currently expect.

Upside scenario

We view a positive rating action as remote given the context of Eiendomskreditt's revenue and risk concentration.

Ratings Score Snapshot

Issuer Credit Rating	BBB-/Stable/A-3
SACP	bbb-
Anchor	a-
Business position	Constrained (-3)
Capital and earnings	Very Strong (+2)
Risk position	Moderate (-1)
Funding and liquidity	Moderate and adequate (-1)
Comparable ratings analysis	0
Support	0
ALAC support	0
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021

- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed

Eiendomskreditt AS

Issuer Credit Rating BBB-/Stable/A-3

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 criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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