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CREDIT OPINION
12 August 2020

New Issue

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RATINGS

SpareBank 1 Boligkreditt AS

Domicile	Norway
Long Term CRR	A2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Issuer Rating	Not Available
Type	Not Available
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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SpareBank 1 Boligkreditt AS

Update to credit analysis

Summary

SpareBank1 Boligkreditt's (SpaBol) A2 long-term issuer rating, A2/Prime-1 Counterparty Risk Rating and A2(cr)/Prime-1(cr) Counterparty Risk (CR) Assesment are derived from the weighted-average credit profile of the larger individual banks forming the SpareBank 1 Alliance in Norway. Accordingly, the ratings assigned to SpaBol take into consideration the ratings assigned to the five largest rated owner-banks, as well as our assessment of the likelihood that these banks will support SpaBol in case of need. The assigned outlook on the issuer rating is stable, in line with the rating outlook assigned to the five largest owner banks.

The key drivers for SpaBol's long-term issuer rating of A2 are: 1) the relatively strong credit profiles of the larger banks that form the alliance, which is reflected in their assigned issuer ratings and the high quality mortgages they transfer to SpaBol, and 2) our assessment of the probability that member banks would provide support to the covered bond entity, taking into account the balance of their obligations and incentives to do so under the SpareBank 1 Alliance structure.

Credit strengths

» The predominantly strong credit profiles of the banks that own SpareBank 1 Boligkreditt, which form the starting point for its ratings

» The benign operating environment in Norway where SpareBank 1 Boligkreditt and its alliance banks operate, despite the challenges this year from the coronavirus

» The member banks' commitment to safeguard SpareBank 1 Boligkreditt's access to sufficient liquidity and capital

Credit challenges

» High concentration of the individual banks and SpareBank 1 Boligkreditt in the Norwegian housing and real-estate market

Outlook

The stable outlook attached to SpareBank 1 Boligkreditt's issuer rating is in line with the stable outlook for the five owner banks' issuer ratings. The stable outlook balances the alliance banks' strong underlying financial fundamentals, against their high reliance on market funding making them vulnerable to investor sentiment and risks stemming from some credit and regional concentrations. We expect that any future changes in outlooks or ratings of the Alliance banks, will drive SpaBol's outlook and ratings as well.

Factors that could lead to an upgrade

» Positive pressure would develop on SpaBol's ratings in case of an improvement in credit quality of a majority of owner banks' credit profile. This improvement in risk profile will be evidenced by stronger asset quality and profitability metrics and reduced concentration levels.

Factors that could lead to a downgrade

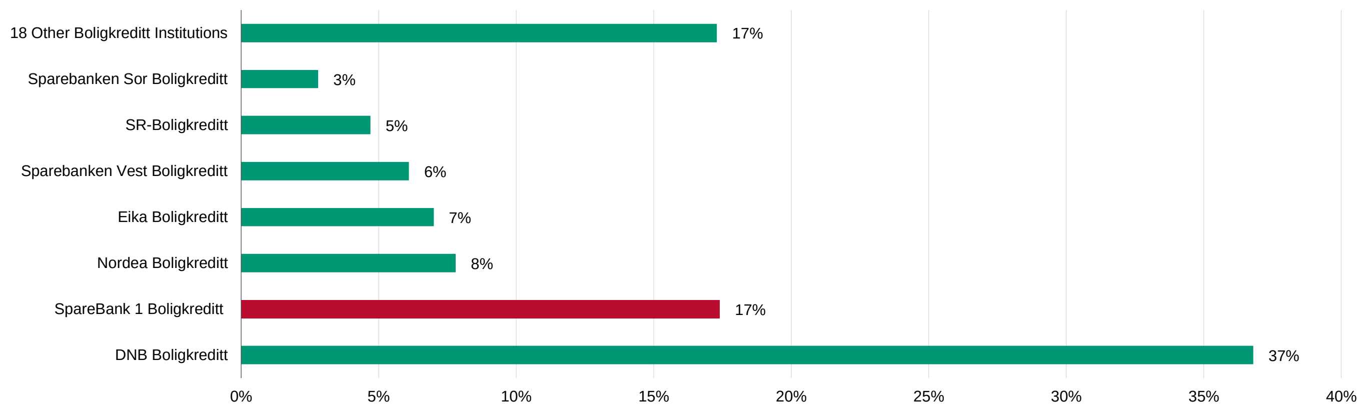
» The ratings of SpaBol would be downgraded if its credit profile or that of its bigger owner banks were to deteriorate significantly, on the back of worsening financial performance and asset quality and weakening capital metrics.

» SpaBol's ratings will also be downgraded in case of reduced likelihood of the owner banks supporting it, as indicated by a loosening in the support agreement and mechanism between SpaBol and the owner banks that are currently in place.

Profile

SpareBank 1 Boligkreditt's primary business purpose is to provide access to the international covered bond markets to its owners, 14 Norwegian savings banks belonging to the SpareBank 1 Alliance, the second largest banking group in Norway with around 22% reported combined market share in residential mortgages. Accordingly, SpareBank 1 Boligkreditt is the second biggest player in the Norwegian covered bond market, with an issuer volume market share of around 17% (see Exhibit 1).

Exhibit 1
Norwegian Covered Bond market by issuer volume



Source: SpareBank 1 Boligkreditt Investor Presentation (February 2020)

Individual member banks operate independently from each other, but there are various benefits that the SpareBank 1 Alliance provides. Such benefits include shared information technology infrastructure, marketing and common non-core banking products/ services through affiliate companies. We believe that these enjoyed benefits act as incentives for member banks to remain part of the SpareBank 1 Alliance, and continue making use of SpaBol as well as the validity of their support commitment.

Recent developments

We have revised our growth forecasts downward for 2020 as the coronavirus pandemic is causing an unprecedented shock to the global economy. Business activity has fallen sharply across advanced economies, and we expect global economic recovery to be delayed. We expect a gradual recovery beginning in the second half of the year, but that outcome will depend on whether governments can reopen their economies while also safeguarding public health. A rebound in demand will determine the ability of businesses and labour markets to recover from the shock. We now expect real GDP for the global economy to contract in 2020, followed by a recovery in 2021.

We note that since 13 March 2020, Norway's central bank, the Ministry of Finance and the Norwegian FSA have taken a number of actions aiming to alleviate the impact on the economy from both the coronavirus lockdown and the oil price drop. These measures include the reduction of the key policy rate by 150 basis points (bps), reducing banks' countercyclical buffer requirement by 150 bps, providing special F-loans to banks to help manage any funding and liquidity stress, as well as extension of unemployment benefits and various social policy schemes to support individuals. We believe these measures will help alleviate the negative impact stemming from the coronavirus outbreak, and will largely sustain borrowers' solvency in the longer term.

Nonetheless, the inevitable negative impact on both the economy and banks in the next 12-18 months, have triggered on 16 April 2020 the change of our Banking System Outlook (BSO) for Norway to negative from stable. The outlook change was also driven by our expectation that sectors such as tourism, hospitality and transportation are more vulnerable to the pandemic, and by the fact that very low oil prices have historically strained Norway's oil/offshore industry that remains a significant pillar of the economy.

Detailed credit considerations

A deteriorating operating environment will likely pressure owner banks' financial fundamentals in 2020, although overall strength of the Norwegian government finances remain supportive to the banking system

Although Norway's operating environment is deteriorating as a result of the global outbreak of Coronavirus and the plunge in oil prices, we believe that the banking system still benefits from the government's generally strong fiscal flexibility and countercyclical buffers available through its sovereign oil fund to respond to economic shocks.

SpaBol and its owner banks operate solely in Norway. We assign a Very Strong- Macro Profile to Norway given that its banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as a very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the last weakening in the oil sector in 2014-15.

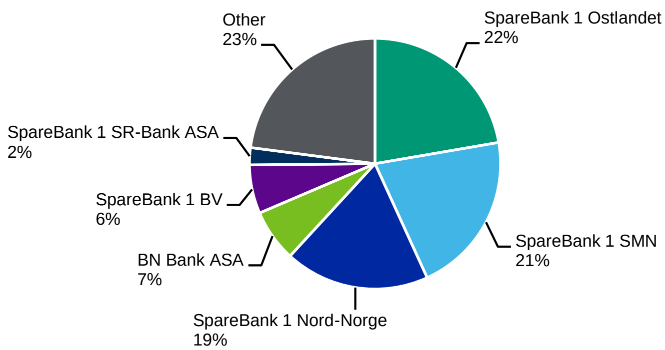
The main risks to the banking system stem from the high level of household debt, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with the total size of the economy.

Nonetheless, we expect the Norwegian mainland economy (excluding any oil-related activity) to contract significantly in 2020 (-3.5%), and recover to around +3.8% in 2021. Unemployment rose to around 10.6% as of March 2020 (although it has fallen significantly since then) which combined with the low economic activity will inevitably impact banks' credit growth, asset quality and earnings that will be strained from elevated credit costs. Accordingly, SpaBol's owner banks' credit fundamentals will likely come under certain pressure this year, although we believe that this will only be a temporary strain that will be absorbed by their satisfactory recurring earnings and strong capitalisation.

Healthy credit profiles across the Alliance banks drive SpaBol's ratings

The credit profiles of the top four owner banks in the Alliance (SpareBank 1 Ostlandet - 22.3%, SpareBank 1 SMN - 20.9%, SpareBank 1 Nord-Norge - 18.7%, and SpareBank 1 BV - 6.3%), in addition to that of SpareBank1 SR-Bank ASA with a smaller stake of 2.2%, constitute the anchor point that drives the ratings assigned to SpareBank 1 Boligkreditt. These Alliance banks had a joined ownership of over 70% in SpareBank 1 Boligkreditt as of June 2020 (see Exhibit 3). We note, however, that SpareBank 1 SR-Bank has been gradually reducing its ownership in SpaBol in the last few years, as it has been increasingly leveraging its own covered bond company (SR-Boligkreditt AS).

Exhibit 2
SpareBank 1 Boligkreditt's Ownership as of June 2020



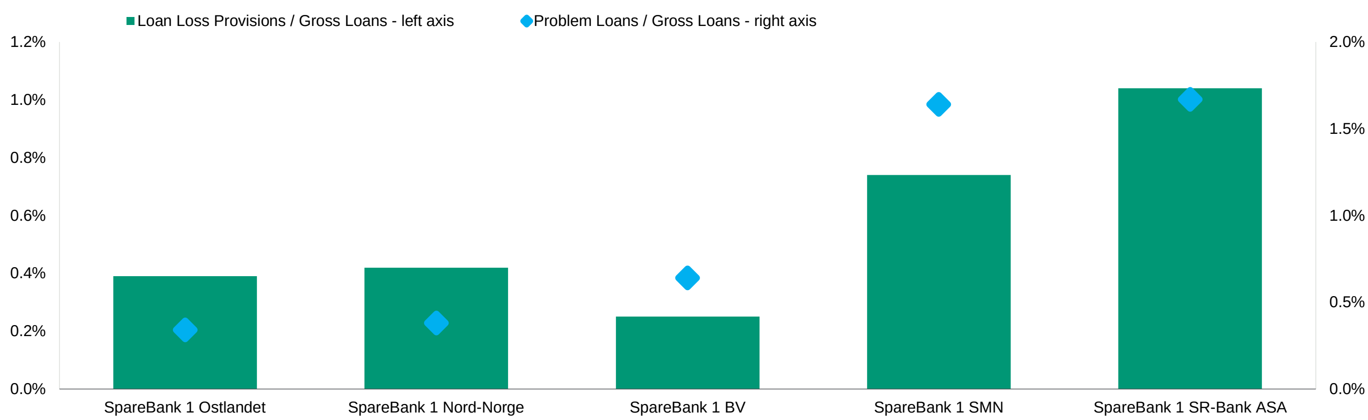
Note: "Other" includes other bank members of the Alliance with individual ownership below 6.3%
Source: SpareBank 1 Boligkreditt Q1 2020 report

These banks maintain relatively strong financial fundamentals, with limited variations in overall credit quality amongst individual members. While most of them focus on residential mortgages and commercial real-estate lending in a relatively small geographic area, which typically translate into high concentration levels, they also tend to feature similar strengths, such as strong overall asset quality metrics and robust capital buffers. Accordingly, all five banks have currently a baseline credit assessment (BCA) of either a3 or baa1, reflecting their relatively solid financial position and capacity to support SpaBol in case of need.

Strong overall asset quality metrics and robust capital buffers across the Alliance banks and SpaBol

The SpareBank 1 Alliance banks have generally strong individual asset qualities and transfer to SpaBol only good-performing residential mortgages. These banks are also incentivised, but are not obliged, to substitute the assets should their performance deteriorate or their loan-to-value (LTV) increase to more than the 75% legal limit for the cover pool. Concurrently, we note that the average nonperforming loans (NPL) ratio for the above five SpareBank 1 Alliance banks was just above 1% as of March 2020 (see Exhibit 4). The relatively low NPL ratio reflects the banks' high quality loan book, despite some sector and geographic concentrations at individual bank-levels. While we expect some deterioration among parent banks' asset quality in 2020 as a result of the coronavirus outbreak, we believe this will be largely manageable and not to the extent that would compromise their overall credit profiles. Accordingly, we do not foresee this strain creating significant downward pressure to SpaBol's ratings.

Exhibit 3
Good asset quality among SpareBank 1 Alliance banks despite high concentrations, March 2020



Source: Moody's Investors Service, Company reports

SpaBol reports a zero NPL ratio, while we expect its loan quality to remain excellent over the next 12-18 months based on the Alliance banks' strong commitment and incentives to maintain SpaBol's loan book intact from any defaults. Additionally, we expect Norwegian households to continue to service their mortgages as interest rates are very low, and unemployment benefits and coronavirus related support measures remain generous.

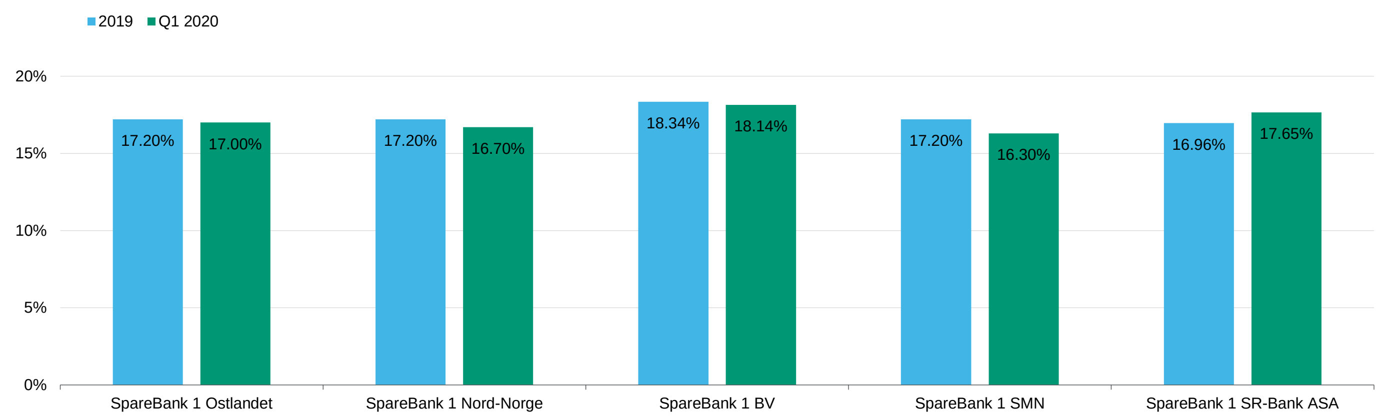
SpareBank 1 Boligkreditt's residential mortgage portfolio is well diversified, with granular loan balances in the cover pool (average size of around NOK1.4 million). We note that the banks in the SpareBank 1 Alliance are required to keep reserves of eligible mortgages (i.e. cover pool pre-qualified) in order to provide replacement assets should this be needed. Such reserves in the banks are robust, and are tested regularly to ensure that a 30% decline in real estate prices can be handled, with sufficient qualifying reserves replenishing the cover pool. In the aftermath of the coronavirus crisis, some mortgage holders applied for deferral of scheduled principal repayment. The outstanding full balance of such loans amounted to around 8% of the mortgage portfolio that are repayment mortgages, with principal deferral for up to six months (interest continues to be serviced).

In addition, the Norwegian FSA has revised banks' capital requirements during the first quarter of 2020 in response to the pandemic. Accordingly, the countercyclical capital buffer requirement has been lowered by 150 basis points to allow more flexibility, while banks were requested to reconsider their dividend payments for 2019. SpaBol's own common equity Tier 1 (CET1) ratio was at 21.3% as of June 2020, well above its regulatory requirement of 13.4%. Furthermore, the large SpareBank 1 Alliance banks are well capitalised, with an average Common Equity Tier 1 (CET1) ratio of around 17% as of March 2020 (see Exhibit 5), indicating their ability to absorb significant losses before any potential impact on their creditors. Such comfortable capital levels also allow these banks to support SpaBol on an on-going basis if needed.

Exhibit 4

SpaBol's owner banks are well capitalised and able to provide support in case of need

CET1 capital ratios as of March 2020



Source: Moody's Investors Service, Company reports

Profitability at Alliance banks to remain robust, despite increased uncertainty

In response to the economic stress from the coronavirus outbreak the Norges Bank has carried out three rate cuts totaling 150 basis points since March 2020, while prior to this period the key policy rate was on a rising trend. Low loan rates coupled with an already fierce competition among Norwegian banks will put pressure on net interest margins of SpaBol and its parent banks, the originators of the loans transferred to SpaBol.

Our ratings take into account the robust profitability of the rated SpareBank 1 Alliance banks, and our expectation that this should remain broadly resilient despite some temporary weakness in 2020. SpaBol and its parent banks have recorded large increases in provisioning costs and losses on financial instruments during Q1 2020 on the back of coronavirus outbreak and introduction of lock down measures at the time. This has resulted in an average return on equity (RoE) of around 4.1% as of March 2020, compared with 13.4% in December 2019, including certain one-off gains.

However, we note that the situation in Norway was relatively quickly taken under control and the banks took a front-loading approach to credit costs using their IFRS 9 models. Looking ahead, we expect that parent banks' profitability in 2020 will be affected by increased provisioning costs and generally elevated uncertainty but to a lesser extent than during Q1 2020. To date, profitability of the Alliance banks was supported by good loan growth and solid mortgage loan performance, which we expect to be maintained. Furthermore, the Alliance banks benefit from a shared information technology platform, infrastructure, marketing and common non-core banking products and services, which act as incentives for banks to remain in the Alliance and support SpaBol if needed.

In terms of liquidity and funding, the five rated Alliance banks had an average Liquidity Coverage Ratio (LCR) of around 156% as of March 2020. The ratio of Market Funds to Tangible Banking Assets was around 37%, which is relatively high due to their predominant reliance on funding from covered bonds issued by SpaBol, a common funding source for most rated Nordic banks.

Environmental, social and governance considerations

In line with our general view of the banking sector, Sparebank 1 Boligkreditt has low exposure to Environmental risks and moderate exposure to Social risks. See our Environmental and Social risk heatmaps for further information.

Norway, similarly to the European Union, has policies in place that ensure new housing to be energy-efficient, which enables SpaBol to gather mortgages for asset pools to issue green bonds on behalf of parent banks. Such policies help limit environmental risks for Norwegian banks with large retail exposure and primarily mortgage lending activity, and thus help strengthen the parent banks' credit profile and mitigate potential environmental risks for SpaBol as a covered bond issuer.

We note that buildings from 2009 (i.e. 10% of the housing stock), buildings finished before 2009 but with an EPC rating of A, B or C (2.6% of the housing stock) and refurbished buildings that have achieved a 30% energy efficiency improvement qualify for selection into SpaBol's green bond cover pools. In total approximately NOK23.2 billion worth of mortgages sold against properties built after 2009, compared to SpaBol's NOK252 billion of total assets, could be classified as green assets as of June 2019. At the end of May, SpaBol issued a new SEK7.5 billion green covered bond, which was well received amongst Scandinavian based investors.

We believe banks face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. In addition, we regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. See our social risk heat map for further information. Overall, we consider SpaBol and its parent banks to face moderate social risks.

Governance is highly relevant for Sparebank 1 Boligkreditt and its parent banks, as it is to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Corporate governance remains a key credit consideration and requires ongoing monitoring. However, we currently do not have any governance related concerns over SpareBank 1 Boligkreditt or its parent banks.

Support and structural considerations

Affiliate support

SpaBol's A2 issuer rating is positioned one notch below the weighted average debt rating of the SpareBank 1 Alliance member banks (A1), reflecting our view of the likelihood that the owner banks will support it in case of need, as outlined in the Shareholders' Note Purchase Agreement (SNPA) and Shareholders' Agreement. The legal and publicly available agreements in place between the member banks and SpaBol, protect the later's access to liquidity and capital and stops short of a full guarantee of timely payment.

Specifically, the owner banks have agreed to maintain SpareBank 1 Boligkreditt's common equity Tier 1 (CET1) capital ratio (21.3% as of June 2020) above its regulatory requirement (currently at 13.4%), and to subscribe to any new covered bond issues in case there is a disruption in the covered bond market. Moreover, in case one or more of owner banks are not able to provide their share of capital or liquidity, the remaining banks may be required by SpareBank 1 Boligkreditt to increase their contribution up to a maximum of twice their initial allocation.

Government support considerations

All rated SpareBank 1 Alliance banks do not benefit from any rating uplift from government support, due to the BRRD law implemented in Norway on 1 January 2019. Accordingly, government support is not incoprorated in SpaBol's issuer ratings.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default; and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

SpaBol's CR Assessment is positioned at A2(cr)/P-1(cr), one notch lower than the weighted-average long-term CR Assessment of A1(cr) of its majority owner-banks in the SpareBank 1 Alliance, as outlined in the 'Affiliate support' section above.

Counterparty Risk Rating

Counterparty Risk Ratings are opinions of the ability of entities to honour the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

SpaBol's Counterparty Risk Rating is positioned at A2/P-1, one notch lower than the weighted-average long-term CRR of A1 of its majority owner-banks in the SpareBank 1 Alliance, as outlined in the 'Affiliate support' section above.

Methodology used, source of facts and figures cited in this report

Moody's Banks Methodology (November 2019) was used in arriving at the SpareBank 1 Alliance banks' issuer ratings, while Appendix 1 of the same methodology referring to the Specialised Covered Bond Issuers (SCBI) was used in assigning SpaBol's ratings.

In arriving at SpaBol's ratings, the financial results of parent banks were taken into consideration. All information is available publicly at respective banks' websites. Moody's incorporates a series of standard and non-standard adjustments on Norwegian banks' financial statements in order to better reflect credit risks and implications (Moody's Standard Adjustments, Sparebank 1 banks illustrate Moody's approach to non-consolidated covered bonds).

Ratings

Exhibit 5

Category	Moody's Rating
SPAREBANK 1 BOLIGKREDITT AS	
Outlook	Stable
Counterparty Risk Rating	A2/P-1
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Issuer Rating	A2

Source: Moody's Investors Service

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