

Global Credit Research - 27 Mar 2015

Orebro, Sweden

## Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Aaa
Senior Unsecured	Aaa
Bkd Commercial Paper	P-1
Bkd Other Short Term	(P)P-1

## Contacts

Analyst	Phone
Jan Skogberg/London	44.20.7772.5454
Sperlein, Harald/Frankfurt am Main	49.69.707.30.700
Sean Marion/London	44.20.7772.5454

## Opinion

### SUMMARY RATING RATIONALE

Kommuninvest i Sverige AB's (Kommuninvest) Aaa rating with a stable outlook reflect (1) its public policy mandate to act as the debt management office for the regional and local government (RLG) sector in Sweden, (2) a joint and several guarantee by all RLGs that are members in Kommuninvest Cooperative Society (Kommuninvest's owner organisation), (3) predictable financial performance, and (4) low risk appetite.

### RATING DRIVERS

- 100% RLG ownership reflects importance of Kommuninvest to Swedish RLG sector
- Strong asset quality rests on RLG's predictable revenues and government oversight
- Kommuninvest's liabilities are guaranteed by all members of Kommuninvest Cooperative Society
- Financial performance is predictable as a result of public policy mandate
- Diverse funding, maturity of assets and liabilities matched and good liquidity
- Capitalisation is good but some uncertainty persists due to new regulatory rules
- Prudent risk management is comparable with peers

### RATING OUTLOOK

The outlook on Kommuninvest's senior unsecured debt ratings is stable.

### WHAT COULD CHANGE THE RATING - DOWN

Downward pressure on the rating could result if (1) asset quality deteriorates, which currently is unlikely, (2) Kommuninvest's public policy mandate is diluted, (3) its ability to access debt capital markets is weakened, and/or (4) its financial performance deteriorates over the longer term, which we currently deem unlikely.

## **DETAILED RATING CONSIDERATIONS**

The ratings assigned to Kommuninvest reflects the application of Moody's Banks and Government-Related Issuers (GRIs) methodologies. In accordance with these methodologies, Moody's first establishes the baseline credit assessment (BCA) for the entity and then considers the likelihood of support coming from the Swedish local and regional governments - its members - and the national government in order to avoid an imminent default by Kommuninvest, should this extreme event ever occur.

While we currently rate Kommuninvest using both our GRI and Bank rating methodologies, in the coming months, we are likely to consider solely using the former methodology to better capture the institution's profile, as its liabilities are guaranteed by the entire regional and local government sector in Sweden. Consequently, we are likely to maintain the current debt ratings and outlook whilst at the same time (i) withdrawing the institution's baseline credit assessment (BCA) and (ii) basing Kommuninvest's ratings solely on a notching framework related to its guarantee, as also outlined in our GRI methodology.

### **100% RLG OWNERSHIP REFLECTS IMPORTANCE OF KOMMUNINVEST TO SWEDISH RLG SECTOR**

Kommuninvest is closely tied to the Swedish RLG sector. The company is fully owned by the RLG sector, and acts as the sector's debt management office. Only Swedish municipalities and county councils can become members in its ownership organisation, and the board of Kommuninvest Cooperative Society (Kommuninvest's ownership organisation) consists exclusively of representatives from the RLG sector.

Kommuninvest's market share of RLG borrowing is 44% at year end-2014 which makes it the market leader. We consider its market share sufficiently large in order for us to conclude that Kommuninvest has a national public policy mandate. Its ability to further strengthen that mandate will depend on its ability to attract some large RLGs which may have other (standalone) funding options, such as the City of Stockholm, to join its membership organisation.

### **STRONG ASSET QUALITY RESTS ON RLG'S PREDICTABLE REVENUES AND GOVERNMENT OVERSIGHT**

Kommuninvest's asset quality is strong as a result of (1) Swedish RLG's have authority to raise income taxes, (2) grants from the central government forms another important source of revenues, (3) a revenue equalisation principle which enables all RLG's to deliver key public services irrespective of the economic conditions in each municipality, (4) legislation states that Swedish RLG's budget imbalances cannot persist for more than three years, and (5) the Swedish central government bears ultimate financial responsibility for the Swedish RLG sector.

The five components above are in place in order to ensure that Swedish RLG's remain creditworthy over the long-term, in order to allow continuous delivery of key public services such as education, healthcare, care for the elderly and housing. We also note that Swedish RLG's cannot be declared bankrupt and have never defaulted on any obligation.

Similar to its Nordic peers, Kommuninvest has a small number of customers and this inevitably translates into lending concentration.

### **KOMMUNINVEST'S LIABILITIES ARE GUARANTEED BY ALL MEMBERS OF KOMMUNINVEST COOPERATIVE SOCIETY**

All liabilities of Kommuninvest are guaranteed by its owners on a joint and several basis. In the currently unlikely event of a default, a creditor can claim full payment from any local government that is a member of Kommuninvest's ownership organisation, Kommuninvest Cooperative Society, thus having recourse to 94% of Sweden's municipalities (year end-2014).

### **FINANCIAL PERFORMANCE IS PREDICTABLE AS A RESULT OF PUBLIC POLICY MANDATE**

Kommuninvest's financial performance is moderate because its mandate is to offer cost-effective lending to the Swedish RLG sector. Its ability to deliver under this mandate is largely determined by its funding cost, which has remained stable in recent years in spite of significant volatility in the financial markets.

Kommuninvest's profitability is predictable as a result of its mandate to lend exclusively to the Swedish RLG sector and related entities guaranteed by Swedish RLGs and leading market position with a market share of 44% at year end-2014. In addition, its customers are financially stable for the reasons outlined in the section above.

Operating expenses are low due to Kommuninvest's monoline business model. For example, in 2014 total expenses were SEK284 million, including a SEK111 million stability fee which authorities also impose on commercial banks, compared to operating income of SEK1,013 million. We expect operating expenses to remain low because we think the institution's business model will remain unchanged for the foreseeable future.

#### DIVERSE FUNDING, MATURITY OF ASSETS AND LIABILITIES MATCHED AND GOOD LIQUIDITY

Kommuninvest issues various types of debt, in multiple markets, in several currencies, to a diverse investor base. We view this approach as prudent because it reduces dependence on a single funding source. That said, we understand that Kommuninvest in the future intends to source a greater proportion of funds from Sweden. Although this is likely to translate into lower credit counterparty risks, due to a lesser need for currency hedging, it will inevitably translate into a less diverse funding profile.

Kommuninvest is match-funded which means that the maturity of its liabilities is generally at least as long as the maturity of its assets.

Similar to peers, some of Kommuninvest's funding comes with option-like features, which suddenly could shorten its liability profile. For its liquidity planning, Kommuninvest assumes that all such funding is called at first call date. We also note that Kommuninvest's funding profile is more domestically orientated than its peers and as a result it is less reliant on callable funding which is mainly sourced from Japan.

Kommuninvest maintains a large liquidity portfolio, which size amounted to 30% of lending at year end-2014. The bulk of the portfolio is of very strong asset quality and the exposure is mainly to sovereigns in Northern Europe and Swedish covered bonds. Kommuninvest also has central bank access which is not the case for all its peers.

#### CAPITALISATION IS GOOD BUT SOME UNCERTAINTY PERSISTS DUE TO NEW REGULATORY RULES

Kommuninvest is adequately capitalised relative to its risks. The institution reported a 34.6% Tier 1 ratio at year end-2014, which is very high namely because a zero risk-weight is applicable on its lending. In comparison, its Norway based peer, Kommunalbanken, applies a 20% risk-weight on its lending. We also note that Kommuninvest has never recorded a loss on its lending.

Kommuninvest's leverage ratio of 0.76% (excluding subordinated debt that will not in the future qualify as capital) is below that of its peers and well below 3% that might become a requirement from 1 January 2018. The institution is targeting a 1.5% ratio in light of the current uncertainty if 3% indeed will become a requirement. We think Kommuninvest is likely to request a capital injection from its owners or issue hybrid debt if 3% were to become a requirement in 2017, as we don't think that one year will be sufficient to organically grow its leverage ratio to 3%.

#### PRUDENT RISK MANAGEMENT IS COMPARABLE WITH PEERS

Kommuninvest has very limited appetite for risk which is consistent with its peers. The institution mitigates currency risks by using hedging agreements and interest rate risk is limited to SEK8.5 million, assuming a one percentage point parallel yield curve shift, and that is a small exposure compared to equity of SEK2.4 billion at year end-2014.

Kommuninvest's extensive use of derivatives for hedging purposes gives rise to credit counterparty risks which the institution mitigates against by entering into standard international swaps and derivatives association agreements (ISDAs) and credit support annex agreements (CSAs) which, however, also increasingly require Kommuninvest to post collateral. All counterparties are required to have a rating of at least A2.

#### SUPPORT CONSIDERATION

Moody's assigns a very high likelihood of support from the Swedish local and regional governments - its members - and the national government in order to avoid an imminent default by Kommuninvest, should this extreme event ever occur.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on <http://www.moodys.com> for the most updated credit rating action information and rating history.

# MOODY'S

## INVESTORS SERVICE

© 2015 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS FOR RETAIL INVESTORS TO CONSIDER MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS IN MAKING ANY INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the

control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody.com](http://www.moody.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

For Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail clients. It would be dangerous for "retail clients" to make any investment decision based on MOODY'S credit rating. If in doubt you should contact your financial or other professional adviser.

For Japan only: MOODY'S Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of MOODY'S Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.