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CREDIT OPINION
14 October 2016

Update

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RATINGS

Kommuninvest i Sverige Aktiebolag

Domicile	Sweden
Long Term Debt	Aaa
Type	Senior Unsecured - Fgn Curr
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.

Analyst Contacts

Yasuko Nakamura 33-1-5330-1030
VP-Senior Credit Officer
yasuko.nakamura@moodys.com

Aleksander Henskjold 44-20-7772-1954
Associate Analyst
aleksander.henskjold@moodys.com

Sean Marion 44-20-7772-1056
Managing Director - Financial Institutions
sean.marion@moodys.com

Kommuninvest i Sverige Aktiebolag

Update following the publication of half-year 2016 results

Summary Rating Rationale

We assign Aaa long-term senior unsecured debt and issuer ratings to Kommuninvest i Sverige AB, a Swedish municipal lender.

Kommuninvest's Aaa long-term ratings reflects the institution's close links to Swedish regional and local governments (RLGs) and ultimately the sovereign. The main drivers of the ratings are (1) the joint and several guarantee that it receives from Swedish RLGs that are part of Kommuninvest's owner organisation, the Kommuninvest Cooperative Society; (2) its narrow public policy mandate to act as the debt management office of the Swedish RLG sector; (3) and the fact that the institution is 100% controlled by RLGs that are members of Kommuninvest Cooperative Society.

Financial metrics such as profitability and asset risk are less indicative of the financial strength of Kommuninvest given its not-for-profit mandate and the limited information traditional asset risk indicators provide, as the institution does not have any problem loans.

Credit Strengths

» Kommuninvest's liabilities are guaranteed by all members of Kommuninvest Cooperative Society

» Full RLG ownership reflects the importance of Kommuninvest to the Swedish RLG sector

» Strong asset quality rests on the RLG's' predictable revenues and government oversight

» Public policy mandate creates predictable financial performance

» Diverse funding, matched maturity of assets and liabilities and good liquidity

» Prudent risk management is comparable with peers

Credit Challenges

» Capitalisation is strong but some uncertainty persists owing to new regulatory rules

Rating Outlook

The outlook on Kommuninvest's ratings is stable, reflecting the joint and several guarantee it receives from RLGs and the RLG guarantors' stable financial performance.

Factors that Could Lead to a Downgrade

Downward pressure on Kommuninvest's rating could follow (1) a weakening of the joint and several guarantee from the RLGs; (2) if Kommuninvest's public policy mandate were

diluted; (3) if its ability to access debt capital markets is weakened; and/or (4) the financial performance of the RLGs deteriorates over the longer term, which we currently consider unlikely

Key Indicators

Exhibit 1
Kommuninvest i Sverige Aktiebolag (Unconsolidated Financials) [1]

	6-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (SEK million)	357,404.9	330,964.9	302,441.1	272,129.4	273,714.7	6.9[4]
Total Assets (EUR million)	37,970.3	36,139	31,928	30,749.2	31,913.6	4.4[4]
Total Assets (USD million)	42,183.1	39,257.6	38,634.6	42,370.6	42,074.7	0.1[4]
Tangible Common Equity (SEK million)	5,865.6	4,362.9	2,361.2	1,710.3	929.7	58.5[4]
Tangible Common Equity (EUR million)	623.2	476.4	249.3	193.3	108.4	54.8[4]
Tangible Common Equity (USD million)	692.3	517.5	301.6	266.3	142.9	48.4[4]
Tangible Common Equity / Risk Weighted Assets (%)	78	66.3	34.8	38.4	16.3	59.7[5]
Net Interest Margin (%)	0.2	0.2	0.3	0.4	0.3	0.3[6]
PPI / Average RWA (%)	0.4	10.6	10.9	15.1	5.1	7.3[5]
Net Income / Tangible Assets (%)	0	0.2	0.2	0.2	0.1	0.1[6]
Cost / Income Ratio (%)	88.8	30.5	28	24.5	50.2	44.4[6]
Market Funds / Tangible Banking Assets (%)	97.9	97.7	98.6	98.7	98.9	98.4[6]
Liquid Banking Assets / Tangible Banking Assets (%)	20.3	19.1	21.6	22.9	26	22[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [5] Basel III - fully-loaded or transitional phase-in & LOCAL GAAP reporting periods have been used for average calculation [6] LOCAL GAAP reporting periods have been used for average calculation
Source: Moody's Financial Metrics

Detailed Rating Considerations

The financial data in the following sections are sourced from Kommuninvest's financial statements or Moody's Financial Metrics unless otherwise stated.

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 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 and 40% of the county councils and regions (end-December 2015).

Full RLG ownership reflects the importance of Kommuninvest to the Swedish RLG sector

Kommuninvest is closely tied to the Swedish RLG sector: the company is fully owned by the 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 the Kommuninvest Cooperative Society consists exclusively of representatives from the RLG sector.

Kommuninvest reported a market share of RLG borrowing of 47% at end-December 2015, which makes it the market leader in this segment. Alternative sources of funding to Swedish municipalities include their own independent funding programs and bank funding. We consider Kommuninvest's market share sufficiently large to consider that the institution has a national public policy mandate. Its ability to further strengthen that mandate will depend on its ability to attract 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 the RLG's' predictable revenues and government oversight

Kommuninvest does not report any problem loans and its creditworthiness rests on the RLG sector that we consider financially strong because of the supportive system that underpins the sector. Swedish RLGs have the authority to raise income taxes, which

together with grants from the central government form key sources of revenues. Furthermore, Swedish RLGs are subject to a revenue equalisation principle that enables all RLGs to deliver vital public services irrespective of the economic conditions in each municipality.

Legislation stating that Swedish RLGs' budget imbalances cannot persist for more than three years and that they cannot be declared bankrupt mitigates the probability of insolvency for Kommuninvest's customers. The financial strength of the Swedish central government (Aaa stable) is also an important positive driver for Kommuninvest's strong asset quality, as it is the central government that bears ultimate financial responsibility for the Swedish RLG sector.

These revenue and solvency components are in place in order to ensure that Swedish RLGs 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.

Similar to its Nordic peers, Kommuninvest has a relatively small number of customers and this inevitably translates into lending concentration. We note that Kommuninvest complies with all regulatory requirements, and is not exempt from requirements on large exposures.

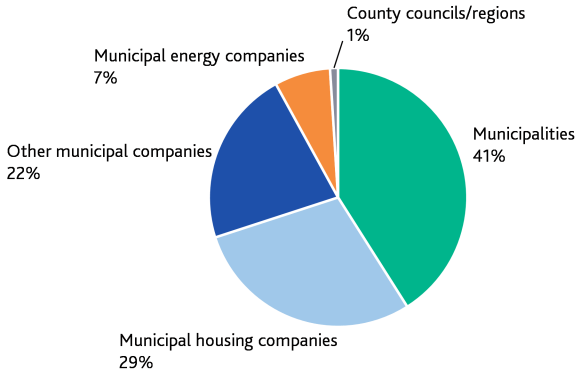
Financial performance is predictable as a result of its public policy mandate

Kommuninvest's profitability is predictable as a result of its mandate to lend exclusively to the financially stable Swedish RLG sector and related entities guaranteed by Swedish RLGs (see Exhibit 2), and its leading market position. Its mandate to offer cost-effective lending leads to a moderate profitability. Its ability to deliver under this mandate is largely determined by its funding cost, which has remained stable in recent years, despite significant volatility in the financial markets.

Exhibit 2

Breakdown of Kommuninvest's Loan Portfolio by Borrower Category at 30 June 2016

Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

Net interest income was largely flat (+0.6%) in the first half of 2016 compared to the same period in 2015. This results from a mix of lower margins on new loans following a change in Kommuninvest's capital build-up strategy and lower funding cost (Kommuninvest are now able to fund and lend at negative rates). Previously, capital needed to meet regulatory requirements and feed growth was built-up through profit accumulation and re-injection of profits. Since the second half of 2015, Kommuninvest's owners (who are also the borrowers) can and are expected to make direct capital contributions whenever needed. In exchange, margins on loans have been lowered, making them more competitive. These have been set in a way to cover the institution's borrowing and operating costs. As loans originated prior to 2015 mature and are replaced by lower margin loans, we expect Kommuneinvest' net interest income to decrease in 2016/2017.

Operating expenses are low due to Kommuninvest's monoline business model: the lender is efficient, as it does not operate branches like commercial banks. We expect that operating expenses to remain low because we think the institution's business model will remain unchanged for the foreseeable future.

Diverse funding, matched maturity of assets and liabilities and good liquidity

Kommuninvest funds itself through issuing a variety of debt, in multiple markets and currencies, to a diverse investor base, which reduces dependence on a single funding source. However, we understand that Kommuninvest in the future plans to continue sourcing a large proportion of funds from Sweden. This is likely to translate into lower credit counterparty risks, owing to a lesser need for currency hedging, but will also inevitably translate into a less diverse funding profile.

Kommuninvest`s refinancing risk is limited as the lender seeks to term-match its funding to its assets. However, similar to peers, some of Kommuninvest's funding includes 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 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: only 6% of funding (excluding commercial papers) was Japanese Yen denominated at the end of June 2016, some of which we understand is callable.

Kommuninvest maintains a large liquidity portfolio, which amounted to 27% of lending (the policy is to maintain a liquidity reserve ranging from 15% to 35% of the lending portfolio) or 19.8% of total assets at end-June 2016. 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 if there were to be a liquidity shortage, which is not the case for all its peers.

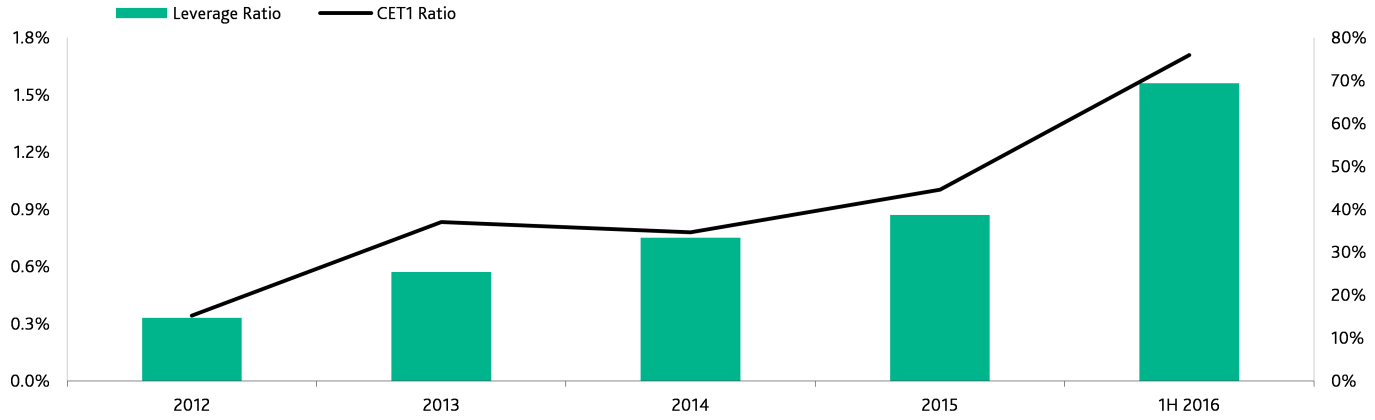
Capitalisation is good but some uncertainty persists owing to new regulatory rules

Kommuninvest is adequately capitalised relative to its risks: it has never recorded a loss on its lending. The institution reported a common equity Tier 1 (CET1) ratio of 75.9% at end-June 2016, up from 44.6% at year-end 2015 as the remaining SEK1.5 billion of the 2015 equity injection into Kommuninvest Cooperative Society (totalling SEK2.7 billion) was paid to the company in March 2016 (see Exhibit 3 for Kommuninvest's capital development). The ratio is particularly high thanks to the zero risk-weight applied on its municipal lending. In comparison, its Norway based peer, Kommunalbanken, applies a 20% risk-weight on its lending.

Exhibit 3

Kommuninvest's Leverage Ratio and CET1 Ratio

Expectations of future capital requirements have resulted in capital build up, with leverage ratio and CET1 ratio increasing significantly since 2012



Source: Company reports

As per 30 June 2016, Kommuninvest's leverage ratio was 1.56% (excluding subordinated debt that will not in the future qualify as capital), which is below that of its peers and well below the level (3%) that might become a requirement from 1 January 2018, under CRR/CRDIV regulation. Following the aforementioned SEK1.5 billion capital injection, the institution has reached its current leverage ratio target of 1.5%. Kommuninvest plans to issue additional Tier 1 capital to the members of the Society if 3% were to become a requirement from January 2018.

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 minimal with a limit set by the Board of Directors at SEK15 million, assuming a one percentage point parallel yield curve shift, a small exposure compared with shareholder's equity of SEK5.4 billion at end-June 2016.

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 increasingly require Kommuninvest to post collateral. All counterparties are required to have a rating of at least A2.

Ratings

Exhibit 4

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

Source: Moody's Investors Service

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