

CREDIT OPINION

24 February 2020

Update

✓ Rate this Research

RATINGS

Domicile	Sweden
Long Term CRR	Not Assigned
Long Term Debt	Aaa
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Not Assigned

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.

Contacts

Niclas Boheman +46.8.5179.6561
AVP-Analyst
niclas.boheman@moodys.com

Malika Takhtayeva +44.20.7772.8662
Associate Analyst
malika.takhtayeva@moodys.com

Simon Ainsworth +44 207 772 5347
Associate Managing Director
simon.ainsworth@moodys.com

Sean Marion +44.20.7772.1056
MD-Financial Institutions
sean.marion@moodys.com

Kommuninvest i Sverige Aktiebolag

Update following ratings affirmation

Summary

On February 20, Moody's affirmed Kommuninvest i Sverige AB's (Kommuninvest) Aaa long-term senior unsecured debt and issuer ratings.

Kommuninvest's Aaa long-term ratings reflects the institution's close links to Swedish regional and local governments (RLGs) and ultimately the [Swedish sovereign](#) (Aaa, Stable). 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 trending downwards as its balance sheet grows, but is not expected to constrain its business.

Outlook

The outlook on Kommuninvest's ratings is stable, reflecting stable outlook on the ratings of the Government of Sweden.

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]

	06-19 ²	12-18 ²	12-17 ²	12-16 ²	12-15 ²	CAGR/Avg. ³
Total Assets (SEK Million)	458,381.4	409,193.1	350,549.6	353,776.4	330,964.9	9.8 ⁴
Total Assets (USD Million)	49,404.1	46,153.8	42,815.2	38,942.4	39,257.6	6.8 ⁴
Tangible Common Equity (SEK Million)	7,867.4	7,587.7	7,599.1	6,490.8	4,362.9	18.3 ⁴
Tangible Common Equity (USD Million)	847.9	855.8	928.1	714.5	517.5	15.2 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	165.8	192.5	253.8	119.4	66.3	159.6 ⁵
Net Interest Margin (%)	0.2	0.2	0.2	0.2	0.2	0.2 ⁵
PPI / Average RWA (%)	16.0	20.2	26.1	6.1	10.6	15.8 ⁵
Net Income / Tangible Assets (%)	0.1	0.1	0.2	0.1	0.2	0.2 ⁵
Cost / Income Ratio (%)	25.4	25.9	19.3	36.8	30.5	27.6 ⁵
Market Funds / Tangible Banking Assets (%)	98.0	97.5	97.3	97.6	97.7	97.6 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	13.7	11.9	10.8	17.0	19.1	14.5 ⁵

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully-loaded or transitional phase-in; LOCAL GAAP. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of Basel III periods presented. [6]Simple average of periods presented for the latest accounting regime.

Source: Moody's Investors Service; Company Filings

Profile

Kommuninvest was established in 1986 under the name of Kommuninvest i Örebro Län AB as a regional project for inter-municipal financial cooperation in the County of Örebro, Sweden. Kommuninvest's activities were expanded to cover the whole of Sweden in 1993, and its name was changed to Kommuninvest i Sverige AB (publ). Since 1995, the organisation has been registered as a joint-stock credit company, subjecting it to the supervision by the Financial Supervision Authority.

Kommuninvest's main purpose is to provide financing at competitive levels to Swedish municipalities and county regions that are members of the Kommuninvest Co-operative Society ("the Society"). The Society owns 100% of the shares of Kommuninvest and as end of 2019 had 290 members, of which 278 were municipalities and 12 were county regions with an additional member - Region Blekinge joining as a member of the Kommuninvest Cooperative Society at the beginning of 2020. Lending is restricted to local authorities that are members and to entities that are majority-owned and fully guaranteed by one or more members. Kommuninvest carries a zero risk-weighting according to Swedish accounting rules, which are in line with those agreed by some other European countries such as Germany and France.

For further information on Sweden's banking system profile see : [Banks - Sweden : Banking System Profile](#)

Detailed credit considerations

The financial data in the following sections are sourced from Kommuninvest's financial statements or Moody's Financial Metrics unless otherwise stated. The figures and ratios in Exhibit 1 are adjusted using Moody's standard adjustments.

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

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Cooperative Society, thus having recourse to 278 municipalities in Sweden (comprising 96% of all municipalities in the country) and 12 regions (57% of the county regions) at the end of 2019.

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 regions 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 56% as of December 2019, 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. Kommuninvest's dominant share in the RLG's sector funding underpins our assessment that the institution function is equivalent to 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 government is also an important positive driver for Kommuninvest's strong asset quality, because the State has ultimate responsibility for ensuring that public services as a whole develop in socio-economic balance.

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 but due to members' decisions, net interest margins will be lower

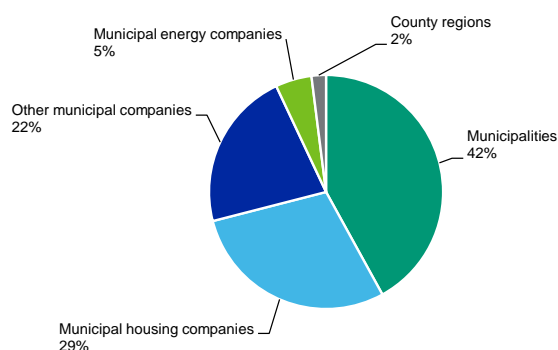
Kommuninvest's profitability is predictable as a result of its mandate to lend exclusively to the financially stable Swedish RLG sector and related entities guaranteed by Swedish RLGs (see Exhibit 2), and its leading market position. Its mandate to offer cost-effective lending leads to a moderate profitability.

Kommuninvest's 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. However, as of June 2018 following the discussion between the members, lending products' prices have been cut by removing part of the marginal supplement that was previously included to cover negative unrealised changes in market values. As a result the margin decreased to 14.5 basis points (bps) as of December 2018 from 23 bps prior to May 2018. Therefore, even despite significantly increased lending, Kommuninvest reported lower net interest income by nearly 9% for 2019 compared to 2018 while lending increased by 15%. The lender estimates that 57% of the municipal loan debt has been financed by them. According to the lender, in the last 12 months Kommuninvest's lending has grown twice as fast as the sector as a whole.

Exhibit 2

Breakdown of Kommuninvest's Loan Portfolio by Borrower Category as of June 2019

Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

We note that since 2015 Kommuninvest is originating loans at negative interest rates,¹ which had a greater impact on earnings in 2016 and 2017, than in 2015 due to gradual replacement of old loans with new lower margin loans. We expect this trend to continue in 2020.

During 2019 operating expenses decreased by 9% compared 2018, on the back of a lower resolution fee of SEK 27.4 million compared to SEK69.1 million in 2018. Excluding this, Kommuninvest reported slightly higher staff costs. Overall, net income decreased to SEK 307.9 million for 2019, from SEK 586,1 million in 2018.

Operating expenses are low due to Kommuninvest's monoline business model. An additional contributing factor to the lender's efficiency is the absence branches, unlike commercial banks. We expect 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. We understand that the lender's funding strategy is based on diversified funding in terms of funding markets, currencies, products and investor categories. The issuer is actively working to increase its funding in major bond programmes, so-called benchmark programmes internationally and in Sweden.

Kommuninvest's refinancing risk is limited as the lender seeks to term-match its funding to its assets. 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. However, a new strategy for matching assets and liabilities was introduced during 2017, which contributes to better terms in lending but also more solid liquidity buffers.

Kommuninvest maintains an adequate liquidity portfolio, which amounted to 11% of lending or 9.5% of total assets at end of year 2019. The bulk of the portfolio is of very strong asset quality and the exposure is mainly to sovereigns in Northern Europe and central banks. 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 declining due to balance sheet growth

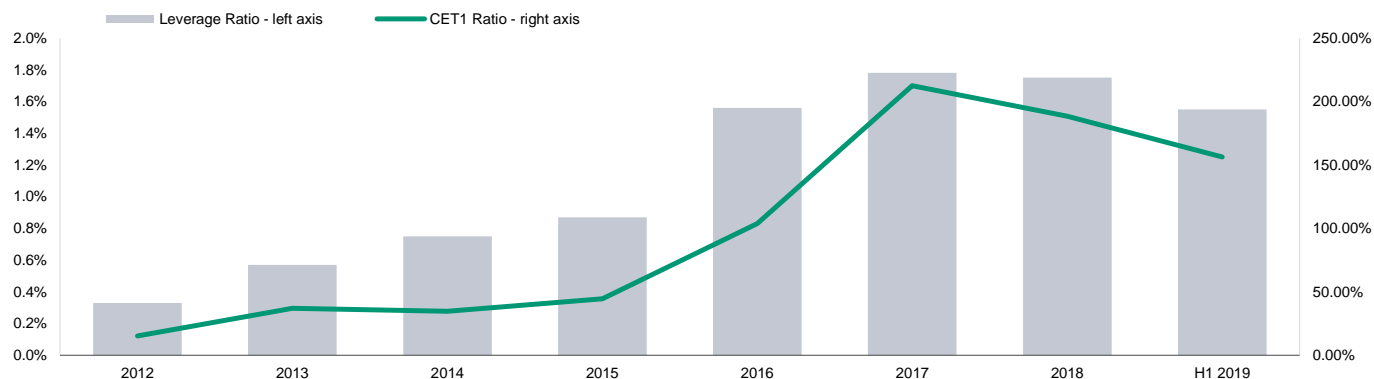
Kommuninvest is adequately capitalised relative to its risks: it has never recorded a loss on its lending. The institution reported a common equity Tier 1 (CET1) ratio of 126.8% at the end of 2019, down from 188.4% as of December 2018 (see Exhibit 3 for Kommuninvest's capital development).

Nevertheless, the capital ratio of Kommuninvest is particularly high due 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

At the same time, as of 31 December 2019, Kommuninvest's leverage ratio according to CRR was 1.58%, decreased from 1.75% in 2018 and still below its Nordic peers. However, if Kommuninvest is classified as Public Development Credit Institution under the proposed regulations by the European Commission, all lending to municipality members and their companies will be deducted from the leverage ratio. The new leverage ratio regulation to come into force (according to the EU final legislation package in its official journal published on the 7th of June 2019) on 28 June 2021 with a transition period of 2 years. ²

According to Kommuninvest, it meets all needed criteria to be defined as a PDCI and believes that lending will be deducted from the exposure measure applied in the calculation of the leverage ratio under Pillar I. Kommuninvest's leverage ratio based on its current capital base would result in a leverage ratio in excess of the 3%, which was not questioned by the Swedish FSA in its preliminary verification letter in connection with its Supervisory Review and Evaluation Process.

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 the current interest rate risk in the portfolio should be below SEK30 million, assuming a one percentage point parallel displacement of the yield curve. The risk may amount to SEK50 million, for a period of up to 5 days, a small exposure compared with shareholder's equity of SEK7.6 billion as of 31 December 2019

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.

Environmental, Social, and Governance Considerations

We consider Kommuninvest to have a low exposure to Environmental risks in line with how we view the banking sector. See our Environmental risks [Environmental heatmap](#) for further information.

Due to Kommuninvest's role as one of Swedish's largest credit institution specialising in the financing of Swedish municipalities, it is susceptible to politically and socially motivated decisions that could affect its financial profile. Its borrowers are exposed to the challenges of providing services to an aging population leading to increasing dependency ratios. Over time, these challenges can add pressure on municipalities' finances, even though the sector's institutional framework overlying Kommuninvest's clients help manage these risks. The framework includes municipalities constitutional right to set local level tax rates independently, an equalisation mechanism supporting financially weaker municipalities, and the joint guarantee where member organisations are responsible for each other's commitments in proportion to their population figures. Overall, we consider the issuer to have a moderate exposure to Social risk.

Other social risks in terms of customer relations or change in consumer preferences, which are generally relevant for the banking industry, are less important for Kommuninvest, given that the issuer does not engage in retail activities. See our Social risks [Social heatmap](#) for further information.

Governance is highly relevant to Kommuninvest's creditworthiness. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. We do not have any particular concern around Kommuninvest's corporate governance, which is regulated by law and influenced by its public ownership structure.

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

Endnotes

- Up to the end of 2014, capital needed to meet regulatory requirements and feed growth at Kommuninvest 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.
- Article 429a(d) of the EC's proposal for a Regulation of the European Parliament and the Council dated 23 November 2016, amending Regulation (EU) No 575/2013 as regards the leverage ratio, the net stable funding ratio, requirements for own funds and eligible liabilities, counterparty credit risk, market risk, exposures to central counterparties, exposures to collective investment undertakings, large exposures, reporting and disclosure requirements and amending Regulation (EU) No 648/2012.

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