

CREDIT OPINION

21 July 2020

Update

✓ Rate this Research

RATINGS

Domicile	Orebro, 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.

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Kommuninvest i Sverige Aktiebolag

Update to credit analysis

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]

	12-19 ²	12-18 ²	12-17 ²	12-16 ²	12-15 ²	CAGR/Avg. ³
Total Assets (SEK Million)	461,265.5	409,193.1	350,549.6	353,776.4	330,964.9	8.7 ⁴
Total Assets (USD Million)	49,275.0	46,153.8	42,815.2	38,942.4	39,257.6	5.8 ⁴
Tangible Common Equity (SEK Million)	7,580.6	7,587.7	7,599.1	6,490.8	4,362.9	14.8 ⁴
Tangible Common Equity (USD Million)	809.8	855.8	928.1	714.5	517.5	11.8 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	129.5	192.5	253.8	119.4	66.3	152.3 ⁵
Net Interest Margin (%)	0.2	0.2	0.2	0.2	0.2	0.2 ⁵
PPI / Average RWA (%)	7.8	20.2	26.1	6.1	10.6	14.2 ⁵
Net Income / Tangible Assets (%)	0.1	0.1	0.2	0.1	0.2	0.1 ⁵
Cost / Income Ratio (%)	39.4	25.9	19.3	36.8	30.5	30.4 ⁵
Market Funds / Tangible Banking Assets (%)	97.9	97.5	97.3	97.6	97.7	97.6 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	10.4	11.9	10.8	17.0	19.1	13.8 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 of end of April 2020, had 291 members, of which 278 were municipalities and 13 were county regions with an additional member - Region Kalmar joining as a member of the Kommuninvest Cooperative Society in April 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](#).

Recent developments

We [expect](#) advanced economies collectively to contract in 2020. 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. Even with a gradual recovery, we expect 2021 real GDP in most advanced economies to be below pre-coronavirus levels.

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 www.moody's.com for the most updated credit rating action information and rating history.

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 Cooperative Society, thus having recourse to 278 municipalities in Sweden (comprising 96% of all municipalities in the country) and 13 regions (62% of the county regions) at the end of April 2020. Swedish RLG's are prevented from going into bankruptcy, and the economic and social well-being of the sector is closely interlinked with that of the Swedish central government.

Kommuninvest has a public mandate to provide cost efficient funding to the RLG's 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, and its role as treasury for many RLGs, underpins our assessment that the institution has a nationwide 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.

The strong creditworthiness of the RLG sector is reflected in asset risk

Although the economic impact from the coronavirus-induced disruption will be negative for Swedish lenders in general, we expect Kommuninvest's asset quality to remain resilient because its creditworthiness is based on the high credit quality of the Swedish RLG sector that the agency serves. 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.

As of year-end 2019, the lending portfolio grew by 14.8% compared to the previous year both to larger and smaller municipalities and especially the increase is greatest among the municipalities with their own market programmes, which has been attracted by Kommuninvest's pricing. Green financing reached 10.1% of the total lending as of the end of 2019 and increased to SEK63.1 billion compared to SEK40.0 billion as of year-end 2018.

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. However, the coronavirus' outbreak will have a substantial implications for public health

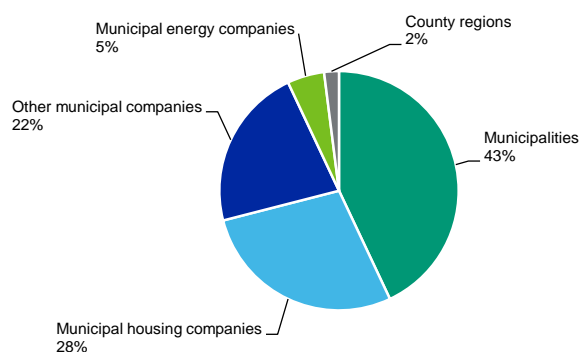
and safety across Sweden, as well as the adverse impact the virus will have on the collection of locally generated tax and service fee revenues due to weaker economic growth.

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, profit is expected to decrease going forward following decisions taken by members in 2018 to reduce lending products' prices by removing part of the marginal supplement that was previously included to cover negative unrealised changes in market values. As a result the pricing model has been changed and 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 and a 56% market share, Kommuninvest reported lower net interest income by 6.5% for 2019 compared to 2018 while lending increased by 14.8%. 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 year-end 2019

Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

During 2019 operating expenses decreased by 9% compared 2018, on the back of a lower resolution fee of SEK27.4 million compared to SEK69.1 million in 2018. Excluding this, Kommuninvest reported slightly higher staff costs. Overall, net income decreased to SEK307.9 million for 2019, from SEK586.1 million in 2018.

Operating expenses are low due to Kommuninvest's niche business model allowing for a slim organisation and absence branches. We expect operating expenses to remain low with increasing due to the nature of its operations.

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 11.8% of lending or 10.5% 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.

Due to slightly reduced lending growth as of June 2020, Kommuninvest has revised its funding forecast for 2020. The need for long-term funding and maturities longer than one year, is expected to be approximately SEK150-160 billion, which is lower than previously

forecasted SEK150-170 billion. The new forecast is built on expected renewal of maturing loans, new lending, customer demand regarding different maturities as well as the size and financing of the liquidity reserve at the end of the year.

Capitalisation is good but declining due to balance sheet growth

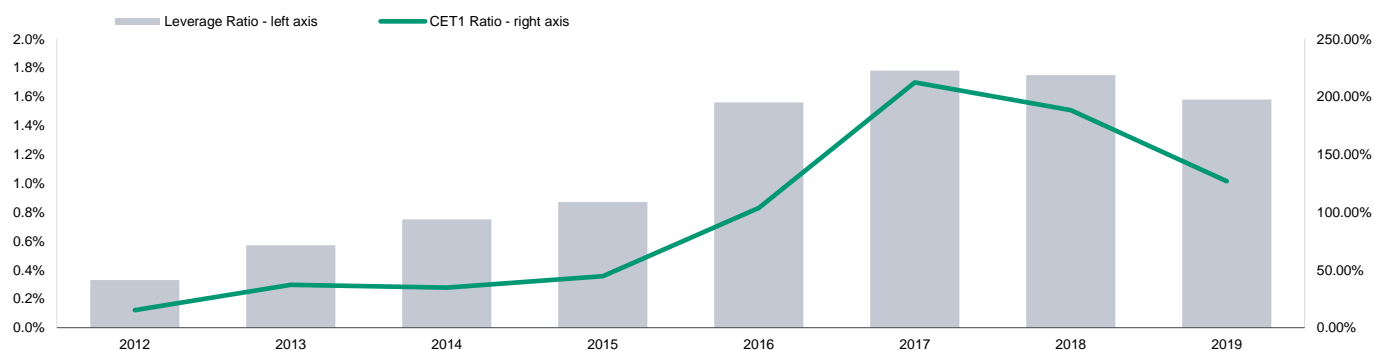
Kommuninvest is adequately capitalised relative to its risks: it has never recorded a loss on its lending. The institution reported a common equity Tier 1 (CET1) ratio of 126.8% at the end of 2019, down from 188.4% as of December 2018 (see Exhibit 3 for Kommuninvest's capital development).

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 year-end 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.¹

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 large 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 market 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.

ESG 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.

We also regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. Other social risks in terms of customer relations or changes in consumer preferences, which are generally relevant for the banking industry, are less important for Kommuninvest, given that the institution does not engage in retail activities. Overall, we consider the issuer to have a moderate exposure to Social risk. 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

- 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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