

CREDIT OPINION

21 December 2020

Update

✓ Rate this Research

RATINGS

Kommuninvest i Sverige Aktiebolag

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.

Contacts

Louise Lundberg +46.8.5179.1280
 VP-Sr Credit Officer
 louise.lundberg@moodys.com

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

Simon James Robin +44.20.7772.5347
 Ainsworth
 Associate Managing Director
 simon.ainsworth@moodys.com

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

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Americas 1-212-553-1653
 Asia Pacific 852-3551-3077
 Japan 81-3-5408-4100
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Kommuninvest i Sverige Aktiebolag

Update to credit analysis

Summary

We assign Aaa long-term senior unsecured debt and issuer ratings to [Kommuninvest i Sverige Aktiebolag's](#) (Kommuninvest), a muni lender .

Kommuninvest's Aaa long-term ratings reflect the institution's close links with Swedish regional and local governments (RLGs) and ultimately the [Government of Sweden](#) (Aaa stable). The main drivers of the ratings are the support offered by the joint and several guarantee provided by its RLGs members, its public-policy mandate; and the fact that the institution is 100% controlled by RLGs that are members of the Kommuninvest Cooperative Society.

Credit strengths

- » Benefits from a joint and several guarantee provided by all members of the Kommuninvest Cooperative Society.
- » Strong asset quality
- » Public policy mandate supports predictable financial performance.

Credit challenges

- » Weak profitability linked to its public policy mandate
- » High reliance on market funding, mitigated by broadly matched maturities

Outlook

The outlook on Kommuninvest's ratings is stable, in line with that on the ratings of the Government of Sweden.

Factors that could lead to a downgrade

Downward pressure on Kommuninvest's ratings could arise over time as a result of a deterioration of the joint and several guarantee or its public-policy mandate; or sustained weak financial performance.

Key indicators

Exhibit 1

Kommuninvest i Sverige Aktiebolag (Unconsolidated Financials) [1]

	06-20 ²	12-19 ²	12-18 ²	12-17 ²	12-16 ²	CAGR/Avg. ³
Total Assets (SEK Million)	525,840.6	461,265.5	409,193.1	350,549.6	353,776.4	12.0 ⁴
Total Assets (USD Million)	56,441.0	49,275.0	46,153.8	42,815.2	38,942.4	11.2 ⁴
Tangible Common Equity (SEK Million)	7,416.4	7,580.6	7,587.7	7,599.1	6,490.8	3.9 ⁴
Tangible Common Equity (USD Million)	796.0	809.8	855.8	928.1	714.5	3.1 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	157.1	129.5	192.5	253.8	119.4	170.5 ⁵
Net Interest Margin (%)	0.1	0.2	0.2	0.2	0.2	0.2 ⁵
PPI / Average RWA (%)	-6.3	7.8	20.2	26.1	6.1	10.8 ⁵
Net Income / Tangible Assets (%)	-0.1	0.1	0.1	0.2	0.1	0.1 ⁵
Cost / Income Ratio (%)	-237.9	39.4	25.9	19.3	36.8	-23.3 ⁵
Market Funds / Tangible Banking Assets (%)	98.6	97.9	97.5	97.3	97.6	97.8 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	12.6	10.4	11.9	10.8	17.0	12.5 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 because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of Basel III periods. [6] Simple average of periods for the latest accounting regime.

Sources: Moody's Investors Service and company filings

Profile

Kommuninvest's main purpose is to provide financing at competitive levels to Swedish municipalities and regions that are members of the Kommuninvest Cooperative Society (the Society). The Society owns 100% of the shares of Kommuninvest, and as of the end of June 2020, it had 291 members, of which 278 were municipalities and 13 were regions. Lending is restricted to regional and local authorities that are members, including 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.

Kommuninvest i Sverige Aktiebolag (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, subject to supervision by the Swedish Financial Supervision Authority (SFSFA).

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

Recent developments

[Nascent global economic recovery](#) is under threat from rising COVID-19 cases and even with a gradual recovery, we expect 2021 real GDP in most advanced economies to be below pre-coronavirus levels. Our baseline forecasts assume that difficulty in controlling the virus will hinder the gradual process of recovery in the short term. But over time, we expect better pandemic management and the availability of an effective vaccine or treatments to reduce the importance of the virus as a macroeconomic variable. Our forecasts assume that an effective vaccine is unlikely to be available widely before the middle of 2021.

Our [outlook](#) for the Swedish banking system remains stable. However, we have [revised](#) our GDP growth forecasts for 2020 and 2021, and we expect the operating environment in Sweden to remain weak in 2021.

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.

Kommuninvest benefits from a joint and several guarantee

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 regional or local government that is a member of Kommuninvest's ownership organisation, the Kommuninvest Cooperative Society, thus having recourse to 278 municipalities in Sweden (comprising 96% of all municipalities in the country) and 13 regions (65% of the regions) as of the end of June 2020. Swedish RLGs are prevented from going into bankruptcy, and the economic and financial 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 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 regions can become members of 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 borrowings of 58% as of June 2020, which makes it the market leader in this segment. RLGs also borrow from the banks and some have direct access to funding markets. Kommuninvest's dominant market share in RLG funding, and its role as a treasury for the majority of RLGs, support our assessment that the institution has a nationwide public-policy mandate. Kommuninvest's ability to further strengthen that mandate will depend on its ability to attract large RLGs, which may have other (stand-alone) funding options, such as the City of Stockholm, to join its membership organisation.

Strong asset quality, supported by the creditworthiness of the RLG sector

Although the economic impact from the pandemic will be negative for Swedish lenders in general, we expect Kommuninvest's asset quality to remain resilient because of the high credit quality of the Swedish RLG sector, and Kommuninvest does not report any problem loans. We consider the RLG sector to be financially strong because of the supportive system that underpins the sector. RLGs have the authority to raise income taxes, which, together with grants from the central government, form key sources of revenue. In addition, Swedish RLGs are subject to a revenue equalization principle, which enables all RLGs to deliver vital public services, irrespective of their own underlying economic and financial conditions.

Legislation states that RLGs' budgets cannot show imbalances for more than three years. They cannot be declared bankrupt, which reduces 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 as the government has the ultimate responsibility for ensuring public services as a whole.

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

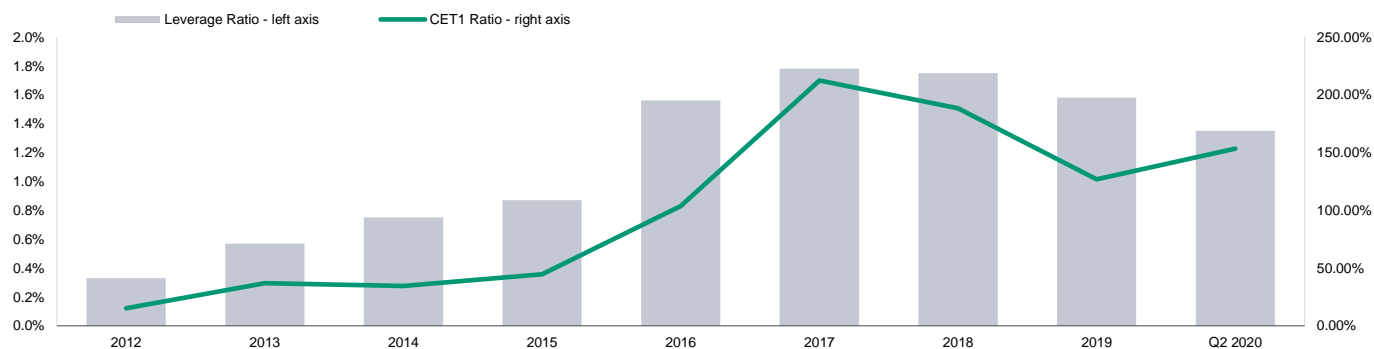
Due to the coronavirus' outbreak, the pace of lending has increased and the lending portfolio grew by 8.1% as of end-June 2020 compared to year-end 2019. Growth was particularly large for municipalities that have stand-alone market funding programmes, but that were attracted by Kommuninvest's pricing. Green financing reached 11.2% of total lending and stood at SEK70.1 billion as of the end of June 2020, compared to SEK63.1 billion at year-end 2019.

Capital is adequate, and the trend has been declining until recently

Kommuninvest is adequately capitalised relative to its risks. The institution reported a Common Equity Tier 1 (CET1) capital ratio of 153.4% as of end June 2020, up from 126.8% as of December 2019 (see Exhibit 3 for Kommuninvest's capital development). The very high CET1 ratio is due to the zero risk-weight applied to its municipal lending. (In comparison, its Norway-based peer, [Kommunalbanken AS](#) (Aaa STA, a1)¹, applies a 20% risk weight to its lending.)

Exhibit 2

Kommuninvest's CET1 and leverage ratios



Source: Company reports

As of end June 2020, Kommuninvest's leverage ratio was 1.35%, according to Capital Requirements Regulation (CRR), lower than the 1.58% at YE 2019 and below that of its Nordic peers.

However, if Kommuninvest were to be classified as a Public Development Credit Institution (PDCI) under the proposed regulation by the European Commission, all lending to RLGs and their companies would be deducted from the exposure (the denominator) in the leverage ratio. The new leverage ratio regulation will come into force (according to the European Union (EU) final legislation package in its official journal, published on 7 June 2019) on 28 June 2021, allowing a transition period of two years.²

According to Kommuninvest, it meets all the 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. If so, Kommuninvest's leverage ratio - calculated based on its current capital base - would result in a leverage ratio exceeding 3%. Kommuninvest's view was not questioned by the Swedish FSA in its preliminary verification letter in connection with its Supervisory Review and Evaluation Process.

Financial performance is predictable, but net interest margins will be lower

We expect Kommuninvest's profitability is to be relatively weak going forward as a result of its mandate to offer cost-effective lending and the recent members' decision (described below), but predictable. However, the pandemic will have substantial implications for public health and safety across Sweden, as well as an adverse impact on the collection of locally generated tax and service fee revenue because of 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 likely to decrease 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 was changed, and the margin decreased to 14.5 basis points (bps) as of December 2018 from 23 bps before May 2018.

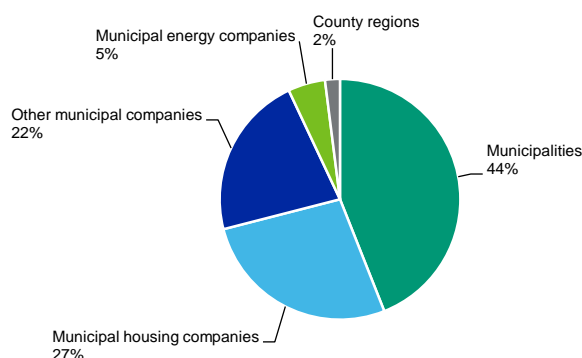
Therefore, Kommuninvest's net interest income declined by 17.5% year-on-year in the first six months of 2020, despite a significant increase in lending by 13.7%.

According to the lender, in the last 12 months, Kommuninvest's lending has grown twice as fast as that of the sector as a whole.

Exhibit 3

Breakdown of Kommuninvest's loan portfolio by borrower category as of end June 2020

Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

During the first half of 2020, operating expenses decreased by 1% from that in H1 2019, on the back of a lower resolution fee of SEK10.4 million (compared to SEK13.7 million in H1 2019). Excluding this, Kommuninvest reported slightly higher staff costs. Overall, the company registered a loss of SEK159.6 million in H1 2020, compared to SEK282.5 million profit in H1 2019.

Operating expenses are low because Kommuninvest's niche business model allows for a slim organisation and the lender doesn't have any physical branches. We expect operating expenses to remain low because of the nature of its operations.

A high reliance on funding, albeit broadly matched maturities, and good liquidity

Kommuninvest'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, the so-called benchmark programmes, internationally and in Sweden.

Kommuninvest's refinancing risk is limited because the lender aims to match its funding maturities to those of its assets. However, similar to those of its peers, some of Kommuninvest's funding includes option-like features, which could suddenly 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 in 2017, which contributes to better terms in lending, as well as more solid liquidity buffers.

Kommuninvest maintains adequate liquidity, which amounted to 17.2% of lending or 14.4% of total assets as of the end of June 2020. The bulk of the portfolio is exposure to sovereigns in Northern Europe and central banks. Kommuninvest also has access to the central bank in case of a liquidity shortage, which is not the case for all its peers.

Prudent risk management, comparable with that of peers

Kommuninvest has very limited appetite for market risk, which is consistent with that of 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 five days, a small amount compared with shareholders' 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 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

Kommuninvest has low exposure to environmental risks, in line with our view of the banking sector. See our [Environmental risks heat map](#) for further information.

Because of Kommuninvest's role as one of Sweden's largest credit institutions specialising in the financing of Swedish municipalities, it is susceptible to politically and socially motivated decisions, which could affect its financial profile. Its borrowers are exposed to the challenges of providing services to an ageing population, leading to increasing dependency ratios. Over time, these challenges can add pressure to municipalities' finances, although the sector's institutional framework overlying Kommuninvest's clients helps 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 pandemic as a social risk under our environmental, social and governance (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, the issuer has moderate exposure to social risks. See our [Social risks heat map](#) for further information.

Governance is highly relevant for 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

- 1 The ratings shown are Kommunalbanken's senior unsecured rating and Baseline Credit Assessment.
- 2 Article 429a(d) of the EC's proposal for a Regulation of the European Parliament and the Council dated on 23 November 2016, amending Regulation (EU) No 575/2013 with regard to 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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