

Kommuninvest i Sverige AB

Primary Credit Analyst:

Johanna Melinder, Stockholm + 46 84 40 5926; johanna.melinder@spglobal.com

Secondary Contact:

Carl Nynerod, Stockholm + 46 84 40 5919; carl.nynerod@spglobal.com

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Kommuninvest i Sverige AB

This report does not constitute a rating action.

Credit Highlights

Issuer Credit Rating

AAA/Stable/A-1+
Nordic Regional Scale
--/--/K-1

Overview

Enterprise risk profile	Financial risk profile
--Low-risk municipal lending, very strong management team, and solid market share and importance for the municipal sector underpin the rating.	--Model for capitalization provides predictability and stability to Kommuninvest's capital adequacy, but we expect it will remain below that of its Nordic peers.
--The Swedish local and regional governments (LRGs) continue to uphold very strong credit quality, despite economic downturn.	--We believe the risk tax on credit institutions will pressure Kommuninvest's near-term profitability and could impact competitiveness unless Kommuninvest is granted an exemption.
--Sweden's wealthy economy, well-developed financial sector, and LRG sector's strong ties to the 'AAA' rated sovereign are credit strengths.	--Funding and liquidity are supported by tight matching of assets and liabilities, a very liquid treasury portfolio, and broad access to diversified funding.

Kommuninvest's strong public policy role is underpinned by increasing market share and importance, further illustrated during the economic uncertainty created by the war and the pandemic. Similar to during the pandemic, we note that demand for funding from Kommuninvest, compared with alternative funding sources, has increased somewhat during the more unpredictable market conditions caused by the Russia-Ukraine conflict. Kommuninvest's market share increased to 59% as of June 2022, up from 55% in 2019.

The risk tax on credit institutions increases Kommuninvest's cost pressure and reduces profitability in the near term. In contrast to initial communication from the government, there is no exemption in place for Kommuninvest from 2023, but an exemption is still on the agenda to be implemented at a later stage. We expect Kommuninvest will absorb the increase in expenditure through a combination of measures, for example cost savings and via its lending margins. Central government support to Swedish LRGs, which includes compensation for its generally higher financing cost, will mitigate part of the potential pressure on Kommuninvest's members.

The company benefits from a solid funding position thanks to diversified funding, efficient funding techniques, excellent name recognition, and adequate liquidity, which enable the agency to withstand most conceivable shocks. Funding and liquidity is supported by tight matching of assets and liabilities, a very liquid treasury portfolio, and broad access to diversified funding, although the short maturity profile of lending results in a need for continuous high funding volumes.

We regard Kommuninvest's guarantee structure as predictable, supportive, and immediately enforceable.

Kommuninvest's members are highly creditworthy and liable for the agency's obligations under a joint and several guarantee. Hence, we believe that Kommuninvest's members would provide extraordinary support if needed.

Outlook

The stable outlook reflects our expectation that the underlying municipal sector will maintain high creditworthiness, Kommuninvest's guarantee structure will remain unchanged, and the agency will continue to benefit from unwavering support from its members. We expect Kommuninvest's management to maintain low risk tolerances and continue to contain risks associated with the wholesale-funded nature of its activities. Moreover, we expect that Kommuninvest will maintain prudent risk policies so that its lending services--and ultimately the execution of its public policy role--will stay on track.

Downside scenario

We could lower our ratings on Kommuninvest if we observed a structural deterioration in the credit quality of the agency's members. We could also consider a downgrade if Kommuninvest's stand-alone credit profile (SACP) came under significant pressure, for example if risk management faltered to the extent that its liquidity and capital position notably deteriorated. This scenario could materialize through a widening funding gap, substantial stress on the agency's liquidity position, and structural weakening capital adequacy. Such financial pressure could hinder the agency's ability to fulfil its public policy mandate and reduce our confidence in the agency's risk management culture.

Rationale

Enterprise risk profile: Very strong management and status as a key lender to LRGs underline a strong market position and public policy role

Kommuninvest's public sector mandate is to provide funding solely to its members, which comprise entities in the Swedish LRG sector. Kommuninvest provides funding directly to its member municipalities and regions, and to companies under their control (in which case a municipal guarantee is required). As such, Kommuninvest's loan book is exposed only to Swedish LRG risk. We believe the agency holds a strong market position, given that its market share has been steadily increasing and stood at 59% of total lending to the sector as of June 30, 2022, up from 58% a year earlier. In 2022, Kommuninvest got one new member and now 294 out of Sweden's 310 LRGs are members of Kommuninvest. Kommuninvest's lending growth has consistently outpaced the domestic sector average, suggesting a competitive offer. This has been further illustrated in recent periods of stress, such as during the pandemic and the Russia-Ukraine conflict.

Kommuninvest has a clear public policy mandate based on its ownership, support structure, niche lending, and nonprofit mission. As such, it plays a very important role in financing the Swedish LRG sector by ensuring stable and advantageous borrowing in national and international capital markets. Kommuninvest's role as a supplier of stable financing to the LRG sector has been especially notable during recent periods of stress, such as the pandemic and following the outbreak of the Russia-Ukraine conflict, and many LRGs have increasingly turned to Kommuninvest for their funding needs, given its more stable and favorable role than the alternatives.

The Swedish Central government implemented a risk tax for all credit institutions that took effect Jan. 1, 2022, including for Kommuninvest. When adopted, the Swedish parliament called on the government to make an exemption for Kommuninvest from at the latest 2023, and to compensate the LRGs for the increased cost until then. However, in the 2023 Budget there is no decision to exempt Kommuninvest from the risk tax, but to continue compensating the LRGs for the higher financing cost stemming from the tax. Although we do not rule out that an exemption will be made at a later stage, we now see a higher risk that the agency's higher level of noninterest expenditure will be more permanent in nature. Kommuninvest expects to pay Swedish krona (SEK) 257 million in 2022 and that it will increase to about SEK310 million-SEK350 million in 2023.

We assume Kommuninvest will absorb the increase in expenditure through a combination of measures, for example cost savings, temporarily lower dividend payouts to its members and potentially via its lending margins, with limited overall impact on its financial profile in the long run. So far, impact on margins has been negligible. However, if Kommuninvest would have to raise them more as a consequence of the higher costs, it could weigh on its competitiveness against capital markets. Nevertheless, we expect its overall policy role, especially for small and midsize municipalities, to remain intact.

In preparation for the regulatory leverage ratio requirement and internal targets for capitalization, Kommuninvest has actively engaged with its members to secure a significant increase in core capital through higher contributions, redistribution of dividends, capital injections, and the replacement of a subordinated loan from the members. The model for capital contributions has been reworked over the past few years and a new model for capitalization was agreed in April 2020. This will support a more predictable and stable capitalization, both for the members and the agency, because it covers four years at the time. We believe these developments highlight the constructive dialogue between Kommuninvest and its members, and confirm our view of the agency's management, relationship with members, and overall capitalization.

The Swedish LRG sector exhibits key structural features that support its high credit standing. For example, the national economy is wealthy, the financial system is advanced, and links between the LRG sector and the 'AAA' rated sovereign are very tight. For example, during the COVID-19 pandemic the central government provided generous support packages, helping the sector to honor its responsibilities while upholding strong performance.

Financial risk profile: Very strong capitalization and liquidity position provide financial buffers

Kommuninvest maintains a strong capital position and we anticipate that our RAC ratio after adjustments will remain around 15%. All of Kommuninvest's equity is eligible as Tier 1 capital, and we incorporate it into our total adjusted capital ratio. Our risk-adjusted capital (RAC) ratio before adjustments for Kommuninvest remains very strong at 45.6% on June 30, 2022, and we estimate it will reach around 47% by year-end 2022. After our adjustments for single-name concentration relating to LRGs, the RAC ratio reduces to about 15%. The increase in the second half of the year reflects SEK600 million in capital from members, related to the capitalization plan for 2022, was received in November.

In a regulatory context, its Tier 1 capital ratio, at about 280% (as of June 30, 2022), is impressive. This is largely thanks to the zero risk-weighting of Kommuninvest's lending, as well as counterparty risk in derivatives being covered by a guarantee from its members.

However, although we expect lending to continue growing, we expect a somewhat slower pace, owing to high liquidity

in the sector and the uncertain macroeconomic situation with increasing costs, restrictive stance to capital expenditure, and Kommuninvest's already high market share. This will support our capital ratios, as will the increased capital base following the capitalization plan agreed in April 2020. Decisions are made for four-year periods and the current plan suggests that the agency's capital base will increase by about 45% by 2024, compared with 2020. Combined, we expect capital levels will remain at the current level.

Kommuninvest's funding profile is a rating support. We expect all major funding markets to remain open to Kommuninvest, thanks to excellent name recognition and its deep investor base even in a stressed scenario, which has been proven during recent periods of market turbulence following Russia's invasion of Ukraine, as well as during the COVID-19 crisis. In Sweden, securities issued by Kommuninvest are considered among those of highest quality in the calculation of the liquidity coverage ratio and have been included in the Swedish Riksbank's asset purchase program during the pandemic. The agency focuses on plain vanilla benchmark issuance and has recently added euros as one of its strategic currencies, together with the Swedish krona and U.S. dollar. Over the past years, Kommuninvest has added green bonds to its funding portfolio, which has allowed further expansion of its investor base. The agency has gradually reduced its exposure to nonbenchmark and callable funding, announced last year that they will no longer issue on the Uridashi market. Given that this exposure stood at about 1% in December 2021, we don't believe this will materially impact Kommuninvest's investor base, but could rather lead to more efficient funding in our view.

We view as positive Kommuninvest's strategy of closely matching assets with liabilities and predominantly relying on funding in krona. This strategy limits the need for derivatives and contributes to Kommuninvest's stable funding profile, with cumulative maturing assets covering about 120% of cumulative maturing liabilities for the next 12 months. However, both lending and borrowing are shorter term than peers', creating a mismatch of lending and funding to the investment cycle of the underlying capital investment and high roll-over rate. Although there is no legal obligation to roll over loans, municipalities expect Kommuninvest to do so and any significant failure would likely damage the franchise. We believe this limits the benefit of having shorter-term exposure, instead creating a roll-over risk in volatile markets.

Kommuninvest has a high level of expertise concerning liquidity portfolio management and execution, which enables stringent asset-liability management and cost efficiency. The liquidity portfolio comprises very liquid and short-term securities issued solely by highly rated government-related entities. The average duration is below 0.5 years, highlighting the very liquid nature of the holdings. In addition, we believe Kommuninvest exercises proactive liquidity management, which we view as important, in light of its shift to two-way credit support annexes in its derivatives counterparty portfolio.

Our liquidity ratio of about 1x for Kommuninvest indicates that the agency can meet its financial obligations over a one-year period. This ratio factors in potentially stressed market conditions, under which we assume the agency wouldn't have access to the capital markets. However, we understand that most loans to its members typically are renewed before maturity date and thereby do not necessarily result in a liquidity inflow for the agency. Given Kommuninvest's relatively short maturity profile in its lending, we believe this aspect is more burdensome to its liquidity position than for peers with longer average lending, which we incorporate into our overall view of Kommuninvest's liquidity position.

We expect Kommuninvest to pass on increased funding costs to its members so that tightening monetary conditions not will have a material impact on its net interest income. The higher interest rates and weaker krona will, however, have temporary impacts on profit, and thereby capital, because of unrealized negative changes in market value in its assets and liabilities. However, since Kommuninvest holds most of its position until maturity, this will likely not impact its cash flows.

Extremely high likelihood of support via a joint and several guarantee from all members

Kommuninvest has a vast membership base that is bound to it by a joint and several guarantee mechanism. We assess Kommuninvest's guarantee structure as predictable and immediately enforceable by law. Any investor, without a court order, could call upon any guaranteeing member to make good on a claim on Kommuninvest. The legal enforceability of the guarantee underpins our assessment of an integral link between the members and Kommuninvest. At the same time, we consider Kommuninvest holds a very important role in terms of providing cost-efficient funding to its members. As such, We consider the likelihood of extraordinary support from its largest members, with credit quality at about 'aa+' on average, to be extremely likely. This leads to an uplift to Kommuninvest's SACP, resulting in a long-term indicative rating of 'aa+'.

In addition, we believe that many of the other members outside the group of guaranteeing supporting members would also be liable and able to support Kommuninvest in a situation of distress. These member governments' aggregate revenue represents more than 20% of the entire LRG sector, underpinning our assessment of support mutualization. Therefore, we include an additional notch of uplift in the long-term issuer credit rating on Kommuninvest.

Key Statistics

Table 1

Kommuninvest i Sverige AB -- Selected Indicators						
(Mil. SEK)	--Year ended Dec. 31--					
	2022H1	2021	2020	2019	2018	2017
Business position						
Total adjusted assets	597,763.9	524,261.7	527,333.0	471,299.0	417,186.0	356,932.0
Customer loans (gross)	462,785.0	460,651.0	445,789.0	408,218.0	355,710.0	310,147.0
Growth in loans	1.9*	3.3	9.2	14.8	14.7	12.0
Net interest revenues	304€	681.0	711.0	828.0	886.0	881.0
Non interest expenses	254€	260.0	248.0	242.0	266.5	265.0
Capital and risk position						
Total liabilities	588,488.0	514,639.4	518,659.0	463,719.0	409,599.0	349,332.0
Total adjusted capital	9,254.3	9,124.7	8,476.0	7,581.0	7,588.0	7,599.0
Assets/capital	65.0	57.0	62.0	62.0	55.0	47.0
RAC before diversification (%)	45.6§	42.3§	39.3§	38.2§	41§	40.5
RAC after diversification (%)	14.5§	14.0§	13.9§	14.8§	17§	16.8
Gross nonperforming assets/gross loans	0.0	0.0	0.0	0.0	0.0	0.0
Funding and liquidity (%)						
Liquidity ratio with loan disbursement (1 year)	1.2§	1.1§	1.1§	1.1§	1.1§	1.0

Table 1

Kommuninvest i Sverige AB -- Selected Indicators (cont.)						
(Mil. SEK)	--Year ended Dec. 31--					
	2022H1	2021	2020	2019	2018	2017
Liquidity ratio without loan disbursement (1 year)	1.04§	1.1§	1.1§	1.1§	1.1§	1.1
Funding ratio (1 year)	1.05§	1.2§	1.2§	1.3§	1.2§	1.2

H1--First half. *Year-on-year. €Year-to-date, §As of end-June. RAC--Risk-adjusted capital. SEK--Swedish krona. N.A.--Not available. Source: S&P Global Ratings.

Ratings Score Snapshot

Table 2

Kommuninvest i Sverige AB -- Ratings Score Snapshot	
Issuer Credit Rating	AAA/Stable/A-1+
SACP	aa-
Enterprise Risk Profile	Strong (2)
PICRA	Strong (2)
Business Position	Strong (2)
Management & Governance	Very Strong (1)
Financial Risk Profile	Strong (2)
Capital Adequacy	Very Strong (1)
Funding and Liquidity	Positive and Adequate (3)
Support	(+2)
GRE Support	(+2)
Group Support	0
Additional Factors	(+1)

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of December 13, 2022)*

Kommuninvest i Sverige AB	
Issuer Credit Rating	AAA/Stable/A-1+

Ratings Detail (As Of December 13, 2022)*(cont.)

<i>Nordic Regional Scale</i>	--/--/K-1
Senior Unsecured	AAA
Issuer Credit Ratings History	
03-Jul-2006	AAA/Stable/A-1+
21-Nov-2008	<i>Nordic Regional Scale</i> --/--/K-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:

Sovereign and IPF EMEA; SOVIPF@spglobal.com

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