

## CREDIT OPINION

22 August 2023

Update



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### RATINGS

#### Kommuninvest i Sverige Aktiebolag

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

We assign Aaa long-term senior unsecured debt and issuer ratings to [Kommuninvest i Sverige Aktiebolag's](#) (Kommuninvest), a municipal lender, reflecting 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 (the 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 if the joint and several guarantee or its public policy mandate were diluted; or in case of sustained weak financial performance.

## Key indicators

Exhibit 1

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

	12-22 <sup>2</sup>	12-21 <sup>2</sup>	12-20 <sup>2</sup>	12-19 <sup>2</sup>	12-18 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (SEK Million)	536,382.0	517,110.5	509,188.6	461,265.5	409,193.1	7.0 <sup>4</sup>
Total Assets (USD Million)	51,478.7	57,158.5	62,001.3	49,275.0	46,153.8	2.8 <sup>4</sup>
Tangible Common Equity (SEK Million)	10,150.2	9,597.6	8,673.5	7,580.6	7,587.7	7.5 <sup>4</sup>
Tangible Common Equity (USD Million)	974.2	1,060.9	1,056.1	809.8	855.8	3.3 <sup>4</sup>
Tangible Common Equity / Risk Weighted Assets (%)	465.1	405.5	355.6	129.5	192.5	309.7 <sup>5</sup>
Net Interest Margin (%)	0.1	0.1	0.1	0.2	0.2	0.2 <sup>5</sup>
PPI / Average RWA (%)	-1.8	18.5	5.0	7.8	20.2	10.0 <sup>5</sup>
Net Income / Tangible Assets (%)	0.0	0.1	0.0	0.1	0.1	0.1 <sup>5</sup>
Cost / Income Ratio (%)	109.9	35.6	53.3	39.4	25.9	52.8 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	97.9	98.0	98.4	97.9	97.5	97.9 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	11.9	9.4	10.7	10.4	11.9	10.9 <sup>5</sup>

[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 Sverige Aktiebolag's (Kommuninvest) main purpose is to provide financing at competitive levels to Swedish municipalities and regions that are members of the Society. The Society owns 100% of the shares of Kommuninvest, and as of the end of December 2022, it had 294 members, of which 280 were municipalities and 14 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 zero risk weight according to Swedish accounting rules, which are in line with those agreed by some other European countries, such as Germany and France.

Kommuninvest was established in 1986 under the name of Kommuninvest i Örebro Län AB as a regional project for intermunicipal 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.

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

## Recent developments

In May 2021, the Swedish government presented a proposal that would oblige Kommuninvest to pay the proposed risk tax in full — the [risk tax proposal](#). The risk tax added a cost of about SEK257.3 million in 2022, which is likely to be a bit higher in 2023 and onwards. Because of Kommuninvest's limited profitability as a nonprofit organisation, the tax is passed on to municipalities and regions in the form of higher interest rates, albeit partly offset by cost savings by Kommuninvest. In addition, larger municipalities and regions that can tap the capital markets directly may choose to replace some of their funding at Kommuninvest by direct bond issuances. Kommuninvest expects the tax to hit small and medium-sized municipalities particularly because Kommuninvest is their sole source of financing.

In December 2021, the Swedish Parliament [approved](#) the risk tax, which was implemented on 1 January 2022. The government put in place a scheme to compensate municipalities and regions for higher costs in 2022 because of the tax. On 8 November 2022, the government proposed a [compensation scheme](#) for the municipalities that would cover all extra costs incurred because of the risk tax for the period 2023-25. However, the exemption for Kommuninvest is yet to be implemented.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody.com> for the most updated credit rating action information and rating history.

In March 2023, our [outlook](#) for Sweden's banking system remained stable, unchanged from last year. The outlook reflects our expectation that Sweden's banking system will remain broadly resilient to a recession in 2023. Financial pressure on borrowers from inflation and rising interest rates will strain asset quality. However, bank profitability will remain strong as higher rates support interest income, outweighing a limited rise in loan loss provisions. Swedish lenders will remain strongly capitalised. Geopolitical risks, particularly from the Russia-Ukraine conflict, remain significant.

### Detailed credit considerations

The financial data in the following sections is 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 Society, thus having recourse to 280 municipalities in Sweden (comprising 97% of all municipalities in the country) and 14 regions (67% of the regions) as of the end of December 2022. 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 Society consists exclusively of representatives from the RLG sector.

Kommuninvest reported a market share of RLG borrowings of 59% as of 31 December 2022, 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 most of the 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 (standalone) funding options, such as the City of Stockholm, to join its membership organisation.

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

We expect Kommuninvest's asset quality to remain very strong because of the high credit quality of the Swedish RLG sector, and Kommuninvest does not report any problem loans. The RLG sector is 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 equalisation 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.

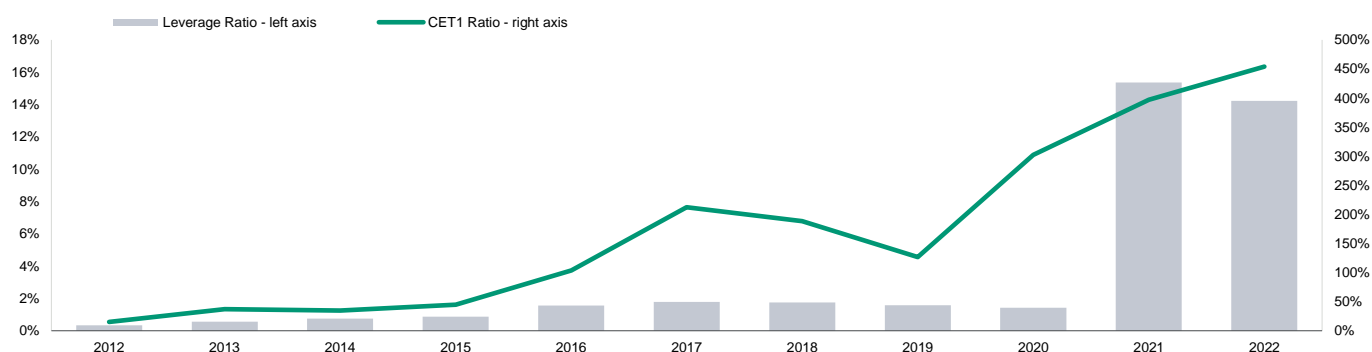
The compound annual growth of gross loans for the period 2017-21 was at around 10%. However, the pace of lending has decreased as a result of large scale government allocations in 2020 and 2021 to tackle the pandemic, and the lending portfolio grew by 2.2% in 2022 compared with 2021. The high inflationary environment is likely to result in lower investments within the municipal sector, resulting in continued lower funding needs. Furthermore, the Riksbank's purchase of municipal bonds in the first six months of 2021 squeezed spreads and decreased the difference between Kommuninvest's prices to customers and the prices at which municipalities (with their own funding programmes) could borrow directly. We expect these effects to abate as the Riksbank continues tightening its monetary policy, resulting in increased interest rate differentials between Kommuninvest and other RLG issuers.

### 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 454.1% as of the end of December 2022, up from 397.1% as of December 2021 (see Exhibit 2 for Kommuninvest's capital development). The very high CET1 ratio is because of the zero risk weight applied to its municipal lending. (In comparison, its Norway-based peer, [Kommunalbanken AS](#) (Aaa stable, a1)<sup>1</sup>, applies a 20% risk weight to its lending.)

Exhibit 2

#### Kommuninvest's CET1 and leverage ratios



The increase in leverage ratio from 2021 onwards is because of a different ratio definition based on the Capital Adequacy Regulation effective from 28 June 2021.

Source: Company reports

As of the end of December 2022, Kommuninvest's leverage ratio was 14.23%, according to the new Capital Requirements Regulation effective as of 28 June 2021, lower than the 15.36% as of year-end 2021 but significantly higher than the leverage requirement of 3%.

Kommuninvest's leverage ratio benefitted from the institution being classified as a Public Development Credit Institution under the proposed regulation by the European Commission, which allows all lending to RLGs and their companies to be deducted from the exposure (the denominator) in the leverage ratio. The new leverage ratio regulation came 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.<sup>2</sup>

### Financial performance is predictable, but net interest margin will be lower

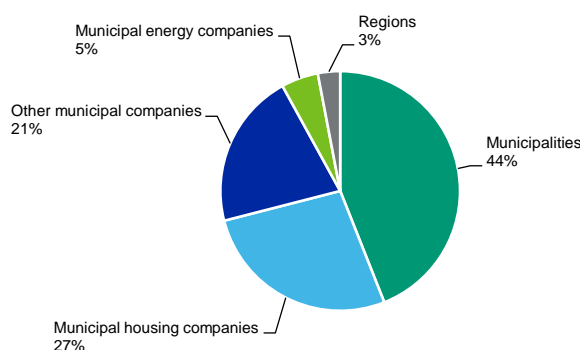
We expect Kommuninvest's profitability to be relatively weak as a result of its mandate to offer cost-effective lending and the recent decision of members (described below), but predictable.

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 additional margin 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 12 bps in 2022, compared to 23 bps before May 2018.

In 2022, Kommuninvest reported a loss of SEK42.1 million, compared with a SEK375.6 million profit a year earlier, mainly driven by unrealised market valuation losses (SEK339.5 million) and the introduction of the risk tax (SEK257.3 million). During 2022, operating expenses excluding the risk tax decreased by 5% to SEK247.3 million because of lower staff expenses. This was, however, partly offset by a SEK2 million higher resolution fee (resulting in a total fee of SEK25 million in 2022). Over the year, net interest income declined by 2.2%, despite an increase in lending by 2.2%, as a result of lower margins in the lending portfolio.

Exhibit 3

### Breakdown of Kommuninvest's loan portfolio by borrower category as of the end of December 2022 Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

Operating expenses, excluding the risk tax, are typically low for Kommuninvest because its niche business model allows for a slim organisation and the lender does not have any physical branches. We expect operating expenses to remain low because of the nature of its operations.

#### High reliance on funding, although with 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 programme - the 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 that 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 13.2% of lending or 11.6% of total assets as of December 2022. 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.

Kommuninvest finances its green loans, granted to finance municipal investment projects promoting low-carbon emissions and sustainable growth, by issuing green bonds, and as of the end of December 2022 the institution was one of the largest green bond issuers in the Nordic region. As of December 2022, the volume of approved green loans grew to SEK99.9 billion from SEK83.5 billion as of year-end 2021. Of the total approved green loans, SEK66.4 billion had been disbursed as of December 2022 (compared with SEK60.2 billion as of year-end 2021) to 563 projects, and 185 municipalities and regions.

In the autumn of 2020, the institution commenced granting social loans to the leading public housing companies in Municipality of Botkyrka and Municipality of Trollhättan, with a goal to build up a sufficient large lending volume to issue the first social bond. As of the end of December 2022, the portfolio of Social Sustainability Loans amounted to SEK1,746 million (2021: SEK614 million), of which SEK1,001 million (2021: SEK207 million) had been disbursed.

#### 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 SEK100 million, assuming a one percentage point parallel displacement of the yield curve, a small amount compared with shareholders' equity of SEK10.2 billion as of 31 December 2022.

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 and credit support annex agreements, 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
<b>KOMMUNINVEST I SVERIGE AKTIEBOLAG</b>	
Outlook	Stable
Issuer Rating	Aaa
Bkd Senior Unsecured	Aaa
Bkd Other Short Term	(P)P-1

Source: Moody's Investors Service

## Endnotes

- The ratings shown are Kommunalbanken's senior unsecured rating and Baseline Credit Assessment.
- Article 429a(d) of the European Commission'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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