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CREDIT OPINION
27 March 2018

Update

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RATINGS

Kommuninvest i Sverige Aktiebolag

Domicile	Sweden
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

We assign Aaa long-term senior unsecured debt and issuer ratings to Kommuninvest i Sverige AB, a Swedish municipal lender.

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 is strong but some uncertainty persists owing to new regulatory rules

THIS REPORT WAS REPUBLISHED ON 27 MARCH 2018 TO ADD OMITTED WORD "DAYS' ON PAGE 5.

Outlook

The outlook on Kommuninvest's ratings is stable, reflecting the joint and several guarantee it receives from RLGs and the RLG guarantors' stable financial performance.

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]

	12-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[3]	CAGR/Avg.[4]
Total Assets (SEK million)	350,550	353,776	330,965	302,441	272,129	6.5[5]
Total Assets (EUR million)	35,656	36,921	36,139	31,928	30,749	3.8[5]
Total Assets (USD million)	42,815	38,942	39,258	38,635	42,371	0.3[5]
Tangible Common Equity (SEK million)	7,599	6,491	4,363	2,361	1,710	45.2[5]
Tangible Common Equity (EUR million)	773	677	476	249	193	41.4[5]
Tangible Common Equity (USD million)	928	714	518	302	266	36.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	253.8	119.4	66.3	34.8	38.4	118.6[6]
Net Interest Margin (%)	0.2	0.2	0.2	0.3	0.4	0.3[7]
PPI / Average RWA (%)	26.1	6.1	10.6	10.9	15.1	13.4[6]
Net Income / Tangible Assets (%)	0.2	0.1	0.2	0.2	0.2	0.2[7]
Cost / Income Ratio (%)	19.3	36.8	30.5	28.0	24.5	27.8[7]
Market Funds / Tangible Banking Assets (%)	97.3	97.6	97.7	98.6	98.7	98.0[7]
Liquid Banking Assets / Tangible Banking Assets (%)	10.8	17.0	19.1	21.6	22.9	18.3[7]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; LOCAL GAAP [3] Basel II; LOCAL GAAP [4] May include rounding differences due to scale of reported amounts [5] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [6] Simple average of Basel III periods presented [7] Simple average of periods presented for the latest accounting regime.
Source: Moody's Financial Metrics

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 councils that are members of the Kommuninvest Co-operative Society ("the Society"). The Society owns 100% of the shares of Kommuninvest and has 288 members out of Sweden's total of 310 municipalities. 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 Cooperative Society, thus having recourse to 277 municipalities in Sweden (comprising around 96% of all municipalities in the country) and 11 councils and regions (or 55% of the county councils and regions) as of 2017.

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 councils 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 50% at December 2017, 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. We note that the number of members increased during 2017 to 288, after 2 new members joined in Q1.

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 central government is also an important positive driver for Kommuninvest's strong asset quality, as it is the central government that bears ultimate financial responsibility for the Swedish RLG sector.

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.

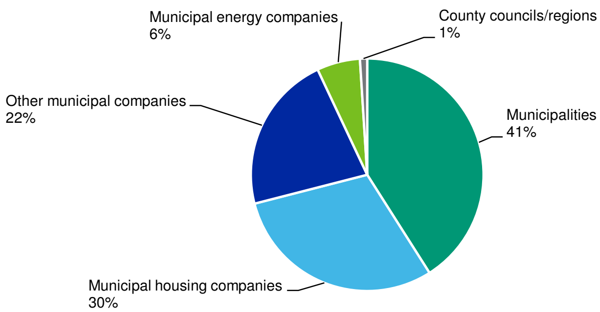
Financial performance is predictable as a result of its public policy mandate

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. Its 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.

Exhibit 2

Breakdown of Kommuninvest's Loan Portfolio by Borrower Category as of 2017

Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

Net interest income improved 15.7% year-on-year during 2017, which is primarily attributable to growth in lending and benign interest rates on short-term liquidity operations. 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 into 2018.

During the year operating expenses increased by 16% on the back of a higher resolution fee cost. Excluding this, Kommuninvest reported slightly higher staff costs and other expenses.

Overall, net income increased to SEK 876 million in 2017, from SEK 309.8 in 2016. However, this was primarily attributable to significant unrealised gains from financial transactions, the impact of which we expect not to materialise since Kommuninvest intends to hold its assets to maturity.

Overall, we consider operating expenses are low due to Kommuninvest's monoline business model: the lender is efficient, as it does not operate branches like commercial banks. We expect that 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. However, we understand that Kommuninvest in the future plans to continue sourcing a large proportion of funds from Sweden. This is likely to translate into lower credit counterparty risks, owing to a lesser need for currency hedging, but will also inevitably translate into a less diverse funding profile.

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. Kommuninvest's funding profile is more domestically orientated than its peers and as a result it is less reliant on callable funding, which is mainly sourced from Japan: only 4% of funding was Japanese Yen denominated at 2017, some of which we understand is callable. 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. In 2016 Kommuninvest issued its benchmark green bond, which now accounts for 4% of all issued securities.

Kommuninvest maintains a large liquidity portfolio, which amounted to 12.3% of lending or 10.6% of total assets as of year-end 2017. The bulk of the portfolio is of very strong asset quality and the exposure is mainly to sovereigns in Northern Europe and Swedish covered bonds. 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 some uncertainty persists owing to new regulatory rules

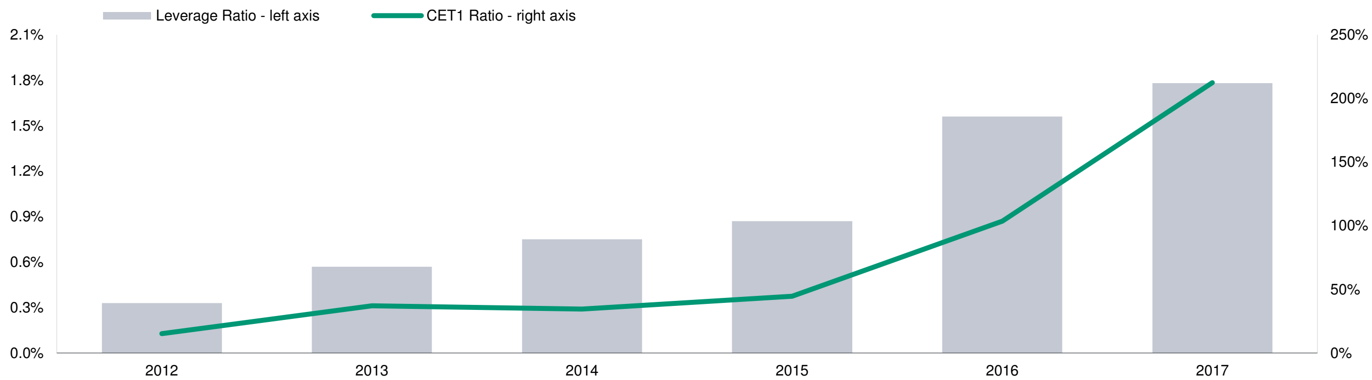
Kommuninvest is adequately capitalised relative to its risks: it has never recorded a loss on its lending. The institution reported a common equity Tier 1 (CET1) ratio of 212.4% at year-end 2017, up from 103.7% at year-end 2016 due to an increase on capital and decline in risk-weighted assets (see Exhibit 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, Kommuninvest's leverage ratio according to CRR was 1.78%, increased from 1.56% in 2016 but still below that of its Nordic peers and the 3% level that will become a requirement from 1 January 2019 according to the CRD/CRDIV regulation. [2]

Kommuninvest canceled SEK 1,000.0 million of subordinated debt in the fourth quarter of 2017, after which a new share issue was implemented for the corresponding amount to the members of the Society. At end 2017, this issuance was considered as on going as it was subject to regulatory approvals. The new share issue was approved as core Tier 1 capital by Finansinspektionen on 23 January 2018. Including the issuance of the new share capital, Kommuninvest's leverage ratio would increase to 2% based on end 2017 figures.

Kommuninvest plans to issue additional Tier 1 capital to the members of the Society if 3% were to become a requirement from January 2019. However, the details on the calculation of the legal minimum leverage ratio requirements for "public development credit institutions" (PDCI) amongst which Kommuninvest will most likely be included, are yet to be set by the European Commission (EC). Following the proposed amendments to the Capital Requirements Regulation (CRR) by the European Commission (published at end November 2016), PDCI's exposures to "regional governments, local authorities or public sector entities in relation to public sector investments" could be excluded from the denominator of the leverage ratio. While the final outcome is still uncertain, Kommuninvest's leverage ratio based on its current capital base could result in a leverage ratio in excess of the 3%.

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 at 2017.

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.

Ratings

Exhibit 4

Category	Moody's Rating
KOMMUNINVEST I SVERIGE AKTIEBOLAG	
Outlook	Stable
Issuer Rating	Aaa
Senior Unsecured	Aaa
Commercial Paper	P-1
Bkd Other Short Term	(P)P-1

Source: Moody's Investors Service

Endnotes

1 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.

2 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.

REPORT NUMBER 1115046

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