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Research Update:

Swedish Local Government Funding Agency Kommuninvest i Sverige Affirmed At 'AAA/A-1+'; Outlook Stable

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Overview

- We continue to view Kommuninvest's liquidity position as strong and expect the agency's financial indicators will remain robust, backed by prudent risk management policies.
- Kommuninvest displays a solid and slightly increasing market position, highly creditworthy borrowers, and very strong capital adequacy.
- We are therefore affirming our 'AAA/A-1+' ratings on Kommuninvest.
- The stable outlook reflects our view that Kommuninvest will maintain an important market share and role in funding Swedish local and regional governments (LRGs), while preserving its strong liquidity position over the next two years.

Rating Action

On Feb. 27, 2019, S&P Global Ratings affirmed its 'AAA' long-term and 'A-1+' short-term issuer credit ratings on Swedish local government funding agency Kommuninvest i Sverige AB. The outlook is stable.

At the same time, we affirmed our 'K-1' short-term Nordic regional scale rating on Kommuninvest.

Outlook

The stable outlook reflects our expectation that Kommuninvest's guarantee structure will remain unchanged and that the agency will continue to benefit from unwavering membership support. 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 successfully navigate instances of regulatory risk and be proactive, so that its low risk profile, lending services, and ultimately the execution of its public policy role, are not affected.

We could lower our rating over the next two years if Kommuninvest's stand-alone credit profile (SACP) came under significant pressure, for example if risk management faltered to the extent that its liquidity position notably deteriorated. This scenario could manifest itself through a widening funding

gap and a sharply reduced stressed liquidity position. Such financial pressure could hinder the agency's ability to fulfil its public policy mandate, which, combined with reduced confidence in the agency's risk management culture, would weigh on its SACP.

We could also consider a downgrade if we reassessed the creditworthiness of Kommuninvest's underlying municipal members or if we saw a risk that the joint and several guarantee structure could lose its stringency or be unwound.

We consider both our downside scenarios to be unlikely at this stage.

Rationale

The ratings reflect our view of Kommuninvest's competent management, which has fostered the agency's public policy role by remaining responsive to members' requirements, while prudently managing the financial risks associated with its expanding activities and regulatory requirements. The highly creditworthy position of Kommuninvest's borrowers and members, supported by key structural underpinnings, confirms our assessment of its very low risk business profile. In addition, Kommuninvest's strong risk-adjusted capitalization levels, positive funding position from excellent name recognition, large reliance on domestic funding, and strong liquidity provide it with buffers to weather most conceivable shocks and underpin our assessment of the agency's very strong financial risk profile.

We combine our assessments of Kommuninvest's enterprise risk profile and financial risk profile to arrive at an SACP of 'aa'. The agency's favorable position versus peers--notably regarding its extremely strong capital adequacy, prudent risk management, and arrangement to tap into central bank liquidity--support our assessment of the SACP. Furthermore, we regard Kommuninvest's guarantee structure as predictable, supportive, and immediately enforceable, which combined with the numerous and highly creditworthy local government members, lifts our long-term rating on Kommuninvest to 'AAA'.

Enterprise risk profile: Very strong management and status as a key lender to the highly creditworthy LRG sector underline a strong market position and public policy role

- Kommuninvest's management is following developments concerning leverage ratio regulation, while keeping an enhanced capital position and its members up to date, with contingency plans in place.
- Increasing market share on strong and further improving lending offerings underpins the agency's strong public policy role.
- A strong public industry country risk assessment (PICRA), owing to the wealthy and resilient national economy, well-developed financial sector, and the LRG sector's strong ties to 'AAA' rated sovereign.

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, county councils, or 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 very strong market position, given that its market share is steadily increasing and stood at 53% of total lending to the sector as of June 30, 2018. Kommuninvest's lending growth has remained consistently in the double-digit area, outpacing the sector average, suggesting a competitive offer.

Moreover, Kommuninvest revised its profitability target during 2018, removing the requirement to cater for the impact of IFRS swings. Such unrealized market value movements have typically added eight basis points (bps) to 10 bps to the profitability requirement. The new focus on underlying operating cash flow will thus allow for lower lending margins, providing scope for further lending expansion and entrenchment of Kommuninvest's public policy role. However, this will also lead to somewhat weaker profitability. We will continue to monitor the potential impact on the agency's liquidity coverage and capital adequacy.

Kommuninvest has a pronounced public policy mandate based on its ownership, support structure, niche lending, and non-profit 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. History suggests that Kommuninvest's role as a supplier of financing to the LRG sector increases in importance in periods of financial distress, such as in 2008 and 2009, when it was called upon to assume large local government financing portfolios from commercial banks.

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. Therefore, our PICRA for Sweden is strong.

We observe that uncertainties regarding the regulatory, mandated leverage ratio requirements are gradually diminishing. In a 2017 proposal, the European Commission revised the requirements for an entity to be labelled a public development credit institution (PDCI), most notably by relaxing the requisite for such an institution to be established under public law. Furthermore, the revised proposal states that even indirect exposures (such as lending to municipal companies) would be subject to exemption from the leverage regulation for PDCIs, in which case, Kommuninvest's leverage ratio would be close to 10%, comfortably above the 3% regulatory level. The Swedish Financial Supervisory Authority (FSA) will have the authority to determine which institutions are labelled PDCI. Nevertheless, we believe Kommuninvest, through its business model and structure, is well positioned to be granted such a status, which will allow it to pursue expansion without further extraordinary capital injections.

In preparation for the leverage ratio requirement, Kommuninvest has actively engaged with its members to secure a notable 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 contribution was reworked previously and offers possibilities for a further increase in members' capital contribution if required. We believe these developments highlight the constructive dialogue between Kommuninvest and its members, and strengthens our view of the agency's management and relationship with members.

With regards to requirements for minimum required eligible liabilities (MREL), the Swedish National Debt Office, which is the appointed resolution authority in Sweden, has concluded that Kommuninvest, despite its role as a systemically important domestic financial institution, is not required to adhere to MREL requirements due to its special nature and limited risk in lending operations.

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

- Kommuninvest exhibits very strong capital ratios, thanks notably to recent capital support from members.
- Tight matching of assets and liabilities, a treasury portfolio, and broad access to diversified funding underpin the agency's strong funding and liquidity.
- Benchmark funding in domestic currency limits the use of derivatives.

Kommuninvest has a very strong capital position. In a regulatory context, its Tier 1 capital ratio is impressive at 188%. This is largely due to the zero risk weighting of Kommuninvest's lending, and counterparty risk in derivatives are covered by a guarantee from its members. Nevertheless, Kommuninvest's equity has strengthened markedly in recent years, due to capital contributions from members and healthy retained earnings, in addition to the replacement of a SEK1 billion subordinated loan with a share issue subscribed by members in 2017. As such, all 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 for Kommuninvest is a very strong 41% before adjustments. After our adjustments, in particular for important single-name concentration relating to municipalities, the RAC ratio reduces to a still very strong 17%. However, over the past 10 years, loan concentration has steadily decreased due to the expansion of membership and lending. Exposure to the 20 largest borrowers was less than 30% of total lending in 2018, down from 45% in 2007. We expect our adjusted RAC ratio will continue to comfortably surpass 15% and remain a key support to Kommuninvest's financial risk profile.

Kommuninvest's funding strategy focuses on benchmark issuance in strategic markets. All markets are open to Kommuninvest thanks to excellent name recognition and its deep investor base. Securities issued by Kommuninvest are, in Sweden, among those considered to be of the highest quality in the

calculation of the liquidity coverage ratio. Funding instruments are primarily non-structured, with any structures typically conducted via Japanese retail Uridashi funding, where call- and index-linked options are typically embedded. The limit for callable funding stands at 10%, compared with the outstanding amount of approximately 2.6% as of June 30, 2018. Over the past few years, Kommuninvest has added green bonds to its funding portfolio, which has allowed further expansion of its investor base.

We view as positive Kommuninvest's strategy of predominantly relying on funding in Swedish krona through its domestic benchmark program, because this limits the need for derivatives and allows for close matching of assets with liabilities. This strategy contributes to Kommuninvest's stable funding profile, with cumulative maturing assets covering 120% of cumulative maturing liabilities for the next 12 months. With the growth of the Swedish benchmark program, transparency and liquidity in the secondary market have improved, leading to gradual tightening of the spread between Kommuninvest's issuances and Swedish government bonds. The outstanding amount under the local currency benchmark program is SEK183 billion or roughly around half of total funding.

Kommuninvest has a high level of expertise concerning liquidity portfolio management and execution, which has allowed more stringent asset-liability management and greater cost efficiency. As such, Kommuninvest has undergone a strategic change regarding its liquidity. Although the amount of liquidity has gradually declined, the nature of the exposures has changed. 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 observe that Kommuninvest remains proactive liquidity management, which we view as important, in light of its ongoing shift to two-way credit support annexes in its derivatives counterparty portfolio. At the same time, Kommuninvest continues to adapt its liquidity portfolio to situations that require it to post collateral. Taking this into account, our liquidity ratio of 1.11x 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.

We also observe that Kommuninvest, unlike most other public-sector funding agencies, is an approved monetary counterparty to its domestic central bank. This means that Kommuninvest can participate in credit facilities from the Swedish Riksbank and can borrow directly from the Riksbank against collateral from its liquidity portfolio. However, its lending book is not eligible as collateral in this regard.

An extremely strong likelihood of support via a joint and several guarantee from all members

- Under the joint and several guarantee mechanism for Kommuninvest, we expect the largest potential supporting members, with credit quality at

about 'aa+' on average, will provide support to the agency if needed.

- We assess the likelihood of extraordinary support from that group of members to be extremely high, thanks to what we view as the agency's integral link with and very important role for, the municipal government members. This leads to an uplift to Kommuninvest's stand-alone credit profile, resulting in an indicative long-term issuer credit rating (ICR) of 'aa+'.
- We also factor in what we regard as support mutualization from additional members, outside the group of supporting members, and their strong investment-grade credit profiles, by including one notch of uplift to the indicative ICR, which leads to the final rating of 'AAA'.

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. We observe that 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 to hold a very important role in terms of providing cost-efficient funding to its members.

In addition, we believe that a large number of other members, outside the group of potential supporting members, would also be liable and able to support Kommuninvest in a situation of distress. These member governments' aggregate revenues represent 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.

Kommuninvest i Sverige AB--Selected Indicators

(Mil. SEK)	--Year ended Dec. 31--					
	2018H1	2017	2016	2015	2014	2013
Business Position						
Total adjusted assets	430,742	356,932	361,712	340,611	312,051	277,459
Customer loans (gross)	331,405	310,147	276,982	254,422	222,804	208,644
Growth in loans	6.9	12.0	8.9	14.2	6.8	3.8
Net interest revenues	454	881	762	799	915	970
Non interest expenses	138	265	228	293	284	245
Capital & Risk Position						
Total liabilities	422,848	349,332	355,211	336,282	309,677	275,731
Total adjusted capital	7,894.0	7,599.0	6,491.0	4,363.0	2,361.0	1,710.0
Assets/capital	54.0	47.0	56.0	78.0	132.0	162.0
RAC before diversification (%)	41.0	40.5	N.A.	N.A.	N.A.	N.A.
RAC after diversification (%)	17.0	16.8	N.A.	N.A.	N.A.	N.A.

Kommuninvest i Sverige AB--Selected Indicators (cont.)

(Mil. SEK)	--Year ended Dec. 31--					
	2018H1	2017	2016	2015	2014	2013
Gross nonperforming assets/gross loans	0	0	0	0	0	0
Funding & Liquidity						
Liquidity ratio with loan disbursement (1 year)	1.1	1.0	N.A.	N.A.	N.A.	N.A.
Liquidity ratio without loan disbursement (1 year)	1.1	1.1	N.A.	N.A.	N.A.	N.A.
Funding ratio (1 year)	1.2	1.2	N.A.	N.A.	N.A.	N.A.

SEK--Swedish krona. N.A.--Not available. Source: S&P Global Ratings.

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 and governance	Very Strong (1)
Financial risk profile	Strong (2)
Capital adequacy	Very strong (1)
Funding and Liquidity	Positive and Strong (2)
Support	1
GRE Support	1
Group Support	0
Additional Factors	+1

Related Criteria

- 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: Stand-Alone Credit Profiles: One Component Of A Rating,

Oct. 1, 2010

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- S&P Global Ratings Definitions, Oct. 31, 2018
- RFC Process Summary: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018 [Section: Assumptions For Liquidity Gap Analysis]
- Credit FAQ: A Closer Look At The New Public-Sector Funding Agencies Criteria, May 22, 2018
- 10 Public-Sector Funding Agencies Placed Under Criteria Observation On Publication Of New Criteria, May 22, 2018

Ratings List

Ratings Affirmed

Kommuninvest i Sverige AB

Issuer Credit Rating	AAA/Stable/A-1+
Nordic Regional Scale	--/--/K-1
Senior Unsecured	AAA

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

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