MOODY'S
INVESTORS SERVICE

CREDIT OPINION
26 March 2019

Update

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RATINGS

Domicile	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.

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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 trending downwards as its balance sheet grows, but is not expected to constrain its business.

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]

	12-18[2]	12-17[2]	12-16[2]	12-15[2]	12-14[2]	CAGR/Avg.[3]
Total Assets (SEK million)	409,193	350,550	353,776	330,965	302,441	7.9[4]
Total Assets (EUR million)	40,374	35,656	36,921	36,139	31,928	6.0[4]
Total Assets (USD million)	46,154	42,815	38,942	39,258	38,635	4.5[4]
Tangible Common Equity (SEK million)	7,588	7,599	6,491	4,363	2,361	33.9[4]
Tangible Common Equity (EUR million)	749	773	677	476	249	31.6[4]
Tangible Common Equity (USD million)	856	928	714	518	302	29.8[4]
Tangible Common Equity / Risk Weighted Assets (%)	192.5	253.8	119.4	66.3	34.8	133.4[5]
Net Interest Margin (%)	0.2	0.2	0.2	0.2	0.3	0.3[6]
PPI / Average RWA (%)	20.2	26.1	6.1	10.6	10.9	14.8[5]
Net Income / Tangible Assets (%)	0.1	0.2	0.1	0.2	0.2	0.2[6]
Cost / Income Ratio (%)	25.9	19.3	36.8	30.5	28.0	28.1[6]
Market Funds / Tangible Banking Assets (%)	97.5	97.3	97.6	97.7	98.6	97.7[6]
Liquid Banking Assets / Tangible Banking Assets (%)	11.9	10.8	17.0	19.1	21.6	16.1[6]

[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 due to scale of reported amounts. [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5] Simple average of Basel III periods presented. [6] 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 regions that are members of the Kommuninvest Co-operative Society ("the Society"). The Society owns 100% of the shares of Kommuninvest and as of January 2019 had 289 members, of which 277 were municipalities and 12 were county regions with an additional member - Region Blekinge joining as a member of the Kommuinvest Cooperative Society at the beginning of 2019. 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 12 regions (60% of the county regions) as of January 2019.

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 regions 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 55% as of December 2018, 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.

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.

In 2015 Kommuninvest introduced Green loans to finance environmental and climate-related investments. Since the launch, the volume of approved Green loans has increased to SEK 39.5 billion as of end - December 2018. By the end of 2018 nearly 109 municipalities and county regions had financed approximately 232 investment projects with Green loans from Kommuninvest and the lender's target is to reach 15-20% of total lending.

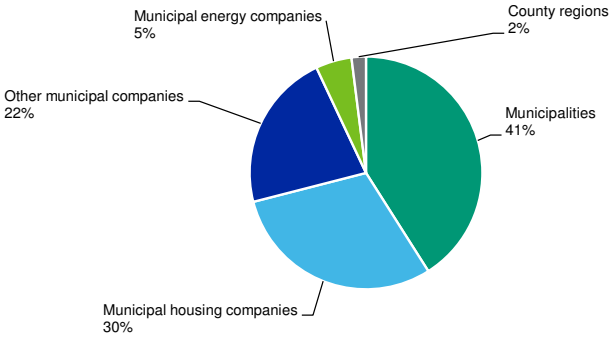
Financial performance is predictable but due to members' decisions, net interest margins will decline

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. However, as of May 2018 following the discussion between the members, lending products' prices have been cut by removing part of the marginal supplement that was previously included to cover negative unrealised changes in market values. As a result the margin decreases to 14.5 basis points (bps) as of December 2018 from 23 bps prior to May 2018. Therefore Kommuninvest expects a decrease in future net profit.

Exhibit 2

Breakdown of Kommuninvest's Loan Portfolio by Borrower Category as of December 2018

Kommuninvest mainly lends to municipalities and municipal housing companies



Source: Company reports

Net interest income improved 0.5% year-on-year during 2018, 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 in 2019.

During 2018 operating expenses increased by 0.9% from the same period of last year, on the back of a higher resolution fee of SEK69.1 million, which accounted for 25% of Kommuninvest's total expenses for 2018. Excluding this, Kommuninvest reported slightly higher staff costs.

Overall, net income decreased to SEK 586.1 million as of December 2018, from SEK 876 million as of December 2017. However, this was primarily attributable to decrease in unrealised gains from financial transactions, the impact of which we expect not to materialise since Kommuninvest intends to hold its assets to maturity.

Operating expenses are low due to Kommuninvest's monoline business model. An additional contributing factor to the lender's efficiency is the absence branches, unlike commercial banks. We expect 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. We understand that the lender's funding strategy is based on diversified funding in terms of funding markets, currencies, products and investor categories. Kommuninvest is making an effort to maintain an even distribution between domestic and international funding over time. As of June 2018, Kommuninvest issued the largest single funding in USD to date for USD 2.5 billion. During 2018, Kommuninvest raised SEK 138.8 billion of long-term debt instruments with maturity of more than a year. Over the year the main focus was on the three strategic funding markets - SEK, USD and Uridashi.

In 2016 Kommuninvest issued its benchmark green bond, and green bonds accounted for 5% of all issued securities as of year-end 2018. Demand for the lender's green bonds has been very high and all issues have been oversubscribed. By the end 2018, 109 municipalities and county regions had financed approximately 232 investment projects with SEK 39.5 billion in Green Loans from Kommuninvest. This has made Kommuninvest Sweden's largest issuer of green bonds.

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. 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.

Kommuninvest maintains a large liquidity portfolio, which amounted to 13.6% of lending or 11.6% of total assets as of December 2018. The bulk of the portfolio is of very strong asset quality and the exposure is mainly to sovereigns in Northern Europe and central banks. 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 declining due to balance sheet growth

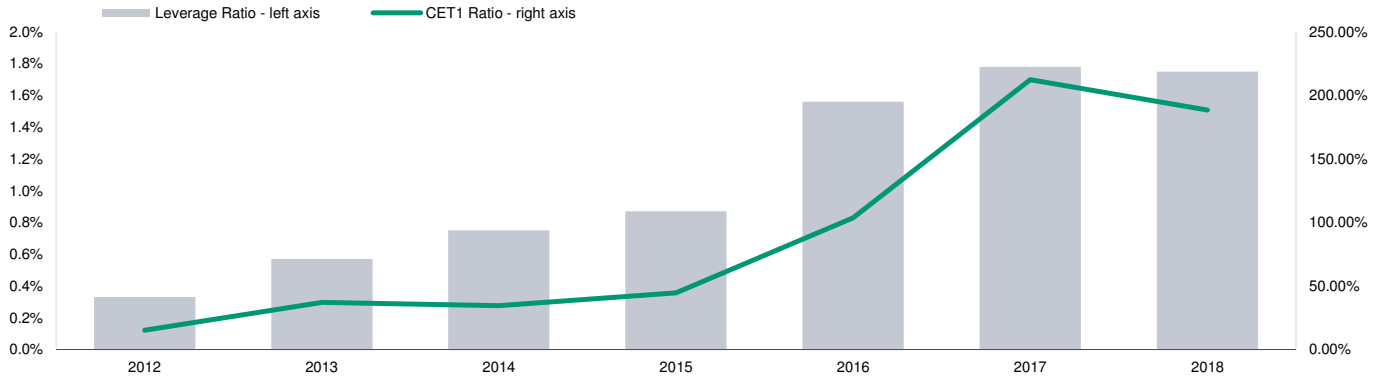
Kommuninvest is adequately capitalised relative to its risks: it has never recorded a loss on its lending. The institution reported a common equity Tier 1 (CET1) ratio of 188.4% as of December 2018, down from 212.4% as of December 2017 (see Exhibit 3 for Kommuninvest's capital development).

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 1.75%, decreased from 1.78% in 2017 and still below its Nordic peers. However, if Kommuninvest is classified as Public Development Credit Institution under the proposed regulations by the European Commission, all lending to municipality members and their companies will be deducted from the leverage ratio. The new leverage ratio regulation is expected to come into force (according to the proposal) on 1 January 2020 with a transition period of 2 years. [2]

According to Kommuninvest, it meets all needed 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. While the final outcome is still uncertain and expected to be communicated during the first quarter of 2019, Kommuninvest's leverage ratio based on its current capital base would result in a leverage ratio in excess of the 3%.

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. As of December 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 as of 23 January 2018. In addition, unrestricted equity has increased through profit carried forward and therefore Kommuninvest's capital base increased by SEK 1,066 million in 2018.

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 as of December 2018.

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.

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