Eiendomskreditt AS

Full Rating Report

COVERED BOND RATING

AAA

ISSUER RATINGS

LONG-TERM RATING

BBB

OUTLOOK

Stable

SHORT-TERM RATING

N3

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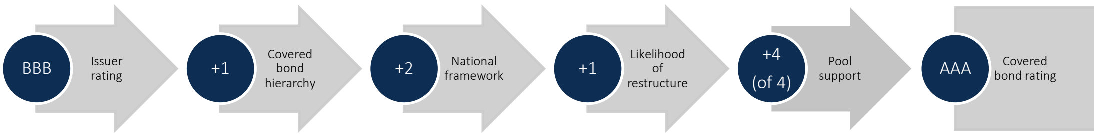
RATING RATIONALE

Our 'AAA' issue rating on covered bonds issued by Norway-based mortgage company Eiendomskreditt AS is ultimately based on our 'BBB' issuer rating on the company and its role as a commercial real estate lender and partner for small and mid-sized Norwegian banks. Our covered bond ratings are supported by our 'a+' qualitative assessment and our analysis of the potential for up to four notches of support from the cover pool, which indicates 'AAA' level support for bondholders in the unlikely event that the pool were to become a standalone entity.

Figure 1. Eiendomskreditt covered bond rating components



Given the stable outlook on the issuer rating on Eiendomskreditt we expect the covered bond ratings to remain stable. The current assessment of pool support is a maximum of four notches.

RATING STRENGTHS:

- Moderate loan-to-value (LTV) profile of commercial mortgages and geographical diversity of cover pool.
- Low historical credit losses.
- Relationship with partner banks.

COVERED BOND RATING DRIVERS:

- Increased credit risk due to higher LTV on commercial mortgages.
- Multi-notch reduction in our issuer rating on Eiendomskreditt.
- Material reduction in overcollateralisation resulting in weaker cover pool support.

Figure 2. Eiendomskreditt cover pool characteristics, Q4 2021–Q4 2023

	Q4 2021	Q2 2022	Q4 2022	Q2 2023	Q4 2023
Eligible cover pool assets (NOKm)	5,908.6	5,776.5	6,118.0	5,878.3	6,271.6
Outstanding covered bonds (NOKm)	4,660.0	4,585.0	4,955.0	4,700.0	4,809.0
Legal overcollateralisation (%)	26.8	26.0	23.5	25.1	30.4
Weighted-average LTV (%)	47.2	42.6	44.7	45.8	46.2
Average loan maturity (years)	5.9	5.8	5.7	5.6	4.8
Average bond maturity (years)	3.0	3.0	3.0	2.9	2.7
Average loan size (NOKm)	21.8	22.0	24.6	25.4	26.8
Commercial property share (%)	88.2	85.7	87.1	85.5	87.5
Residential rental property share (%)	11.8	14.3	12.9	14.5	12.5
>90 day past due loans (bps)	0.34	0.69	0.90	0.53	3.23
10 largest borrowers share (%)	24.0	25.5	23.8	25.0	24.4

Source: Eiendomskreditt (https://eiendomskreditt.no/investor/cover-pool/).

Figure 3. Loan per property by region (NOKbn), 30 Sep. 2023

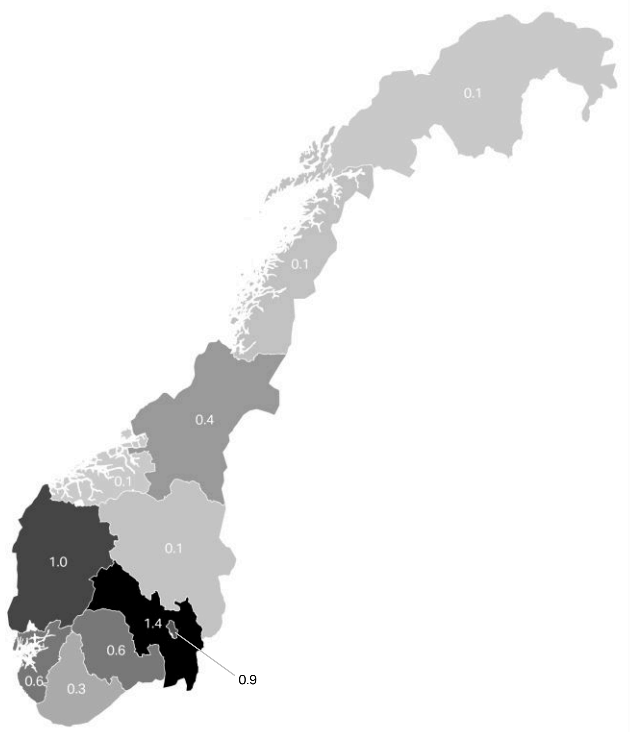


Figure 4. Weighted LTV by region (%), 30 Sep. 2023

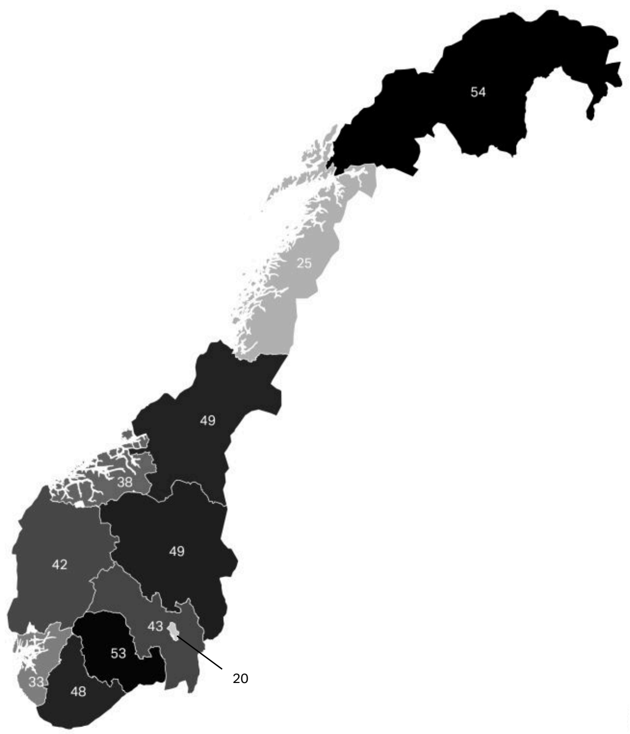


Figure 5. Average loan size per property by region (NOKm), 30 Sep. 2023

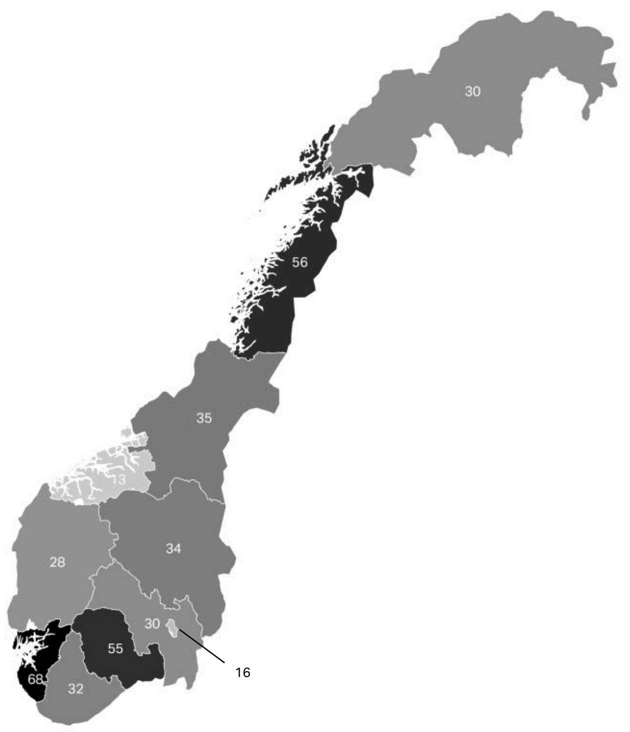
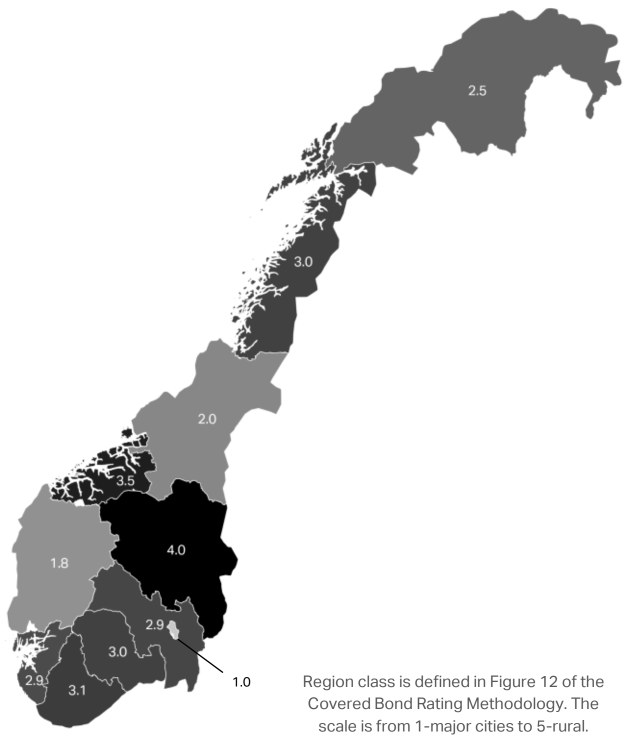


Figure 6. Average class of properties by region, 30 Sep. 2023



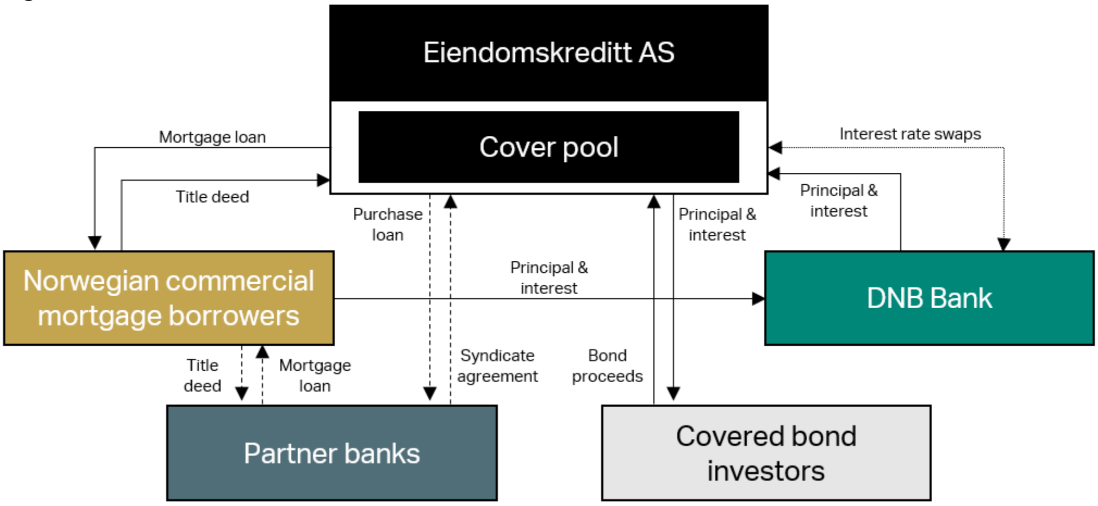
Region class is defined in Figure 12 of the Covered Bond Rating Methodology. The scale is from 1-major cities to 5-rural.

COMPANY PROFILE

Eiendomskreditt was established in 1997 and is a regulated mortgage credit institution based in Bergen, Norway. The company is a specialised mortgage provider, financing commercial real estate for SME borrowers, multi-family rental housing and housing association mortgages. The company has issued covered bonds in Norway since 2009 and received approval to issue European Covered Bond (Premium) covered bonds in 2022. As of 31 Dec. 2023, virtually all loans are included in the cover pool. Most of the financed properties are in metropolitan areas of Norway's largest regions, namely Oslo, Viken, Rogaland and Vestland.

Meteva AS (Trond Mohn) and R Transit AS (The Rieber family) each own 30% of the company. In addition, over 60 Norwegian savings banks, Voss Veksel og Landmansbank, and Pareto Bank own over 38%. Eiendomskreditt is independent and not aligned with any Norwegian savings bank alliances, however all of these alliances are represented among the owners.

Figure 7. Eiendomskreditt covered bond structure



QUALITATIVE ASSESSMENT

Qualitative assessment 'a+'

Our qualitative assessment of Eiendomskreditt's covered bonds is 'a+', reflecting the issuer rating on the company and the notches of support described below. Our qualitative assessment indicates a relatively low likelihood that the cover pool will become a standalone entity, and a high likelihood that bondholders will receive timely coupon and principal payments. However, given that the qualitative assessment does not reach the 'aaa' level, a bottom-up analysis of the cover pool was undertaken to determine the ability of the underlying assets to support timely payments and full repayment.

Issuer rating 'BBB'

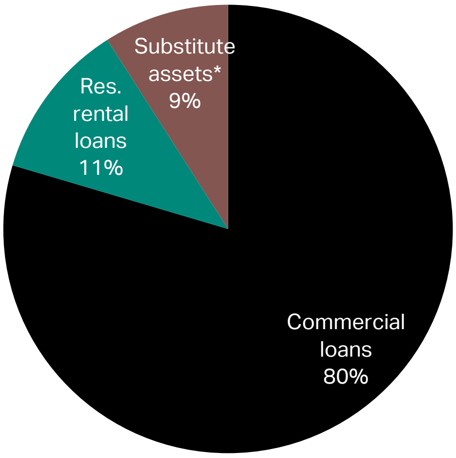
The repayment capacity for covered bonds is linked to Eiendomskreditt's own credit quality. Our 'BBB' issuer rating on Eiendomskreditt reflects the company's moderate risk appetite, conservative underwriting, strong capital position, modest competitive position, and expectations of strong cost efficiency and modest loan losses. The outlook on our issuer rating on Eiendomskreditt is stable. Details of the issuer rating rationale are provided at the end of this report.

Senior unsecured issue rating in line with the issuer rating

Eiendomskreditt's liability structure consists primarily of covered bonds, which are already excluded from bail-in according to the EU's Bank Recovery and Resolution Directive (BRRD), which has been in effect in Norway since 1 Jan. 2019 (BRRD II has been in effect since 1 Jun. 2022). In addition, as of 15 Feb. 2024, the company has three outstanding senior unsecured bonds totalling NOK 610m with NOK 300m maturing in October 2024, and the remainder maturing in December 2025 and August 2026, and NOK 80m in outstanding senior unsecured commercial paper.

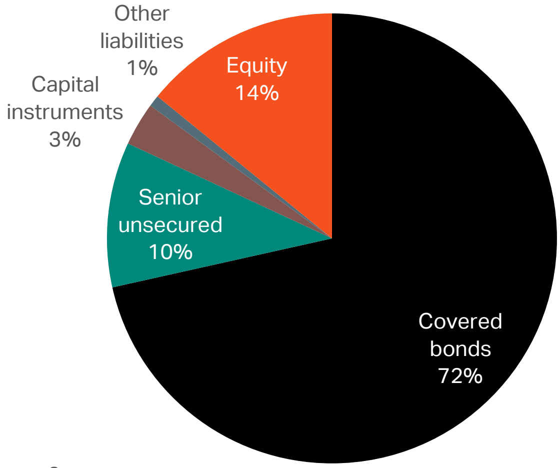
We consider covered bonds to have structural priority above other liabilities, given the preferential claim of the cover pool over most the company's loan assets in the event of default. As a result, we add an additional notch of uplift to the covered bond ratings in comparison with ratings on the company's senior unsecured instruments. This reflects the BRRD's explicit definition of covered bonds as having priority claim over senior unsecured debt obligations in the default hierarchy of financial institutions. The directive also limits the potential for bail-in of covered bonds in instances in which covered bond liabilities exceed eligible cover pool assets. The Norwegian regulator uses independent oversight of the cover pool register to ensure that liabilities never exceed the value of pool assets.

Figure 8. Eiendomskreditt loans and assets, 31 Dec. 2023



Source: company. *per Q3 2023 57% cash and 43% bonds.

Figure 9. Eiendomskreditt liabilities and equity, 31 Dec. 2023



Source: company.

Following Norway's adoption of the BRRD, the creditor hierarchy for Norwegian banks is as follows:

1. Secured or collateralised obligations, including covered bonds.
2. Guaranteed deposits.
3. Unguaranteed household and SME deposits.
4. Senior preferred debt and wholesale and institutional deposits.
5. Senior non-preferred debt.
6. Subordinated debt.
7. Tier 2 capital instruments.
8. Additional Tier 1 instruments.
9. Equity.

National regulations provide two-notch uplift to covered bond ratings

We consider the legal framework for Norwegian covered bonds as supportive of the creditworthiness of covered bonds secured by residential and commercial mortgage loans, adding an additional two notches to the rating on Eiendomskreditt's covered bonds.

Norwegian covered bond legislation was introduced in 2007 and the law is governed by the Norwegian Financial Institutions Act (*Lov om finansforetak og finanskonsern) and related regulation* (*Forskrift om finansforetak og finanskonsern*). On 8 Jul. 2022 Norway implemented its version of the EU's updated covered bond directive.

The Norwegian Covered Bonds Issuance Act ensures:

- the bankruptcy remoteness of the cover pool and the maintenance of an accurate register of pool assets, including derivative agreements;
- covered bond investors' preferential claim to pool assets;
- covered bond investors' pari passu claim with other senior creditors to additional assets;
- independent monitoring of the cover pool appointed by the Norwegian Financial Supervisory Authority;
- a liquidity buffer requirement covering 180 days of net outflows using extended maturity dates for extendable maturity (soft bullet) bonds;
- soft bullet bonds are only extended if approved by the Norwegian regulator to avoid insolvency;

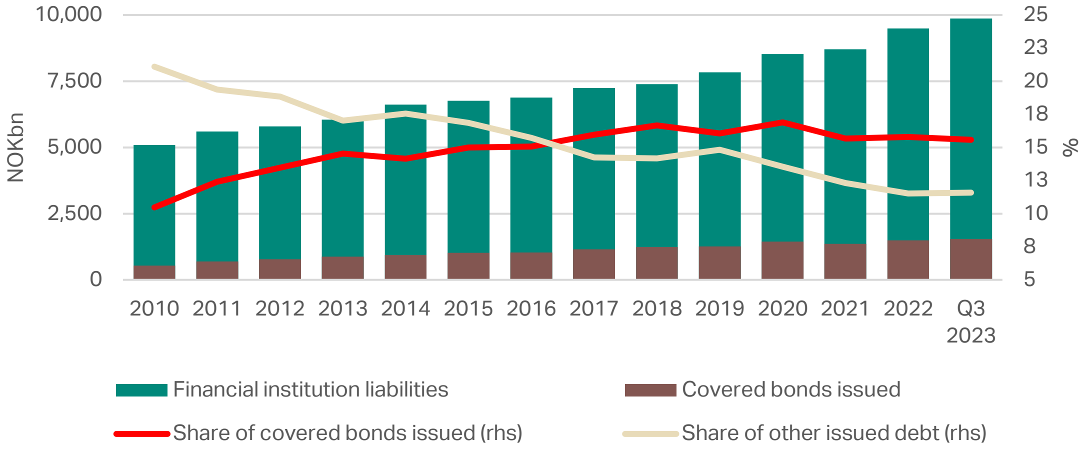
- acceptance of lower-rated derivative counterparties, where necessary, to avoid counterparty concentrations;
- separate bank accounts for pool-related transactions; and
- the national administrator's authority to borrow and issue derivatives, as well as sell assets, if necessary to maintain a balance between incoming and outgoing cash flows.

In addition, the law sets out the following conditions for cover pool assets:

- property exposures should be located in Norway or other states of the European Economic Area;
- maximum LTV of 80% for residential mortgages and 60% for holiday properties included as eligible security;
- maximum LTV of 60% for commercial and agricultural mortgages included as eligible security, which can be increased to 70% if overcollateralisation in the cover pool exceeds 10% (Agricultural mortgages are defined as either primarily residential or commercial);
- maximum of 5% single-name concentration in the cover pool;
- the amount of additional liquid security that can be pledged in the cover pool is 20%; and
- the nominal value of eligible pool assets must exceed bond liabilities by 5%, i.e. overcollateralisation of 5%.

In addition to strong national regulations, covered bonds are a significant part of the Norwegian financial fabric and constitute a material portion of domestic bank financing. The country had over NOK 1.5 trillion in outstanding covered bonds as of September 2023, constituting a material proportion of low-risk market assets given only NOK 0.6 trillion in outstanding government debt. Covered bonds represent 16% of Norwegian monetary financial institution liabilities, making them one of the most important financing sources in the country's banking system, behind only customer deposits. The long-term proportion of covered bond financing has decreased slightly from a peak in 2021 level, but we expect it to remain above 15%, as it has been since 2015.

Figure 10. Norwegian financial institutions' share of liabilities by type, 2010-Sep. 2023



Source: Statistics Norway, Finance Norway

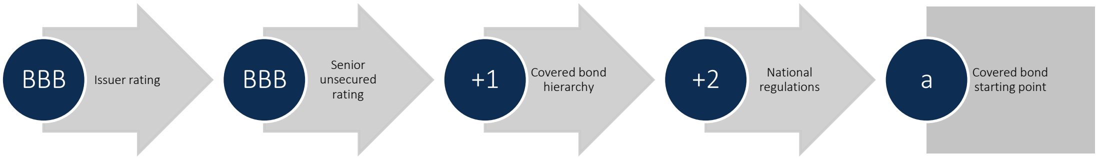
Uncertain likelihood of restructuring leads to 'a+' qualitative assessment

The possibility of resolution or restructuring is an important component in our evaluation of the likelihood of Eiendomskreditt's cover pool being run down by an administrator. In our view, we believe there is the potential that a restructuring would allow the cover pool to continue servicing the covered bonds as a going concern under new ownership. However, the likelihood is uncertain, resulting in only one notch of uplift.

We consider the resolution of Eiendomskreditt as unlikely given its relatively small size and niche profile. The company has not been named as a systemically important financial institution in Norway, nor has the issuer received any minimum requirement for own funds and eligible liabilities requirements from the Norwegian regulator. Neither does our assessment consider that default by Eiendomskreditt, with nearly NOK 5bn in outstanding covered bonds, would be material enough to risk the financial stability of the banking market or to negatively affect the reputation of Norwegian covered bonds among investors.

However, we consider that default by Eiendomskreditt could have repercussions for the financial situation of its partner banks. For this reason, we believe it likely that a high proportion of still-performing loans would be repatriated by partner banks with the means to finance their customers' loans on their own balance sheet. An increase in prepayments of pool loans would support the liquidity of the cover pool. After this initial effect, we believe that larger commercial or regional banks could acquire the remaining performing assets and support the cover pool as a going concern.

Figure 11. Eiendomskreditt covered bond starting point



Our evaluation of the impact of restructuring compares the implicit default frequency of the covered bond starting point with the probability of the covered bonds being protected in a restructuring. We assess the probability of restructuring as 33%, reflecting considerable uncertainty compared with an issuer with a high likelihood of resolution or a pool of residential mortgages. This results in a qualitative assessment of 'a+' (see Figure 12).

Figure 12. Qualitative assessment based on the covered bond starting point and the probability of resolution or restructuring

COVERED BOND STARTING POINT	95%	67%	33%	0%
aaa	aaa	aaa	aaa	aaa
aa+	aaa	aaa	aaa	aa+
aa	aaa	aaa	aa+	aa
aa-	aaa	aa+	aa	aa-
a+	aaa	aa	aa-	a+
a	aaa	aa	**a+**	a
a-	aa+	aa-	a	a-

COVER POOL ANALYSIS AND STRESS TESTING

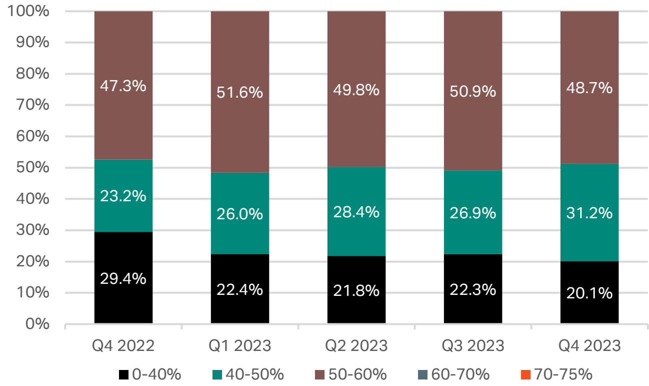
Our cover pool analysis results in four additional notches of support from the security in the cover pool. In combination with the qualitative assessment of 'a+', the cover pool analysis supports the 'AAA' rating on Eiendomskreditt's covered bonds. We have used loan, property and borrower level details from Eiendomskreditt to analyse pool assets and conduct sensitivity analysis and credit risk stress testing on the cover pool according to our criteria. In addition, we have complemented detailed data with data available from Eiendomskreditt's quarterly covered bond summaries to stress cash flows according to the standard stress assumptions specified in our criteria.

Our stress test results in a shortfall in the fifth year of the most difficult stress scenario. We have no overcollateralisation requirement in our methodology but stress pool assets to determine the ability to fulfil commitments as a standalone entity. Accordingly, overcollateralisation is a key component of an issuer's ability to repay bondholders in full in the event of a rundown.

LTV levels low due to conservative underwriting, but yields are rising

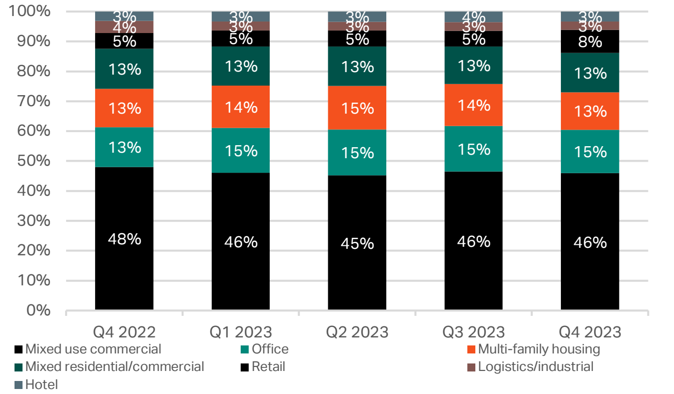
The following charts (Figures 13-22) provide an overview of the cover pool assets. As of 31 Dec. 2023, the pool included NOK 6.3bn in eligible commercial, housing association and multi-family housing mortgage loans, i.e. loans qualifying for overcollateralisation, LTV and loan performance requirements. This results in a legal overcollateralisation of 30.4%. In addition, Eiendomskreditt had a balance of NOK 192m in non-eligible loans in the cover pool, resulting in total overcollateralisation of 34.4%.

Figure 13. Share of pool by whole-loan LTV, last five quarters



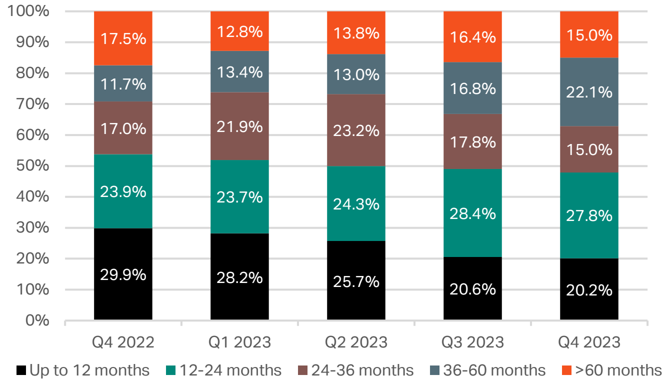
Source: company. Entire eligible loan amount in respective bucket based on borrowers' LTV.

Figure 14. Share of pool by property type, last five quarters



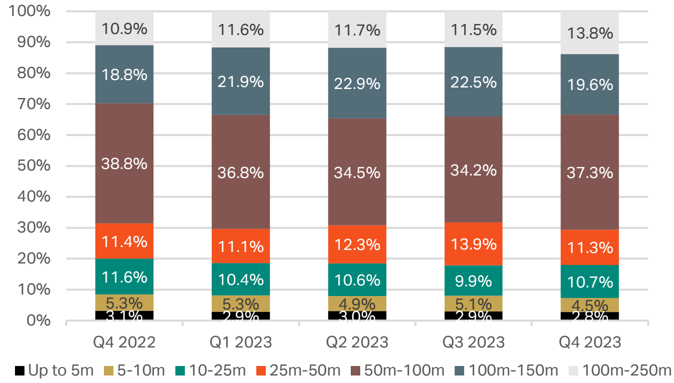
Source: company.

Figure 15. Share of pool by loan seasoning, last five quarters



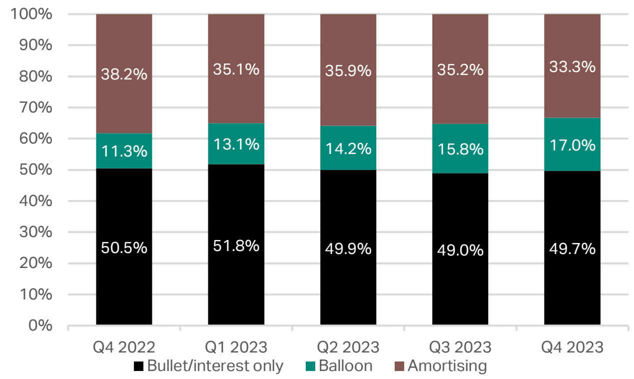
Source: company.

Figure 16. Share of pool by loan size (NOK), last five quarters



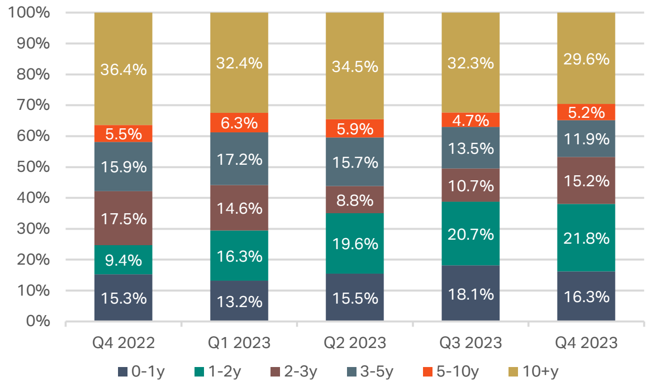
Source: company.

Figure 17. Share of pool by payment profile, last five quarters



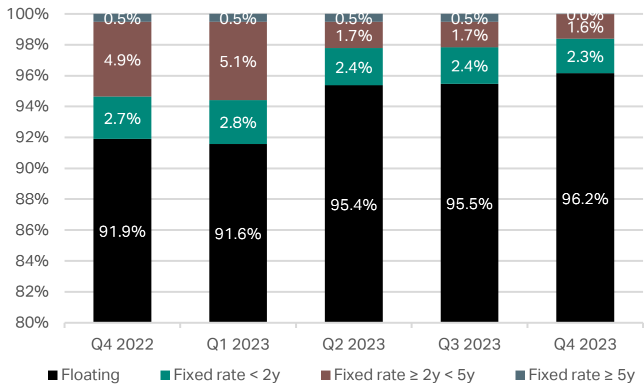
Source: company.

Figure 18. Share of pool by maturity, last five quarters



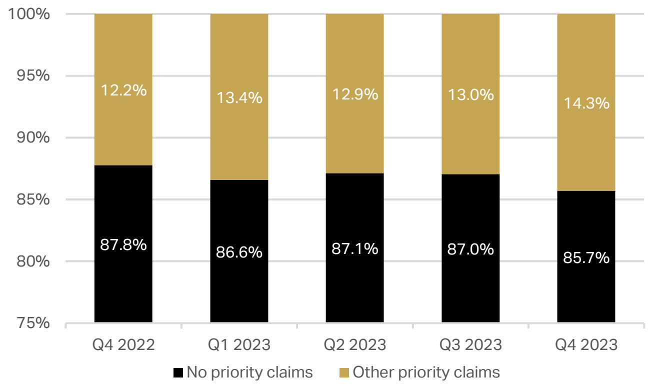
Source: company.

Figure 19. Share of pool by interest rate, last five quarters



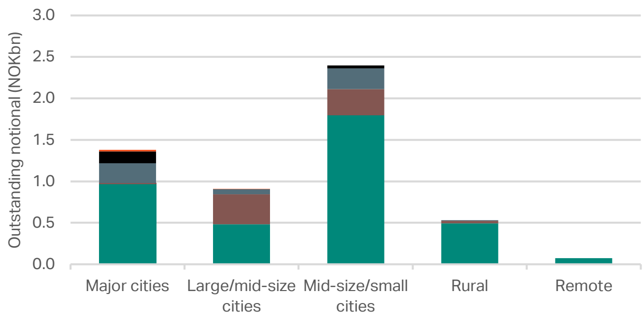
Source: company.

Figure 20. Share of pool by priority claims, last five quarters



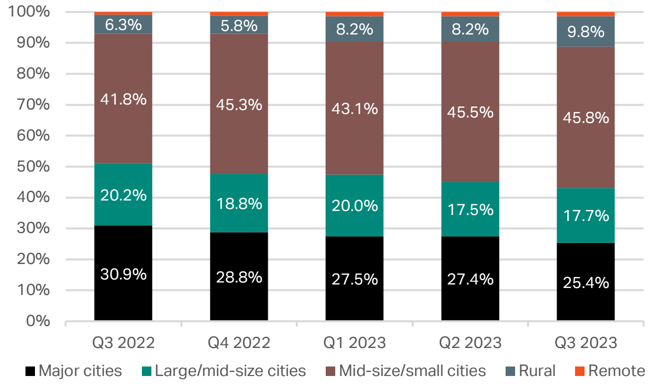
Based on cover pool data,

Figure 21. Region class and property type, 30 Sept. 2023



Based on cover pool data, NCR region definitions.

Figure 22. Region class, Q3 2022 – Q3 2023



Based on cover pool data, NCR region definitions.

Commercial and multi-family rental housing carries the default risk of the property owner and their ability to service their loans. Ability to service debt is also dependent on maintaining low vacancies and stable rental income. The strength and available alternatives in the local rental market and attractiveness of the underlying asset therefore play a large role in the default risk for these types of loans. Eiendomskreditt allows a maximum 55% LTV for commercial properties and a 60% LTV for multi-family housing properties. In terms of expected losses (see Figure 24), we assume that the one-year probability of default of these exposures is 1.8% ('BB' according to our rating principles).

We view housing association loans as carrying similar default risk to residential mortgages, but with a higher concentration given the higher average loan sizes. Housing cooperatives in Norway can increase fees to tenant owners and own the physical collateral. In addition, the risk of vacancy or unpaid rent is minimal for housing associations once all tenant rights are sold. When housing associations default, the building is sold to a new owner, forcing the tenant owners to become renters and lose their own ownership rights. Eiendomskreditt allows a maximum 65% LTV for housing association properties. In terms of expected losses, we assume that the one-year probability of default for housing association loans is 0.2% ('BBB' according to our rating principles).

At 31 Dec. 2023, the cover pool included NOK 0.6bn in eligible substitute assets, of which a little more than half is cash held at DNB Bank and the remainder are Norwegian covered bonds.

Stress testing

Our standalone stress testing of the cover pool assumes that all forms of external support for the pool are exhausted and that only the underlying assets can provide enough liquidity to make coupon and principal payments. The stress test was conducted based on cover pool details as of 30 Sep. 2023. This analysis begins with the assumption that the issuer and/or banking group is being liquidated and administrators have committed to winding down the pool and selling necessary assets at a discount to ensure investors receive timely payment. For more details of the stress assumptions, see *Appendix 1: Analysing the Cover Pool* in our Covered Bond Rating Methodology, 14 Feb. 2024.

For each scenario, if the modelled cash flows demonstrate that the existing cover pool assets can generate enough liquidity to repay outstanding covered bonds then a notch of cover pool support is added to the qualitative assessment, up to a maximum of 'aaa'. This is measured by comparing the existing overcollateralisation with the modelled interest cash flows and cover pool liquidation proceeds to make coupon and principal payments and the modelled default rates for mortgages and other cover pool assets.

We conduct credit risk and cash flow stress testing on the cover pool assets with five increasingly difficult stress scenarios – Level 1 to Level 5 – with Level 5 being the most severe. Where the qualitative assessment is below 'aaa', the varying levels of stress can determine whether additional credit support is available from pool assets and reflected in additional notches in the covered bond ratings. For Eiendomskreditt, with a qualitative assessment of 'a+', the potential exists for up to four notches of support based on the pool analysis.

Credit risk stress tests show a decrease in stressed losses in recent quarters

Our stress scenarios are based on Norwegian commercial real estate prices being 5–15% above their long-term trend levels due to a long period of low interest rates. While Norwegian property values declined in 2023, Eiendomskreditt revalues its cover pool only once a year. Consequently the lower valuations have not affected most of the pool, resulting in the stable net LTV (see Figure 2). We expect the lag will become apparent by the time of the first quarterly report of 2024. We also expect that property values will decrease in 2024, but to a lesser extent than in 2023. Consequently, once the portfolio is revalued in the next few months, we would expect to reduce the additional stresses applied to the portfolio assets in line with our methodology.

According to our criteria, the current price level results in property value stresses as described in Figure 23. We expect commercial properties to have a higher probability of default and price correction than housing associations. In addition, we adjust stressed valuations based on the basis of our definition of the region class of the specific property.

Figure 23. Standard asset quality assumptions used in credit risk stress testing (%)

	Housing association probability of default*	Housing association price fall	Commercial property probability of default* (3x)	Commercial property price fall (1.25x)
Level 1	4.0	25.0	12.0	31.3
Level 2	5.2	30.0	15.7	37.5
Level 3	6.9	35.0	20.6	43.8
Level 4	9.0	40.0	27.0	50.0
Level 5	11.8	45.0	35.4	56.3

*Half of instances of default are assumed to result in an executive auction at discounted prices.

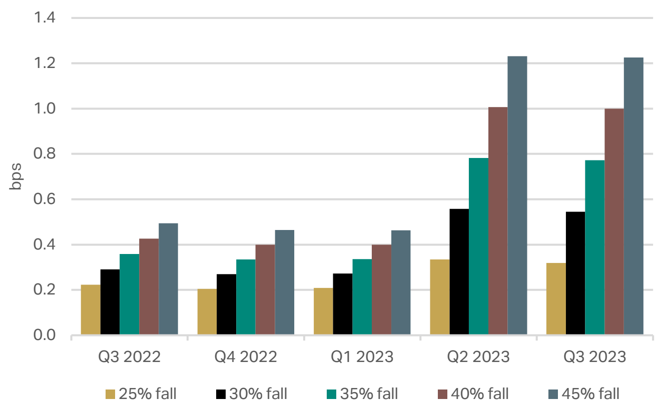
We do not make an additional geographic concentration adjustment to the stressed losses, reflecting the spread of the portfolio across Norway's primary commercial real estate markets (Figure 3) and that its geographic diversification is similar to that of other Norwegian residential and commercial cover pools.

Given the low LTV profile of the loan book, Eiendomskreditt had low expected losses, even with a 45% reduction on current valuations (as of 30 Sep. 2023). While expected losses increased significantly in the second quarter of 2023 in relative terms, in absolute terms they remained modest, with 123 bps in expected losses if the current portfolio were to decline by 45% (49bps a year earlier). The increase was mainly driven by a just few exposures with increased risk and LTVs. We assume that the one-year probability of default of commercial exposures is 1.8% ('BB' according to NCR rating principles) and that the one-year probability of default for housing association loans is 0.2% ('BBB') (see Figure 24).

The cover pool has greater single-name concentration than most Norwegian cover pools given the nature of commercial real estate loans in comparison with private residential mortgages. The company's policy limits the top 10 loans to a maximum 30% of commercial loans in the portfolio and the top 20 loans to a maximum 50%. The largest loan is NOK 175m with an LTV of 46%. The top 25 exposures total NOK 2.8bn or 46.8% of the cover pool and had a weighted average LTV of 49.9% as of 30 Sep. 2023 (Figure 25). Given the property- and loan-level stress test, single-name concentrations are reflected in the stress test scenarios.

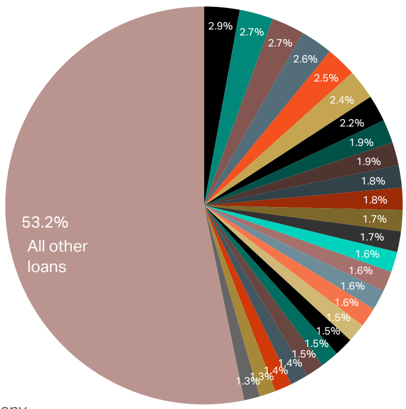
As shown in Figure 26, Level 5 credit risk stress test resulted in a one-year credit loss of NOK 309m, 5.7% of pool loans and 33% of Tier 1 capital as of 30 Sep. 2023.

Figure 24. Expected loss as a share of cover pool loans, based on actual portfolio composition and NCR stress test, Q3 2022-Q3 2023



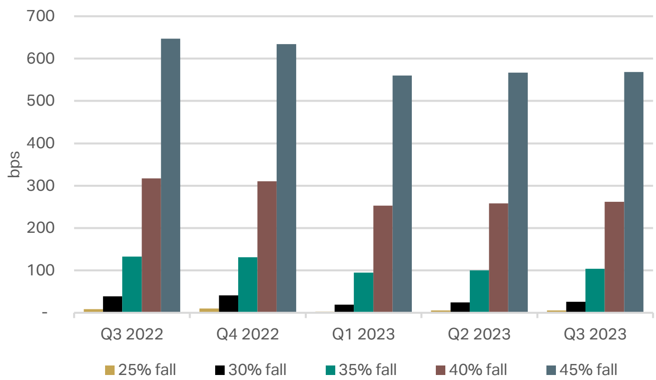
Based on NCR analysis of company data.

Figure 25. Top 25 exposures as a share of eligible cover pool loans, 30 Sep. 2023



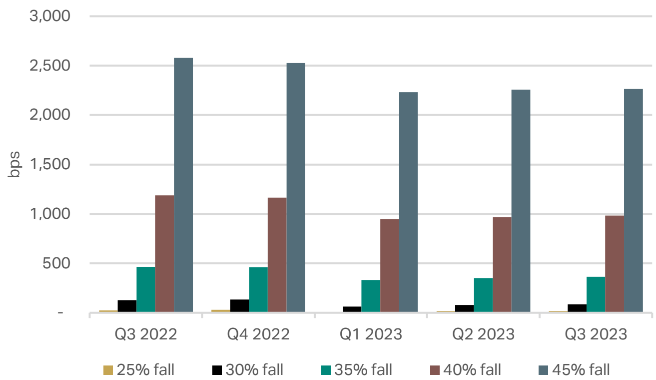
Source: company.

Figure 26. One-year credit loss as a share of cover pool loans, based on actual portfolio composition and NCR stress, Q3 2022-Q3 2023



Based on NCR analysis of company data.

Figure 27. Multi-year credit loss as a share of cover pool loans, based on actual portfolio composition and NCR stress test, Q3 2022-Q3 2023



Based on NCR analysis of company data.

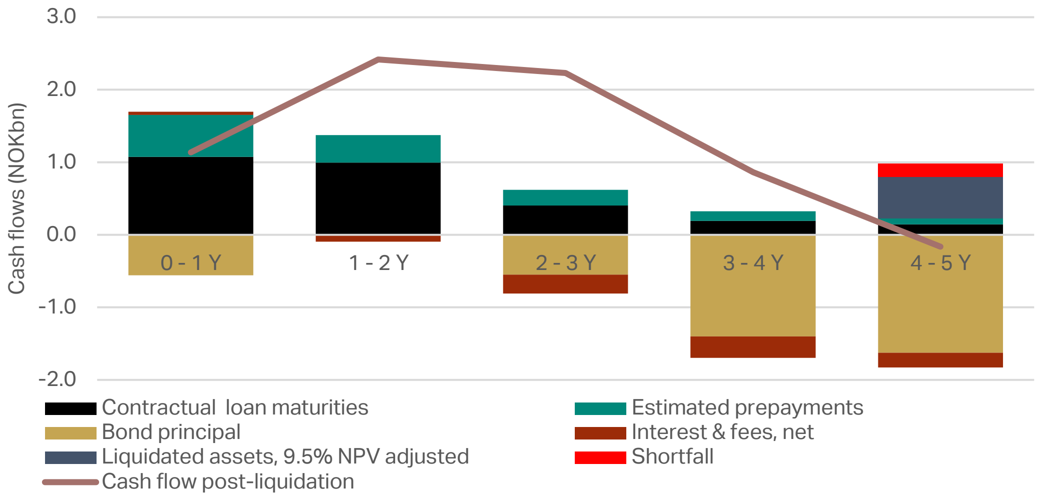
Cash flow stress test shows shortage in year five of rundown

The stressed losses and non-performing loans (NPLs) are input into our cash flow stress test based on an assumption of the portfolio being run down by an administrator and outstanding bonds being repaid by selling pool assets at a discount.

Our stress analysis shows a shortfall in our most extreme cash flow scenario (Level 5), in which the sale of highly discounted cover pool assets is not sufficient to repay existing bondholders (see Figure 28). The scenario assumes prepayments of 10% and repayment of performing loans at maturity. It also assumes that margins on performing loans fall from 2.2% to 0%. Assuming stable margins, this would be enough for cash flows to cover outflows.

The outcome of this analysis is theoretical given the assumption that the stress is immediate and based on current assets and outstanding bonds. The stress scenario is primarily dependent on our assumptions about the severity of discount rates and the liquidation rebates on assets sold. Interest and fees have only a modest impact on our analysis of Eiendomskreditt's stressed cash flows.

Figure 28. Stressed cash flows in NCR's level 5 scenario for Eiendomskreditt, 30 Sep. 2023



Based on NCR analysis of company data. NPV-net present value

ADDITIONAL FACTORS

Counterparty risk from interest rate swaps with DNB Bank

Swaps in the cover pool serve to reduce the interest rate risk between the pool and the outstanding bonds by swapping bond interest payments to the three-month Norwegian Interbank Offered Rate. The maturity profile of the swap agreements generally reflects that of the outstanding maturities of the bonds. Eiendomskreditt's primary interest rate swap counterparty is DNB Bank, which fulfils our criteria in terms of the creditworthiness of swap counterparties. DNB Bank is also the bank account provider for Eiendomskreditt. We believe that Eiendomskreditt will actively replace deteriorating and/or defaulting derivative counterparties to support the hedging profile of the cover pool and uphold regulatory requirements and do not adjust the rating on the covered bonds despite the concentration in Eiendomskreditt's swap partners.

Since July 2022 the Norwegian covered bond act has allowed issuers to use bank counterparties ranked at the EU's Credit Quality Step 3 (broadly similar to a public credit rating at the 'BBB' level). According to our criteria, we could adjust covered bond ratings to reflect the risk of overreliance on derivative counterparties with public credit ratings of 'BBB+' or lower (or equivalent NCR credit assessments) outside the issuer's banking or ownership group.

EIENDOMSKREDITT ISSUER RATING

Our 'BBB' long-term issuer rating on Eiendomskreditt reflects the operating environment for Norwegian commercial real estate, as well as the company's robust capitalisation and earnings and low historical and projected credit losses. It also reflects weaknesses due to the concentration of Eiendomskreditt's loan portfolio, its modest market position, and its concentrated funding profile.

STABLE OUTLOOK

The outlook is stable, reflecting our view that Eiendomskreditt's selective underwriting and moderate LTV profile will prevent a material decline in credit quality. We expect LTV levels to rise in the next 12 months and that NPLs and credit losses will increase due to rising yields and liquidity strains in the commercial real estate market. We also believe that Eiendomskreditt's continued access to capital market financing will allow it to continue to support its partner banks' demand for commercial real estate financing.

POSITIVE RATING DRIVERS:

- Improved capital and earnings, with a common equity Tier 1 (CET1) capital ratio sustainably above 22%.
- Pre-provision income sustainably above 3.0% of risk exposure amount (REA).
- Increased size and diversification of the loan book.

NEGATIVE RATING DRIVERS:

- A material deterioration in the operating environment that negatively affects the company's asset quality.
- A lasting reduction in the CET1 capital ratio to below 15%.
- Risk-adjusted pre-provision income persistently below 1.5% of REA.

Figure 29. Eiendomskreditt key credit metrics, 2019–2025e

%	2019	2020	2021	2022	2023	2024e	2025e
Net interest margin	1.8	1.7	1.8	1.9	2.2	2.1	2.0
Loan losses/net loans	-0.02	0.11	0.00	0.00	0.05	0.13	0.03
Pre-provision income/REA	1.6	1.6	1.7	1.9	2.4	2.2	2.1
Cost-to-income	22.0	21.8	22.0	20.2	17.7	19.3	20.6
Return on ordinary equity	7.7	7.1	8.3	8.8	9.9	8.5	8.3
Loan growth	12.7	4.0	7.3	4.6	1.5	1.5	5.0
CET1 ratio	15.5	15.5	14.6	16.9	16.4	17.0	17.2
Tier 1 ratio	17.2	17.1	16.1	18.6	18.0	18.6	18.8

Based on NCR estimates and company data. e–estimate. All metrics adjusted in line with NCR methodology.

RATING RATIONALE

Operating environment assessment 'bbb'

We view the Norwegian banking market as the strongest in the Nordic region given strong capital and earnings, and exceptional public finances. In our view, the risk of a deeper recession in Norway is low, but economic activity has slowed, and is likely to remain weak to moderate through 2024.

Our assessment of the operating environment is largely affected by our view of the commercial property market in Norway. In our view the sector faces increased financial risk, ranging from moderate to high. We believe stable interest rates and normal levels of inflation will be positive for the sector, but that vacancy risk will remain elevated through 2024, especially among retail properties. In addition, increased rental revenue is only starting to catch up with higher operating and financing costs for much of the sector, and cash positions have been strained to a varying degree for the past two years. Property values declined in 2023, due to wider yields though these were offset slightly by higher net operating margins. We expect some additional value changes in 2024, as long-term interest rates settle, but that few valuation changes remain. Generally, we expect risk levels to decline by end-2024, but that significant numbers of small companies and projects will continue to face major difficulties.

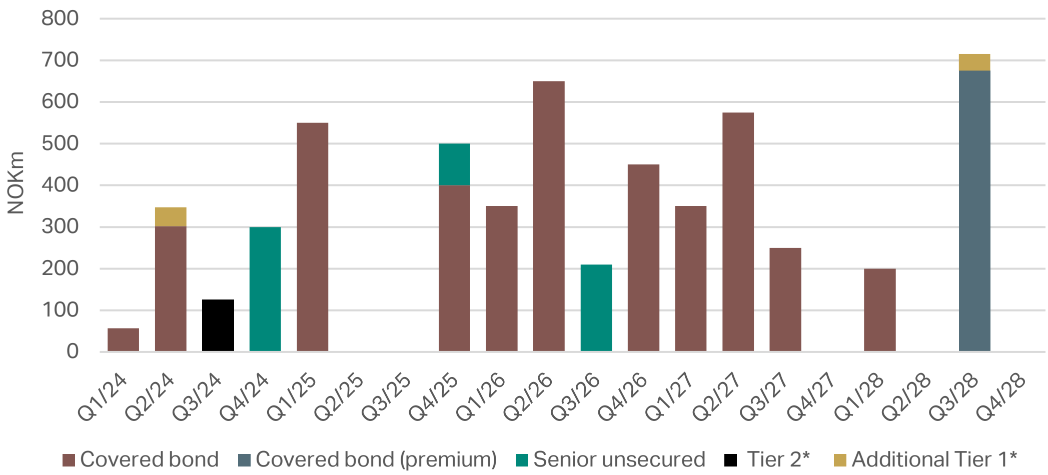
Risk appetite assessment 'bbb'

We believe that risk resources are proportionate and adequate, and view Eiendomskreditt as having a restrained risk appetite despite its focus on a relatively high-risk segment. Eiendomskreditt has a simple business model and a small portfolio of outstanding loans and borrowers. The company conducts its own evaluation of risk associated with potential money laundering by customers. This includes loans distributed by partner banks and/or transaction managers. The company has just over 10 employees and we view key-person risk as significant. However, the management team is experienced and the board includes current and former executives from Norwegian savings banks and other senior executives with legal and advisory experience. Cooperation with Kredittforeningen for Sparebanker, with which it shares offices, provides access to additional and flexible resources.

Eiendomskreditt's capital ratios improved materially with the implementation of the EU's SME rebate for banks operating in Norway in 2022, which included a reduction in the average risk weights applied to commercial real estate loans. The company's CET1 ratio was 16.4% as of 31 Dec. 2023, compared with a low of 14.6% at end-2021. The company has issued two additional Tier 1 instruments, which we view as loss-absorbing, leading to a Tier 1 ratio of 18.0% as of 31 Dec. 2023. We project these ratios will increase over the next two years due to modest loan growth of 1.5% in 2024 and 5% in 2025. We expect a positive effect from the implementation of the EU's Capital Requirements Regulation (CRR/CRD IV) on risk weights, most likely in mid-2025, but do not include this in our forecast due to uncertainty about the timing.

We assume that the company will continue to pay out at least 50% of net profit to its owners, providing some capital flexibility. The company's regulatory total capital requirement was 18.8% as of end-2023 (compared with a 20.3% total capital ratio), of which 14.73pp must be covered by CET1 capital and 16.48pp by Tier 1 capital. Capital requirements have increased due to an increase in the systemic risk buffer to 4.5% from 3% as of end-2023. This is mitigated by the Norwegian Financial Supervisory Authority's decision that banks can meet part of their Pillar 2 guidance with supplementary capital. Eiendomskreditt has Pillar 2 guidance of 1.33%.

Figure 30. Eiendomskreditt debt maturity profile, as of 31 Dec. 2023



Source: company. *date reflects first call date. Excluding commercial paper.

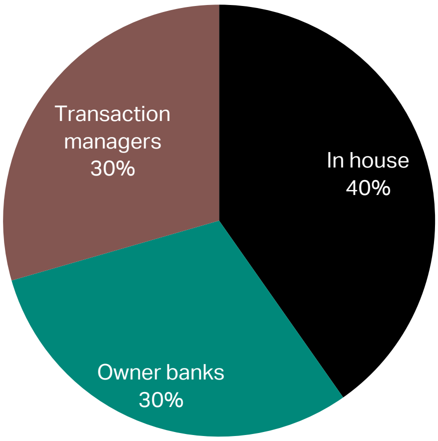
We view covered bonds as a stable funding source in the Nordic market and note that Eiendomskreditt's green covered bonds could expand its investor base. We also believe that tap issuance and the practice of early buybacks as well as Norway's history of supporting liquidity in the covered bond market support overall liquidity for all domestic issuers. However, Eiendomskreditt is one of the smallest issuers in Norway with about 0.3% of outstanding bonds and one of only two issuers (along with SpareBank1 Næringskreditt) issuing covered bonds backed primarily by commercial real estate. For this reason, we believe that the company could face more difficulty in refinancing in times of stress than other Norwegian covered bond issuers. In addition, the company issues senior unsecured bonds to finance additional collateral and liquid assets necessary for maintaining regulatory funding and liquidity ratios, increasing its dependence on functioning capital markets. All outstanding bonds are denominated in Norwegian kronor, thereby matching the underlying assets.

Eiendomskreditt has material concentrations in its credit risk profile due to the size of the loan book and its role as a commercial real estate lender. As of 31 Dec. 2023, the cover pool consisted of 219 loans to 190 borrowers, highlighting the small scale of the operation compared with those of other mortgage institutions in Norway. These concentrations are largely captured in our stress testing of the portfolio, which points to strong resilience in the loan book in all but the most dramatic scenarios. Eiendomskreditt also considers transition and physical risk associated with all new loans, and is working with Norwegian company Eiendomsverdi AS to understand the inherent exposure to climate-related risk more fully given its real estate lending profile.

The geographic spread of the portfolio covers the whole country, with many borrowers and properties located in major cities and centres of economic activity. The weighted LTV based on indexed property values was 46.2% as of 31 Dec. 2023, compared with 44.7% at end-2022, demonstrating a restrained risk appetite commensurate with the company's policy of underwriting commercial loans with a LTV of 55% or lower and 60% or lower for housing associations. We expect that portfolio revaluations in early 2024 will lead to higher LTV in the loan book, but that Eiendomskreditt's prudent risk management will limit the increase.

Growth in recent years has been buoyed by strong transaction markets and syndicated loans extended via partner banks and transaction managers. In addition to its own origination, the company's loans are originated through owner banks and transaction managers. Most of the loans are distributed in-house and have smaller ticket sizes than loans sourced via partner banks and transaction managers. We are expecting muted growth of around 1.5% in 2024 (in line with 2023), and a further rise of 5% in pick-up in 2025.

Figure 31. Eiendomskreditt loan book by sources of loan origination, 30 Jun. 2023



Source: company.

Competitive position assessment 'bb'

Eiendomskreditt began issuing covered bonds for its partner banks in 2009, establishing its role as an alternative financier of partner banks' customer loans as well as its own originated loans. The company is not part of any of Norway's banking alliances, but has owner banks from all the alliances. However, the company is a minor financial institution in domestic terms and has negligible income outside of net interest income from mortgage lending. In addition, it aims to use green loan financing to improve its attractiveness to partner banks and customers.

Performance indicators assessment 'a-'

Eiendomskreditt's earnings are robust, primarily due to the small size of its operations and the sharing of costs and resources with Kredittforeningen for Sparebanker. Earnings have improved due to rising interest rates and higher risk premiums for commercial real estate borrowers. We project pre-provision income to REA will fall slightly as net interest margins decline, but remain above 2% through our forecast period, with cost metrics increasing from exceptionally low levels toward 20%.

Eiendomskreditt has a history of low credit losses, even though it sets aside loss reserves for Stage 1 performing loans and has reported a volatile level of net NPLs since reporting according to IFRS 9 in 2020. We project the company will report loan losses of around 13 bps in 2024 and 3 bps in 2025, after booking 5 bps of loan losses in 2023, largely due to a reduced valuation of a property seized early in the year. The proportion of net Stage 3 loans had increased to over 3% by end-2023, up from 0.9% at end-2022. We expect that the proportion of net Stage 3 loans will decrease in 2025, but that the Stage 3 coverage ratio will increase from low levels, due to higher LTVs in Stage 2 and 3 loans. The projected loss also reflects potential for greater-than-expected declines in the valuation of single properties. The projected losses lie between the Level 1 and Level 2 credit risk stress tests in Figure 26 indicating the potential impact of falling valuations and rising interest rates on collateral values.

Neutral aggregate ESG impact

Environmental, social and governance (ESG) factors are considered throughout our analysis where material to the credit assessment. On aggregate, we view Eiendomskreditt's ESG profile as having a neutral impact on its creditworthiness. Eiendomskreditt's activities include the provision of green financing for green loans to partner banks and direct customers.

Figure 32. Eiendomskreditt priority ESG factors

Issue/area	Risk/opportunity	Impacted subsections (impact on credit assessment*)
Sustainable/green bond framework	Ability to offer green funding to partner banks is an advantage, as it allows the banks to diversify funding sources and access additional markets/investors.	Competitive position (+)
Physical climate risk to collateral	Climate-related damage to real-estate collateral (closely linked to supervision of insurance). Longer-term term effects on market values in flood risk areas.	Credit risk (-) Loss performance (0) Risk governance (0)
Anti-money laundering capacity	Risk of sanctions and fraud due to insufficient control of customers, given the relatively high risk in the construction sector and Eiendomskreditt's limited size.	Risk governance (-)
Control of sustainability issues	Credibility of green bond framework depends on rigour of application and allocation/impact reporting.	Risk governance (0)

*Defined according to a 5-step scale ranging from double minus (--) to double plus (++), with (--) representing the most negative impact and (++) the most positive. See **ESG factors in financial institution ratings**.

Ownership support neutral

Eiendomskreditt is owned by Meteva AS (Trond Mohn) and R Transit AS (The Rieber family), each with a 30% stake. In addition, over 60 Norwegian savings banks and Pareto Bank own over 38%, with other private investors owning less than 2%. We note that Meteva and R Transit would require regulatory approval to increase their ownership shares above 30% and consider this a hinderance to additional capital support.

Issue ratings

Our rating on Eiendomskreditt's senior unsecured instruments is in line with the 'BBB' issuer rating. The bank has an outstanding tier 2 instrument and two additional tier 1 instruments, which we rate two and four notches below the issuer rating, respectively. Consequently, the tier 2 instrument is rated 'BB+', while the tier 1 instruments are rated 'BB-'.

The short-term rating is 'N3', in line with our definition for the long-term rating level ('BBB').

METHODOLOGIES USED

(i) Financial Institutions Rating Methodology, 14 Feb. 2024.
(ii) Covered Bond Rating Methodology, 14 Feb. 2024.
(iii) Rating Principles, 14 Feb. 2024.
(iv) Group and Government Support Rating Methodology, 14 Feb. 2024.

RELEVANT RESEARCH

(i) Norwegian savings banks face margin squeeze in 2024, 11 Dec. 2023
(ii) Mid-sized Norwegian savings banks navigate economic challenges, 28 Aug. 2023.
(iii) High real-estate exposure poses climate risk for Swedish and Norwegian banks, 12 Apr. 2022.

Figure 33. Eiendomskreditt key financial data, 2020–2023

Key credit metrics (%)	FY 2020	FY 2021	FY 2022	FY 2023
INCOME COMPOSITION				
Net interest income to op. revenue	94.4	92.1	96.0	95.6
Net fee income to op. revenue	4.3	4.3	4.4	3.5
Net trading income to op. revenue	1.1	3.3	-0.4	0.9
Net other income to op. revenue	0.3	0.3	0.0	
EARNINGS				
Net interest income to financial assets	1.7	1.8	1.9	2.2
Net interest income to net loans	2.0	2.1	2.2	2.5
Pre-provision income to REA	1.6	1.7	1.9	2.4
Core pre-provision income to REA (NII & NF&C)	1.5	1.6	1.9	2.4
Return on ordinary equity	7.1	8.3	8.8	10.1
Return on assets	1.0	1.1	1.2	1.4
Cost-to-income ratio	21.8	22.0	20.2	17.5
Core cost-to-income ratio (NII & NF&C)	22.1	22.8	20.2	17.6
CAPITAL				
CET1 ratio	15.5	14.6	16.9	16.4
Tier 1 ratio	17.1	16.1	18.6	18.0
Capital ratio	19.4	18.3	21.1	20.3
REA to assets	89.4	88.8	76.5	79.9
Dividend payout ratio	49.6	49.8	49.8	
Leverage ratio	15.1	14.1	14.1	14.2
GROWTH				
Asset growth	4.3	7.1	2.9	1.2
Loan growth	4.0	7.3	4.6	1.7
Deposit growth				
LOSS PERFORMANCE				
Credit provisions to net loans	0.11	0.00	0.00	0.05
Stage 3 coverage ratio	3.31	0.67	3.21	1.14
Stage 3 loans to gross loans	2.13	0.35	0.93	3.27
Net stage 3 loans to net loans	2.06	0.35	0.90	3.24
Net stage 3 loans/ordinary equity	12.63	2.18	5.67	20.09
FUNDING & LIQUIDITY				
Loan to deposit ratio				
Liquid assets to deposit ratio				
Net stable funding ratio	102.1	105.6	116.2	117.0
Liquidity coverage ratio	204.0	209.7	130.3	112.0

Key financials (NOKm)	FY 2020	FY 2021	FY 2022	FY 2023
BALANCE SHEET				
Total assets	6,024	6,454	6,644	6,726
Total tangible assets	6,024	6,454	6,644	6,725
Total financial assets	6,006	6,443	6,631	6,699
Net loans and advances to customers	5,169	5,544	5,797	5,893
Total securities	474	561	506	528
Customer deposits	–	–	–	–
Issued securities	5,034	5,441	5,583	5,636
of which other senior debt	4,909	5,316	5,458	5,510
of which subordinated debt	125	125	125	125
Total equity	929	964	1,002	1,035
of which ordinary equity	844	879	917	950
CAPITAL				
Common equity tier 1	837	837	861	883
Tier 1	922	922	946	968
Total capital	1,047	1,047	1,071	1,093
REA	5,387	5,733	5,083	5,376
INCOME STATEMENT				
Operating revenues	105	121	131	154
Pre-provision operating profit	82	94	104	127
Impairments	6	0	0	–
Net Income	58	72	79	94

Source: company. FY–full year. YTD–year to date.

Figure 34. Eiendomskreditt rating scorecard

Subfactors	Impact	Score
National factors	5.0%	a
Regional, cross border, sector	15.0%	bbb-
Operating environment	20.0%	bbb
Capital	17.5%	a-
Funding and liquidity	15.0%	bbb
Risk governance	5.0%	bbb-
Credit risk	10.0%	bb+
Market risk	-	-
Other risks	2.5%	bbb
Risk appetite	50.0%	bbb
Competitive position	15.0%	bb
Earnings	7.5%	a+
Loss performance	7.5%	bbb
Performance indicators	15.0%	a-
Indicative credit assessment		**bbb**
Transitions		Neutral
Borderline assessments		Neutral
Peer calibration		Neutral
Stand-alone credit assessment		**bbb**
Material credit enhancement		Neutral
Rating caps		Neutral
Support analysis		Neutral
Issuer rating		**BBB**
Outlook		Stable
Short-term rating		**N3**

Figure 35. Capital structure ratings

Seniority	Rating
Covered bond	AAA
Senior unsecured	BBB
Tier 2	BB+
Additional Tier 1	BB-

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