



KBN

The Norwegian Agency
for Local Governments

2020

Report for first quarter

About KBN

Kommunalbanken AS (KBN) is the Norwegian state agency for local government funding. KBN is 100 per cent owned by the Kingdom of Norway (AAA/Aaa) and is managed in accordance with the Central Government Maintenance Statement.



Horten High School is the first plus house school in Norway. The school is built with a high proportion of sustainable materials such as solid wood, low carbon concrete and recycled steel. This reduces the greenhouse gas emissions by 40% compared to a reference building. The school is financed with a green loan from KBN. Photo: Hundven-Clements Photography

KBN's sole purpose is to grant loans to local and regional governments or inter-municipal companies in line with KBN's explicit public policy mandate. As an instrument of the state, KBN recognizes its critical role in enabling the local and regional governments to improve living standards across the country. 100 percent of Norwegian municipalities are KBN customers.

Through its Green Bond program, KBN aims to finance the Norwegian local

sector's transition to a climate-resilient, low-carbon society. Proceeds from Green Bonds are disbursed as discounted Green Loans to climate and environmentally conscious investments in the local sector. This reflects KBN's traditional, long-term focus on environmental, ethical and social impact.

KBN is guided by prudent financial and risk management policies. All financial transactions are fully hedged and KBN maintains liquidity in excess

of policy requirements. KBN's focused, specialized monoline lending model has never suffered a loan loss.

Owing to full state ownership, the central public policy mission, a strong capital base, solid financial and operating performance and prudent financial and risk management policies, KBN is assigned Triple-A ratings by Standard & Poor's and Moody's.

Financial highlights

(Amounts in NOK 1 000 000)

	January-March 2020	January-March 2019	2019
RESULTS			
Net interest income	443	458	1 875
Core earnings ¹	223	273	1 071
Profit before tax	(308)	217	1 771
Profit for the period	(229)	164	1 283
Return on equity after tax ²	(6.9 %)	4.5 %	9.5%
Return on equity after tax (core earnings) ²	6.3 %	8.2 %	8.3%
Return on assets after tax ²	(0.2 %)	0.1 %	0.3%
Return on assets after tax (core earnings) ²	0.2 %	0.2 %	0.2%
LENDING			
New disbursements	14 424	13 129	53 825
Outstanding loans ³	306 687	305 740	309 758
LIQUIDITY PORTFOLIO³	147 659	111 446	107 350
BORROWINGS			
New long-term borrowings	30 293	34 787	72 508
Repurchase of own debt	49	8	276
Redemptions	42 618	26 137	95 704
Total borrowings ³	451 816	421 647	400 489
TOTAL ASSETS	554 286	461 830	460 778
EQUITY	16 575	15 801	16 401
Total capital adequacy ratio	21.6%	22.4%	22.6%
Tier 1 capital adequacy ratio	19.2%	19.8%	20.1%
Common equity Tier 1 capital adequacy ratio	16.5%	17.0%	17.4%
Leverage ratio	3.2%	3.5%	3.7%

	January-March 2020	January-March 2019	2019
LIQUIDITY COVERAGE RATIO (LCR)⁴			
Total	417%	310%	348%
NOK	67%	73%	73%
EUR	351%	135%	800%
USD	411%	346%	422%
AUD	905%	586%	Infinite
JPY	426%	3 922%	533%
GBP	426%	Insignificant	Infinite
OTHER KEY FIGURES			
Green loans ⁵	20 201	19 463	23 049
Emissions in CO ₂ e ⁶	30.4	N/A	192.4

¹ Profit after tax adjusted for unrealised gain/(loss) on financial instruments after tax. This result measure is included to give relevant information about the company's underlying operations.

² Annualised return on equity after tax: Profit after tax/Core earnings as percentage of average equity and average assets.

³ Principal amounts

⁴ Liquidity coverage ratio (LCR) is a measure for the regulatory liquidity reserve. LCR is defined as liquid assets as a percentage of net payments in

a given stress period of 30 days ahead.

⁵ Outstanding green loans according to KBN's set of criteria for green loans. In addition, the bank has a small portfolio of green loans that were given before these criteria were established. These loans are no longer financed with green bonds.

⁶ Includes the company's direct (Scope 1) and indirect (Scope 2) emissions, as well as residual waste and flights (Scope 3).

Good underlying operations in a very demanding market

KBN's net interest income in the first quarter of 2020 was NOK 443 million as compared to NOK 458 million in the same period in 2019. KBN's underlying operations were good, but the very turbulent market conditions affected its result for the first quarter of 2020 and balance sheet as at the end of the quarter.

The coronavirus situation

On the whole, the COVID-19 outbreak and the associated significant financial market volatility seen in March 2020 have only affected KBN to a limited extent in both operational and financial terms. KBN has been identified as an organisation that is critical to society and has been able to maintain its normal operations. The number of employees working physically in its offices has been kept to a minimum. All other employees are working from home. The volatile markets have affected KBN in that the weaker Norwegian krone has increased KBN's balance sheet markedly, while the increase in credit spreads has resulted in unrealised losses on financial instruments.

Results

These matters have reduced KBN's key financial figures at 31 March 2020.

In the first quarter of 2020 KBN's net interest income again made a strong positive contribution to its result for the period. In the first quarter of 2020 KBN's net interest income totalled NOK 443 million as compared to NOK 458 million in the same period in 2019.

KBN's lending activities contributed net interest income that was approximately in line with the same period in 2019. KBN's lending margin in March 2020 was affected by the unusual market conditions associated with the COVID-19 outbreak, primarily because KBN reduced its standard variable rate following Norges Bank's first interest rate cut. KBN further cut its lending rate in the month of April 2020 following Norway's key policy rate being further cut to 0.25%. KBN's liquidity portfolio generated lower margins and consequently weak earnings in the first quarter of 2020.

KBN's result for the first quarter was a loss of NOK 229 million, compared to a profit of NOK 164 million in the first quarter of 2019. The main reason for the negative result for the period was unrealised losses totalling NOK 626 million on financial instruments and loans which are carried at fair value. The unrealised losses on KBN's fixed-rate loans totalled NOK 450 million due to an increase in credit spreads in the markets in March 2020. The hedging instruments held by KBN to convert US dollars into Norwegian krone contributed an unrealised loss in the order of NOK 270 million due to a widening of basis spreads. KBN's liquidity portfolio contributed an unrealised gain of NOK 90 million on the basis of falling interest rates and higher asset prices, including for American government bonds. In the first quarter of 2019, KBN recognised unrealised losses totalling NOK 164 million, primarily from hedging instruments. KBN's unrealised losses are expected to reverse, either as market conditions normalise or as the instruments approach maturity. KBN realised no losses on financial instruments in the first quarter of 2020.

A change in the expected credit losses on KBN's loans and bond investments of NOK 28 million was recognised in the quarter. This increases KBN's total provision for losses from NOK 12 million to NOK 40 million and is due to the greater uncertainty in the Norwegian real economy, but KBN's provision for losses is relatively limited due to the fact that Norwegian municipalities cannot be declared insolvent, no discernible payment problems are being encountered in the local government sector, and KBN's liquidity portfolio is of very high credit quality.

KBN's core earnings totalled NOK 223 million in the first quarter of 2020, compared to NOK 273 million in the same period in 2019. KBN's expected credit losses are included in its core earnings and therefore reduce this figure.

Total operating costs for the first quarter of 2020 were NOK 65 million as compared to NOK 60 million in the same period in 2019. The increase was primarily due to higher costs for IT infrastructure in accordance with a planned upgrade. KBN operated more or less normally in the quarter and its costs were little impacted by the COVID-19 outbreak. No employees have been furloughed.

Table 1
Profit for the period

	Q1 2020	Q1 2019	2019
Profit/(Loss) for the period	(229)	164	1 283
Net interest income	443	458	1 875
Fees and commission expenses	35	21	87
Net unrealised gain/(loss) on financial instruments	(626)	(164)	213
Expected credit loss	28	0	1
Net trading income	3	3	23
Total operating expenses	65	60	252
Income tax	(79)	52	488

Amounts in NOK 1 000 000

Table 2
Comprehensive income
for the period

	Q1 2020	Q1 2019	2019
Total comprehensive income for the period	183	387	1 515
Profit/(Loss) for the period	(229)	164	1 283
Unrealised change in fair value of liabilities (and related financial derivatives) after tax due to changes in own credit risk	412	222	242
Actuarial gain/(loss) on defined benefit plan	-	-	(10)
Tax effect on positions in Statement of comprehensive income	(137)	(74)	(77)

Amounts in NOK 1 000 000

Based on its result from ordinary activities, KBN's return on equity in the first quarter of 2020 was -6.9%, compared to 4.5% in the first quarter of 2019. This was due to the unrealised losses on financial instruments discussed above. Based on its core earnings, KBN achieved a return on equity of 6.3%, compared to 8.2% in the first quarter of 2019. This decrease is somewhat larger than was expected prior to the start of the quarter, due in part to the higher loss provisions caused by the COVID-19 outbreak .

Total comprehensive income in the first quarter of 2020 amounted to NOK 183 million, compared to NOK 387 million in the same period in 2019. The credit spreads for KBN-issued bonds increased due to the market turmoil, as did the spreads for similar types of issuers in the international financial markets. This increase caused the market value of KBN's debt to decrease, and an unrealised gain totalling NOK 550 million was recognised as part of total comprehensive income on the basis of the changes in the value of KBN's own debt. There was an equivalent unrealised gain in the first quarter of 2019 totalling NOK 296 million.

Lending

KBN's lending portfolio totalled NOK 306.7 billion at the end of the first quarter of 2020. In the first quarter of 2020 KBN's lending portfolio decreased by NOK 3.1 billion, equivalent to a decrease of 1.0%. KBN's lending portfolio grew by 1.2% in the first quarter of 2019.

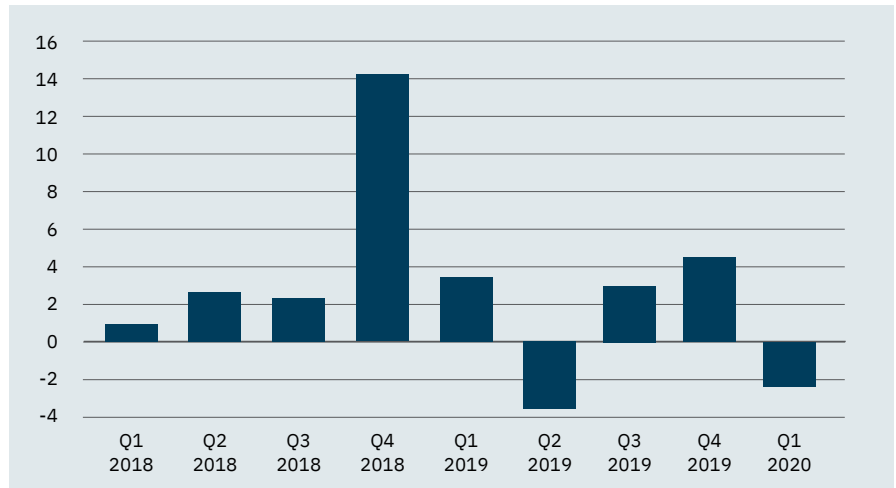
The decrease in the size of KBN's lending portfolio as a result of extraordinary loan redemptions in January was followed by strong growth in the second half of March due to the turmoil in the financial markets and an occasional lack of availability of funding from the capital markets. The marked decrease in long-term fixed interest rates created greater demand for fixed-rate loans. Norges Bank's cuts to its key policy rate have resulted in KBN reducing its standard variable rate by a total of one percentage point, with the last change coming into force on 14 April 2020.

New loan disbursements totalled NOK 14.4 billion in the first quarter of 2020 as compared to NOK 13.1 billion in the same period in 2019. These figures include loans disbursed as new financing and as refinancing for existing loans.

KBN disbursed six green loans totalling NOK 879.7 million in the first quarter of 2020, as compared to NOK 663.0 million in the same period in 2019. The projects financed include Huseby School in Trondheim, a pumping station for a treatment plant in Nesodden, and a plant for future biogas production in Sørumsand.

The rate of debt growth in the local government sector in 2019 was very high, with its total debt growing over the year (according to Statistics Norway's C2 credit indicator) by 7.1%. The sector's debt continued to grow in January and February, with twelve-month growth to the end of February standing at 7.4%. This increase is in line with the increase seen in the same period in 2019. KBN's overall market share as at the end of February 2020 was approximately 47%.

Lending growth
Amounts in
NOK 1 000 000 000

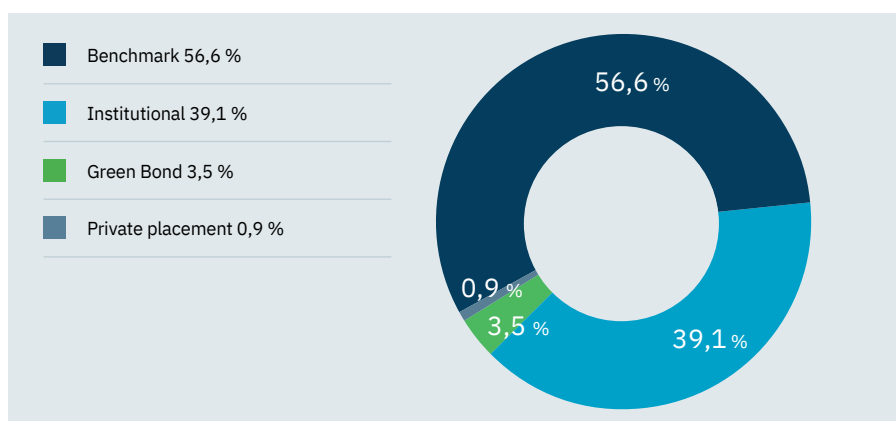


Financial markets

Funding KBN's funding activities in the first quarter of 2020 were less extensive than in the same period in 2019 due to it having less need for refinancing and strong liquidity. There was a positive underlying tone in the capital markets with a good level of activity for much of the quarter, but the global COVID-19 outbreak in the month of March resulted in considerable market disruption and changes to credit spreads in all sectors towards the end of the period.

New borrowings in the first quarter of 2020 totalled NOK 30 billion across four different currencies, compared to NOK 35 billion in the same period in 2019. The largest single bond issued by KBN in the first quarter was a five-year benchmark bond totalling USD 1.25 billion, which was issued in March 2020. The bond was well received in the market and was significantly oversubscribed at launch. In the first quarter of 2020 KBN also saw a good level of activity from institutional investors in Australian dollars, British pounds and euros. The weakening of the Norwegian krone against other currencies reduced KBN's need for funding in the first quarter of 2020, and we expect that this will persist through the second quarter of 2020. KBN's continued low borrowing costs and good market access are ensured by its AAA/Aaa rating.

Funding
Investor markets
first quarter 2020



Liquidity management KBN's liquidity portfolio totalled NOK 147.7 billion at 31 March 2020 as compared to NOK 111.4 billion at the end of the first quarter of 2019. KBN seeks to ensure its liquidity portfolio matches its capital requirements, including lending growth, for the subsequent twelve months at all times, and it is managed on the basis of a low-risk investment strategy. The liquidity portfolio is principally held in zero-risk-weighted assets and primarily in foreign currencies

The market implications of the COVID-19 outbreak proved to be very extensive in March 2020. Stock exchanges reacted very negatively, interest rates fell, credit margins increased and the Norwegian krone weakened significantly. At its weakest point, the Norwegian krone was down about 20% against the US dollar. Some of these movements reversed as the world's central banks and other authorities implemented support measures. A range of central banks, including Norges Bank, cut their countries' interest rates significantly in March 2020. Norges Bank's key policy rate is now at the historically low level of 0.25%. Further stimulus measures were implemented by central governments in the form of purchase programs and loan facilities of various types.

The market volatility resulted in major fluctuations in KBN's holdings of cash collateral, which form part of the liquidity portfolio. Very short-term investments were prioritised during this period. The weakening of the Norwegian krone together with the inflow of collateral resulted in the liquidity portfolio, with short-term money market deposits included, standing at NOK 162 billion at the close of the quarter.

Capital

KBN's capital adequacy was temporarily lower at the end of the first quarter due to the market turmoil, but remained within the requirements.

At the end of the first quarter of 2020 KBN's total common equity Tier 1 capital was NOK 13.4 billion, its total Tier 1 capital was NOK 15.6 billion, and its total primary capital was NOK 17.6 billion. KBN's capital structure was unchanged in the quarter. KBN's total assets at the end of the first quarter 2020 totalled NOK 554 billion as compared to NOK 461 billion at the end of 2019 and NOK 462 billion at the end of the first quarter of 2019. The increase since the start of 2020 is primarily due to the weakening of the Norwegian krone in the month of March, which resulted in KBN's non-NOK-denominated balance sheet items increasing in value in NOK terms. In addition, the weakening of the krone caused the market value of KBN's derivative contracts to increase significantly, and KBN received significant amounts of cash collateral deposits. This cash collateral is invested in short-term money market deposits, and increases KBN's total assets. KBN was consequently very liquid during this quarter.

At the end of the first quarter of 2020, KBN had a common equity Tier 1 capital adequacy ratio of 16.5%, a Tier 1 capital adequacy ratio of 19.2%, and a total capital adequacy ratio of 21.6%. The corresponding capital requirements imposed by the authorities at this point were 14.1%, 15.6% and 17.6% respectively. The requirements are all 0.7 percentage points lower than at the end of 2019, when the requirements were 14.8%, 16.3% and 18.3% respectively. The decrease is a combination of KBN's pillar 2 requirement having increased by 0.7 percentage points with effect from 31 March 2020 and of the KBN's institution-specific countercyclical buffer decreasing by 1.4 percentage points as a result of the Ministry of Finance reducing the Norwegian countercyclical buffer rate to 0.5% in connection with the COVID-19 outbreak. KBN's leverage ratio at the end of the first quarter was 3.2%, which compares with the requirement of 3.0%. Both KBN's risk-weighted

and non-risk-weighted capital adequacy ratios were affected negatively by the unrealised losses recognised as part of its result from ordinary activities, while the non-risk-weighted capital adequacy ratio in particular was negatively affected by the large volume of cash collateral KBN received in the quarter.

Future prospects

On 31 March 2020 the Government of Norway put forward a proposal to Norway's parliament to grant KBN an additional NOK 750 million of equity capital "to help the markets to function as well as possible and to prevent municipalities' refinancing of short-maturity securities from contributing to further stress in the markets". The proposal was approved by the Norwegian Parliament in April, and KBN received the funds the same month. The capital increase will enable KBN to lend an additional NOK 20-25 billion, which will make KBN more able to refinance a significant amount of the local government debt that is due to mature between now and the summer, and also to quickly compensate for the decrease in the availability of financing from other markets.

A state guarantee scheme for companies with severe liquidity difficulties was introduced on 27 March. This guarantee scheme involves the Norwegian state guaranteeing 90% of the amount of new loans and is intended to increase companies' access to debt. The scheme can be used by inter-municipal companies and companies with loans on the basis of municipal guarantees that are currently customers of KBN. It seems likely that the scheme will be less relevant to the majority of KBN's customers.

As of 14 April, the Norwegian Parliament had granted municipalities and county authorities NOK 6.45 billion in block grants in connection with the COVID-19 outbreak, while earmarked grants had increased by NOK 0.25 billion.

To reduce the risk of its employees being infected with COVID-19, KBN has reduced the number of its employees working physically in its offices to the minimum required for it to maintain its necessary operations. All other employees are working from home. Going forward, it will become possible for some additional employees to work from KBN's premises. KBN's premises will continue to be closed to external parties, with meetings with such parties being carried out using telephone or video conferencing solutions. Travel and physical events have been postponed or cancelled.

Since the end of March KBN has organised weekly customer webinars, which have received good feedback. Going forward, KBN will also be running a webinar series on municipalities' exposure to climate risk, which will replace a planned conference on the topic. Further work will be done on developing digital solutions that can replace some of KBN's normal travel activities on a permanent basis, in line with KBN's objectives in respect of customer-driven digitalisation, efficiency, and reducing its own greenhouse gas emissions. On 18 April KBN launched a range of new website pages and features that are exclusively for logged-in customers.

Interim condensed financial information

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	January-March 2020	January-March 2019	2019
Interest income from assets measured at amortised cost		1 384	1 123	5 039
Interest income from assets measured at fair value		1 049	944	3 777
Total interest income		2 433	2 067	8 817
Total interest expense		1 990	1 609	6 942
Net interest income	1	443	458	1 875
Fees and commission expenses		35	21	87
Net unrealised gain/(loss) on financial instruments	2	(626)	(164)	213
Expected credit loss	6	28	0	1
Net trading income		3	3	23
Total other operating income		(686)	(182)	148
Salaries and administrative expenses		40	41	159
Depreciation on fixed assets		6	6	22
Other expenses		19	14	71
Total operating expenses		65	60	252
Profit before tax		(308)	217	1 771
Income tax		(79)	52	488
Profit for the period		(229)	164	1 283
Portion allocated to shareholder		(244)	152	1 231
Portion allocated to owners of additional Tier 1 capital		15	13	52

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	January-March 2020	January-March 2019	2019
Profit for the period		(229)	164	1 283
Other comprehensive income				
<i>Items which will not be reclassified to profit or loss</i>				
Change in fair value of liabilities due to changes in own credit risk	10	550	296	319
Actuarial gain/(loss) on defined benefit plan		0	0	(10)
Tax effect		(137)	(74)	(77)
Total other comprehensive income		412	222	232
Total comprehensive income for the period		183	387	1 515

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	31 March 2020	31 March 2019	31 December 2019
Assets				
Deposits with credit institutions	3,4,9	18 517	29 659	18 181
Other money market deposits		12 490	-	3 244
Instalment loans	3,4,5,6	311 262	307 317	310 912
Notes, bonds and other interest-bearing securities	3,4,6,7,8	153 265	114 418	111 111
Financial derivatives	3,4,9	56 499	10 267	15 025
Deferred tax asset		2 076	-	2 134
Other assets		178	169	172
Total assets		554 286	461 830	460 778
Liabilities and equity				
Loans from credit institutions	3,4	45 336	4 370	4 462
Commercial paper	3,4	2 648	-	2 631
Senior securities issued	3,4,10	458 435	414 280	403 913
Financial derivatives	3,4,9	25 138	23 917	27 425
Other liabilities		92	108	55
Current tax liabilities		3 868	52	3 868
Deferred tax liabilities		0	1 238	0
Pension liabilities		36	47	36
Subordinated debt	3,4	2 157	2 016	1 987
Total liabilities		537 711	446 029	444 377
Share capital		3 145	3 145	3 145
Additional Tier 1 capital		2 189	2 189	2 189
Retained earnings		11 471	10 303	11 067
Profit for the period		(229)	164	
Total equity	11	16 575	15 801	16 401
Total liabilities and equity		554 286	461 830	460 778

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)

	1 January - 31 March 2020				
	Share capital	Additional Tier 1 capital	Value changes on liabilities due to changes in own credit risk	Retained earnings	Total equity
Equity as of 31 December 2019	3 145	2 189	(395)	11 460	16 401
Profit for the period	0	0	0	(229)	(229)
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	412	0	412
Other comprehensive income—actuarial gain/loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(9)	(9)
Dividends for 2019	0	0	0	0	0
Equity as of 31 March 2020	3 145	2 189	17	11 223	16 575

	1 January - 31 March 2019				
	Share capital	Additional Tier 1 capital	Value changes on liabilities due to changes in own credit risk	Retained earnings	Total equity
Equity as of 31 December 2018	3 145	2 189	(634)	10 720	15 421
Profit for the period	0	0	0	164	164
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	222	0	222
Other comprehensive income—actuarial gain/loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(7)	(7)
Dividends for 2018	0	0	0	0	0
Equity as of 31 March 2019	3 145	2 189	(412)	10 878	15 801

	1 January - 31 December 2019				
	Share capital	Additional Tier 1 capital	Value changes on liabilities due to changes in own credit risk	Retained earnings	Total equity
Equity as of 31 December 2018	3 145	2 189	(634)	10 720	15 421
Profit for the period	-	-	-	1 283	1 283
Other comprehensive income—value change on liabilities due to changes in own credit risk	-	-	239	-	239
Other comprehensive income—actuarial gain/loss	-	-	-	7	7
Interest paid on Tier 1 capital	-	-	-	(69)	(69)
Dividends for 2018	-	-	-	(481)	(481)
Equity as of 31 December 2019	3 145	2 189	(395)	11 460	16 401

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)			
	January-March 2020	January-March 2019	2019
Cash flows from operating activities			
Interest received	2 347	1 974	8 666
Interest paid	(1 449)	(1 734)	(6 514)
Fees and commissions paid	(27)	(21)	(87)
Receipts from repurchase of issued securities	3	3	21
Cash payments to employees and suppliers	(63)	(53)	(246)
Income taxes paid	0	0	0
Net disbursement of loans to customers	3 102	(3 510)	(7 557)
Net (increase)/decrease in deposits with credit institutions	32 088	(14 275)	(5 758)
Net (increase)/decrease in notes, bonds and other interest-bearing securities	(27 382)	768	6 812
Net (increase)/decrease in other assets	2	0	(9)
Net increase/(decrease) in other liabilities	29	31	(23)
Net (increase)/decrease in financial derivatives	3 261	7 366	24 528
Net cash flows from operating activities	11 911	(9 450)	19 832
Cash flows from investing activities			
Net (purchase)/sales of property and equipment	(8)	(6)	7
Net cash flows from investing activities	(8)	(6)	7
Cash flows from financing activities			
Proceeds from issuance of commercial paper	9 764	-	20 337
Repayment of commercial paper	(10 192)	-	(17 678)
Repayment on lease obligation	(2)	(2)	(6)
Proceeds from issuance of debt securities	30 293	34 787	72 508
Repayment of debt securities	(42 468)	(25 343)	(94 564)
Proceeds from issuance of additional Tier 1 capital	0	0	0
Interest paid on Tier 1 capital	(9)	(7)	(69)
Proceeds from issuance of subordinated debt	0	0	0
Repayment of subordinated debt	0	0	0
Dividends paid	0	0	(481)
Net cash flows from financing activities	(12 612)	9 435	(19 952)
Net cash flows	(709)	(21)	(113)
Effects of foreign exchange differences	495	139	296
Net cash flows after foreign exchange differences	(214)	119	183
Cash and cash equivalents at 1 January	459	276	276
Net change in cash and cash equivalents	(214)	119	183
Cash and cash equivalents at end of period	245	395	459
Whereof			
Deposits with credit institutions without agreed time to maturity	245	395	459
Loans from credit institutions without agreed time to maturity	0	0	0

ACCOUNTING POLICIES

KBN prepares its financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The interim financial statements as of 31 March 2020 are prepared in accordance with IAS 34 *Interim Financial Reporting*, and follow the same accounting policies as presented in the annual financial statements for 2019, except for the following:

The preparation of financial statements in accordance with IFRS requires that management uses estimates and judgments that may affect the carrying amounts of assets and liabilities, and revenues and costs. Estimates and judgments are based on historical experience and expectations regarding future developments, and actual outcomes may deviate from the estimates.

Fair value of financial instruments that are not traded in an active market or where quoted prices are not readily available on the reporting date is determined using valuation techniques. The measurement of fair value requires management to make judgments and assumptions related to credit and liquidity risk related to the financial instruments. Even though the judgments and assumptions are based to the largest extent possible on actual mar-

ket conditions on the reporting date, they may increase the uncertainty related to carrying amounts.

International work related to the replacement of today's Interbank Offered Rates (IBOR) may be postponed due to the corona crisis. KBN has a number of contracts with terms related to such reference rates and will be affected by the changes. The bank monitors developments both in connection with changes in accounting standards and otherwise. In April 2020, the IASB published draft amendments for phase 2 of its work in this area. The preliminary opinion is that already hedged relationships with IBOR terms can be continued. No transition effects are otherwise recognised in KBN's accounts.

Events after the reporting period

KBN's share capital was increased by the issuance of 750 000 new shares with a par value of NOK 1 000 for each share on April 15 2020. The new shares were subscribed by the Norwegian State through the Ministry of Local Government and Modernisation.

NOTE 1

NET INTEREST INCOME

(Amounts in NOK 1 000 000)

January-March 2020	Total	At fair value				Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	0	0	0	0	0	0
Other money market deposits	(6)	0	0	0	0	(6)
Instalment loans	1 786	535	0	0	535	1 251
Notes, bonds and other interest-bearing securities	990	851	0	0	851	138
Financial derivatives	(337)	0	(337)	0	(337)	0
Total interest income	2 433	1 386	(337)	0	1 049	1 384
Loans from credit institutions	0	0	0	0	0	0
Commercial paper	39	0	0	0	0	39
Senior securities issued	2 635	1 172	0	0	1 172	1 464
Financial derivatives	(699)	0	(446)	(254)	(699)	0
Subordinated debt	15	15	0	0	15	0
Total interest expenses	1 990	1 187	(446)	(254)	487	1 503
Net interest income	443	199	109	254	562	(119)

January-March 2019	Total	At fair value				Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	4	0	0	0	0	4
Instalment loans	1 441	452	0	0	452	989
Notes, bonds and other interest-bearing securities	267	137	0	0	137	130
Financial derivatives	355	0	355	0	355	0
Total interest income	2 067	588	355	0	944	1 123
Loans from credit institutions	0	0	0	0	0	0
Senior securities issued	2 948	1 642	0	0	1 642	1 306
Financial derivatives	(1 355)	0	(1 517)	162	(1 355)	0
Subordinated debt	15	15	0	0	15	0
Total interest expenses	1 609	1 657	(1 517)	162	302	1 306
Net interest income	458	(1 069)	1 873	(162)	641	(183)

2019	Total	At fair value				Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	0	0	0	0	0	(0)
Instalment loans	6 350	1 878	0	0	1 878	4 472
Notes, bonds and other interest-bearing securities	1 200	632	0	0	632	568
Financial derivatives	1 267	0	1 267	0	1 267	0
Total interest income	8 817	2 511	1 267	0	3 777	5 039
Loans from credit institutions	(0)	(0)	0	0	(0)	0
Senior securities issued	10 897	5 689	0	0	5 689	5 207
Financial derivatives	(4 016)	0	(4 202)	186	(4 016)	0
Subordinated debt	61	61	0	0	61	0
Total interest expenses	6 942	5 751	(4 202)	186	1 735	5 207
Net interest income	1 875	(3 240)	5 468	(186)	2 043	(168)

NOTE 2

Net unrealised gain/(loss) on financial instruments

(Amounts in NOK 1 000 000)	January-March 2020	January-March 2019	2019
Instalment loans	3 319	124	(412)
Notes, bonds and other interest-bearing securities	1 294	333	750
Financial derivatives	(1 950)	4 570	15 380
Loans from credit institutions	0	0	0
Senior securities issued	(3 134)	(5 172)	(15 501)
Subordinated debt	(155)	(19)	(4)
Net unrealised gain/(loss) on financial instruments	(626)	(164)	213

Changes in fair value of liabilities due to changes in own credit risk are not included in the line Net unrealised gain/(loss) on financial instruments in the table above. Such fair value changes are recognised in Other comprehensive income in the Statement of comprehensive income. See Note 9 Senior securities issued for information on calculating such value changes. The change in fair value arising from Senior securities issued presented in the above table is due to changes in parameters other than credit.

Changes in fair value are the result of changes in market prices, mainly prices on bonds, interest rates, credit spreads, basis swap spreads and FX rates, and are reflected in carrying amounts in the Statement of financial position and in the Income statement. As KBN takes very limited currency and interest rate risk, the changes in relevant parameters will mostly be symmetric on the asset and liabilities sides of the Statement of financial position and therefore to a small extent give rise to net effects in the income statement. Changes in credit spreads for investments in the liquidity portfolio, fixed rate instalment loans and issued bonds may on the other hand lead to significant income statement effects, as may changes in basis swap spreads.

In the first quarter of 2020, unrealised changes in fair value have been significantly affected by the corona situation with its associated national and international market turmoil. Net unrealised losses in the quarter of NOK 626 million (unrealised losses of NOK 164 million in Q1 2019) mainly result from instalment loans (fixed

interest loans) that are recognised at fair value and their related financial derivatives with a loss of NOK 449 million. The main driver here is the significant increase in credit spreads in the interest rate markets in March 2020, which is a consequence of the financial turmoil. Market-movements in March 2020, along with limited access to relevant observable prices, led to the need for management to conduct a management overlay on the valuation model which increased the unrealised loss on fixed-rate loans by NOK 338 million.

Furthermore, hedging instruments that convert USD to NOK contribute to an unrealised loss of NOK 268 million, due to a widening of the basis spreads. Notes, bonds and other interest-bearing securities and their associated financial derivatives contribute to a gain of NOK 91 million, mainly through the value-increase of US government bonds due to falling interest rates in March 2020.

Recognised value changes on financial instruments in fair value hedges amount to NOK -35 million in the first quarter of 2020. This amount is included in the above table as net unrealized changes in value. The carrying amount of financial instruments included in fair value hedges amounts to NOK 201 billion.

NOTE 3

Classification of financial instruments

(Amounts in NOK 1 000 000)

At 31 March 2020	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Deposits with credit institutions	18 517	0	0	0	18 517
Other money market deposits	12 490	0	0	0	12 490
Instalment loans	311 262	102 091	0	0	209 171
Notes, bonds and other interest-bearing securities	153 265	115 206	0	0	38 059
Financial derivatives	56 499	0	49 119	7 380	0
Total financial assets	552 032	217 297	49 119	7 380	278 237
Loans from credit institutions	45 336	0	0	0	45 336
Commercial paper	2 648	0	0	0	2 648
Senior securities issued	458 435	182 218	0	0	276 217
Financial derivatives	25 138	0	24 984	153	0
Subordinated debt	2 157	2 157	0	0	0
Total financial liabilities	533 714	184 375	24 984	153	324 201

At 31 March 2019	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Deposits with credit institutions	29 659	0	0	0	29 659
Instalment loans	307 317	88 270	0	0	219 047
Notes, bonds and other interest-bearing securities	114 418	80 989	0	0	33 429
Financial derivatives	10 267	0	8 651	1 616	0
Total financial assets	461 661	169 259	8 651	1 616	282 135
Loans from credit institutions	4 370	0	0	0	4 370
Senior securities issued	414 280	170 270	0	0	244 010
Financial derivatives	23 917	0	22 882	1 035	0
Subordinated debt	2 016	2 016	0	0	0
Total financial liabilities	444 583	172 286	22 882	1 035	248 380

At 31 December 2019	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Deposits with credit institutions	18 181	0	0	0	18 181
Other money market deposits	3 244	394	0	0	2 850
Instalment loans	310 912	95 014	0	0	215 898
Notes, bonds and other interest-bearing securities	111 111	89 397	0	0	21 714
Financial derivatives	15 025	0	12 095	2 929	0
Total financial assets	458 472	184 805	12 095	2 929	258 643
Loans from credit institutions	4 462	0	0	0	4 462
Commercial paper	2 631	0	0	0	2 631
Senior securities issued	403 913	170 856	0	0	233 057
Financial derivatives	27 425	0	27 046	379	0
Subordinated debt	1 987	1 987	0	0	0
Total financial liabilities	440 418	172 844	27 046	379	240 149

NOTE 4

Financial instruments measured at fair value

Methods used for the determination of fair value fall within three categories, which reflect different degrees of valuation uncertainty:

Level 1 - Quoted prices in active markets for identical assets and liabilities

Level 2 - Valuation techniques with observable inputs

Level 3 - Valuation techniques where inputs are to a significant degree unobservable

See Note 11 in the Annual Report 2018 for further information about valuation techniques, inputs, value change analysis and sensitivities. Financial instruments measured at fair value in KBN's Statement of financial position as of 31 March 2020 are distributed in the following way in the fair value hierarchy:

<i>(Amounts in NOK 1 000 000)</i>	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	0	0	0
Other money market deposits	0	0	0	0
Instalment loans	0	13 300	88 791	102 091
Notes, bonds and other interest-bearing securities	96 708	8 324	10 174	115 206
Financial derivatives	0	54 025	2 474	56 499
Total financial assets measured at fair value	96 708	75 649	101 439	273 796
Loans from credit institutions	0	0	0	0
Commercial paper	0	0	0	0
Senior securities issued	16 757	100 937	64 525	182 218
Financial derivatives	0	12 399	12 739	25 138
Subordinated debt	0	0	2 157	2 157
Total financial liabilities measured at fair value	16 757	113 336	79 421	209 512

Reconciliation of movements in Level 3

	Instalment loans	Notes, bonds and other interest-bearing securities	Senior securities issued	Subordinated debt	Financial derivatives
Carrying amount at 31 December 2019	81 437	7 406	66 156	1 987	(7 376)
Purchase	0	2 055	0	0	0
Sale	0	0	(63)	0	17
Issue	8 684	0	0	0	0
Settlement	(6 804)	(1 272)	(7 429)	0	(1 768)
Transfer into Level 3	1 119	1 957	0	0	0
Transfer out of Level 3	(636)	(195)	0	0	0
Gain/(loss) recognised in the period	4 990	222	5 860	170	(1 138)
Carrying amount at 31 March 2020	88 791	10 174	64 524	2 157	(10 265)

Net holdings amounting to NOK 157 million have been transferred from Level 1 to Level 2 in 2020. There are net transfers of NOK 2.2 billion to Level 3 during 2020. The transfers into and out of Level 3 are mainly due to changes in market conditions that affect the assessment of inputs to the valuation techniques during the reporting period, and refinancing/change of loan product for Instalment loans. All gains/(losses) on financial instruments in Level 3 are recognised in the Income statement under "Net interest income", "Net unrealised gain/(loss) on financial instruments" or "Net trading income", or in Other comprehensive income.

Information on valuation techniques:

The methods used for determining the fair value of financial instruments are defined based on the instruments' features and structure. Fair value of financial instruments without embedded derivatives or option elements is determined using the discounted cash flows method, where discount rates are derived from the relevant observable money market interest rates and other significant risk factors that may affect the fair value of the instruments. When such factors cannot be reliably observed at a reporting date, management may make assumptions and use estimates when determining fair value. Fair value of financial instruments with embedded derivatives or option elements is determined using a combination of a discounted cash flow method and option pricing models with observable market data and estimates as inputs. The most significant unobservable inputs used in the valuation in Level 3 are credit spreads for financial instruments not traded in an active market. The table below shows the impact of a 10 bp increase in the credit spread for financial assets and liabilities in Level 3 at 31 March 2020:

	31 March 2020
Instalment loans	(359)
Notes, bonds and other interest-bearing securities	(22)
Financial derivatives	(569)
Senior securities issued	286
Subordinated debt	16
Total	(648)

NOTE 5

Instalment loans

(Amounts in NOK 1 000 000)	31 March 2020	31 March 2019	31 December 2019
Principal amount	306 687	305 741	309 758
Accrued interest	1 478	1 234	1 318
Fair value adjustment	3 135	353	(183)
Expected credit loss	(38)	(11)	(11)
Total instalment loans	311 262	307 317	310 881

NOTE 6

Expected credit loss

Changes in expected credit losses on instalment loans and bond investments of NOK 29 million were recorded in the quarter based on the corona crisis, nationally and internationally. This is an increase in the bank's total loss provisions from NOK 12 million to NOK 40 million due to increased uncertainty in the real economy, but the bank's loss provisions are still relatively limited because Norwegian municipalities cannot go bankrupt, no significant payment problems are experienced in the municipal sector, and the bank's liquidity portfolio is of very high credit quality.

The below table shows expected credit loss as part of the carrying amount of Instalment loans and Notes, bonds and other interest-bearing securities at the end of the period.

(Amounts in NOK 1 000 000)	31 March 2020		31 December 2019
	Carrying amount	Expected credit loss	Expected credit loss
Instalment loans	209 171	(38)	(11)
Notes, bonds and other interest-bearing securities	38 059	(2)	(1)
Total	247 230	(40)	(12)

The below table shows a specification of the period's change in expected credit loss that is recognised in the income statement:

(Amounts in NOK 1 000)	January-March 2020	January-March 2019	2019
Instalment loans	(27 031)	(87)	(282)
Notes, bonds and other interest-bearing securities	(1 430)	(90)	(384)
Total	(28 460)	(177)	(666)

The following table shows an allocation of KBN's expected credit losses as at 31 March 2020 to stage 1, 2 and 3. According to the impairment principles described in IFRS 9 *Financial Instruments*, Stage 1 implies no significant increase in credit risk since recognition of the asset. Stage 2 implies such a significant increase, while stage 3 implies that the asset is credit-impaired. See the Accounting Policies in the 2019 annual report for a description of the allocation to stages and the model for calculation of expected credit loss.

All exposures are estimated to be in Stage 1, which has remained unchanged since 2018.

	Stage 1	Stage 2	Stage 3
Instalment loans	(38)	0	0
Notes, bonds and other interest-bearing securities	(2)	0	0
Total expected credit loss	(40)	0	0

NOTE 7

Notes, bonds and other interest-bearing securities

(Amounts in NOK 1 000 000)

Notes, bonds and other interest-bearing securities by type of issuer	31 March 2020	31 March 2019	31 December 2019
Domestic			
Issued by other borrowers	17 760	17 706	16 584
Foreign			
Issued by public bodies ¹	112 313	94 040	75 285
Issued by other borrowers	23 192	2 672	19 243
Total notes, bonds and other interest-bearing securities	153 265	114 418	111 111

¹Issued by or guaranteed by sovereigns, central banks, regional authorities and multilateral development banks.

Notes, bonds and other interest-bearing securities by time to maturity	31 March 2020	31 March 2019	31 December 2019
Under 1 year	61 175	61 722	40 923
1-5 years	87 436	42 279	60 604
Over 5 years	4 654	10 417	9 584
Total notes, bonds and other interest-bearing securities	153 265	114 418	111 111
Average time to maturity (years)*	1.56	1.55	1.51

*Average time to maturity shown in the table above applies to Notes, bonds and other interest-bearing securities, but not to money market deposits. These are presented on the line Deposits with credit institutions. Including such deposits, the average time to maturity of liquid assets is 1.56 years as of March 31, 2020.

NOTE 8

Credit exposure in notes, bonds and other interest-bearing securities

Amounts in the table below represent actual credit exposure

(Amounts in NOK 1 000 000)

Time to maturity	Exposure as at 31 March 2020									
	< 1 year				> 1 year					
Risk class	A-1	A-2	A-3	Not rated	BBB	A	AA	AAA	Not rated	Total
Sovereigns and central banks	11 954	0	0	1 151	0	4 988	28 550	802	0	47 445
Multilateral development banks	2 814	0	0	0	0	0	117	4 420	0	7 351
Regional authorities	23 750	0	0	11 355	0	0	13 377	5 940	3 096	57 517
Financial institutions	336	0	0	0	0	0	0	0	0	336
Securitisation	0	0	0	0	0	0	0	6	0	6
Covered bonds	5 778	0	0	4 039	0	2 497	5 233	23 063	0	40 610
Total	44 631	0	0	16 545	0	7 485	47 277	34 231	3 096	153 265

NOTE 9

Financial derivatives and cash collateral

(Amounts in NOK 1 000 000)	31 March 2020	31 March 2019	31 December 2019
Financial derivatives - assets	56 499	10 267	15 025
Financial derivatives - liabilities	25 138	23 917	27 425
Market value financial derivatives	31 361	(13 650)	(12 400)
Deposits with credit institutions (asset)	18 517	29 659	18 181
- of which pledged cash collateral	16 373	16 043	17 073
Loans from credit institutions (received cash collateral)	45 336	4 370	4 462
Net received (+)/pledged cash collateral (-)	28 963	(11 673)	(12 611)

Due to the corona situation and associated market turmoil, the NOK exchange rate has moved sharply against the USD, amongst others, and the Norwegian krone depreciated substantially during the month of March. The NOK-USD exchange rate increased from 8.78 at year-end 2019 to 10.51 at the end of Q1 2020, and was up to 11.40 on 19 March. When the Norwegian krone depreciates, the value of balance sheet items in foreign currency converted to Norwegian kroner increases, see note 7 Notes, bonds and other interest-bearing securities and note 10 Senior securities issued.

A further effect of the depreciation of the Norwegian krone is that the market value of the bank's hedging contracts increases. The above table shows that the value of financial derivatives with positive market value increased from NOK 15 billion at year-end to NOK 56 billion at the end of Q1 2020. Similarly, the total market value of financial derivatives changed from NOK -12 billion to NOK 31 billion in the same period. When the market value increases in KBN's favor, the bank receives cash collateral from its counterparties. Cash collateral moved from total pledged cash security of NOK 12.6 billion at year-end to received cash security of NOK 29.0 billion at the end of the first quarter. Received cash collateral is placed in the liquidity portfolio and in short money market deposits, thus increasing the bank's balance sheet.

The above effects increase the bank's total assets, which amounted to NOK 554 billion at the end of Q1 2020, against NOK 461 billion at year-end. Almost the entire increase of NOK 93 billion can be attributed to the depreciation of the Norwegian krone.

NOTE 10

Senior securities issued

<i>(Amounts in NOK 1 000 000)</i>	31 March 2020	31 March 2019	31 December 2019
Senior securities issued (nominal amounts) as at 1 January	400 489	414 603	414 603
New issuance	30 293	34 787	72 508
Redemptions	(42 667)	(26 145)	(95 981)
Amortisation	199	802	1 417
Translation differences	63 501	(2 399)	7 943
Senior securities issued (nominal amounts) as at end of period	451 816	421 647	400 489
Accrued interest	5 013	3 917	4 402
Fair value adjustment	1 606	(11 284)	(978)
<i>Of which value change that is due to change in own credit risk</i>	(23)	549	527
<i>Of which value change that is due to other reasons</i>	1 629	(11 833)	(1 505)
Total senior securities issued	458 435	414 280	403 913

The value change on liabilities that is due to changes in own credit risk is calculated as the change in the credit spread that KBN pays converted to 3M USD Libor, Euribor or Nibor interest rates, i.e. after adjustment for any conversion from other currencies to USD. Value changes on liabilities that are due to changes in own credit risk are recognised in Total comprehensive income, while value changes on liabilities that are due to changes in other market parameters are recognised in the Income statement on the line Net unrealised gain/(loss) on financial instruments.

NOTE 11

Primary capital

(Amounts in NOK 1 000 000)	31 March 2020	31 March 2019	31 December 2019
<i>Common equity Tier 1 capital</i>			
Share capital	3 145	3 145	3 145
Retained earnings	11 471	9 822	9 784
Profit for the period included in Tier 1 capital	(229)	164	1 283
Pension funds above pension commitments	0	0	0
Deferred tax asset*	(669)	0	(688)
Intangible assets	(118)	(112)	(126)
Dividends payable	(150)	(128)	0
Other additions/deductions in common equity Tier 1 capital	(47)	386	370
Share of nulled unamortised estimate differences	0	0	0
Total common equity Tier 1 capital	13 402	13 278	13 768
Other approved Tier 1 capital	2 189	2 189	2 189
Total Tier 1 capital	15 591	15 467	15 957
<i>Supplementary capital</i>			
Ordinary subordinated debt	2 000	2 000	2 000
Total supplementary capital	2 000	2 000	2 000
Total primary capital	17 591	17 467	17 957

*Only non reversing deferred tax asset to be deducted here.

Primary capital has been calculated under the Regulation on the calculation of primary capital for financial institutions. Unrealised gain/(loss) on liabilities that is due to changes in own credit risk include both non-derivative and derivative liabilities.

NOTE 12

Capital adequacy

(Amounts in NOK 1 000 000)	31 March 2020		31 March 2019		31 December 2019
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Minimum capital requirements	Minimum capital requirements
Credit risk					
Sovereigns and central banks	56 656	0	0	0	0
Regional governments and local authorities	358 005	62 613	5 009	4 952	5 006
<i>Of which are Norwegian municipalities</i>	<i>311 261</i>	<i>62 613</i>	<i>5 009</i>	<i>4 952</i>	<i>5 006</i>
Public sector entities	10 774	0	0	0	0
Multilateral development banks	7 351	0	0	0	0
Financial institutions	67 474	3 091	247	605	153
<i>Of which counterparty exposure on derivatives</i>	<i>52 726</i>	<i>3 019</i>	<i>242</i>	<i>106</i>	<i>138</i>
Claims secured by residential property	29	29	2	2	2
Covered bonds	40 610	4 061	325	236	284
Other assets	1 433	3 544	283	1	291
Securitisation	6	1	0	1	0
Credit Valuation Adjustment	334	4 176	334	176	300
Total credit risk	542 672	77 514	6 201	5 973	6 037
Market risk	0	0	0	0	0
Operational risk—Basic Indicator Approach		3 879	310	264	310
Minimum capital requirements		81 393	6 511	6 237	6 348
Total capital ratio			21.6%	22.4 %	22.6 %
Tier 1 capital adequacy ratio			19.2%	19.8 %	20.1 %
Common equity Tier 1 capital adequacy ratio			16.5%	17.0 %	17.4 %
Leverage ratio			3.2%	3.5 %	3.7 %

