



REPORT FOR SECOND QUARTER 2019

ABOUT KBN NORWAY

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 managed in accordance with the Central Government Maintenance Statement.



The mountain lift in Holmenstrand municipality is financed with KBN's green lending rate.
Photo: John Trygve Tollefsen

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 aim 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-June 2019	January-June 2018	2018
RESULTS			
Net interest income	929	960	1 885
Core earnings ¹	569	602	1 194
Profit before tax	632	1 150	1 996
Profit for the period	487	863	1 496
Return on equity after tax ²	7.0%	13.5%	11.9%
Return on equity after tax (core earnings) ²	8.7%	9.7%	9.8%
Return on assets after tax ²	0.2%	0.4%	0.4%
Return on assets after tax (core earnings) ²	0.3%	0.3%	0.3%
LENDING			
New disbursements	22 007	19 988	55 749
Outstanding loans ³	302 002	285 629	302 229
LIQUIDITY PORTFOLIO³			
	107 599	79 424	113 557
BORROWINGS			
New long-term borrowings	53 167	65 917	104 844
Repurchase of own debt	8	98	206
Redemptions	50 356	67 508	79 937
Total borrowings ³	412 652	367 199	414 603
TOTAL ASSETS			
	457 239	400 440	457 701
EQUITY			
Total capital adequacy ratio	15 684	14 891	15 421
Tier 1 capital adequacy ratio	22.6%	23.7%	22.9%
Common equity Tier 1 capital adequacy ratio	20.0%	21.0%	20.3%
Leverage ratio	17.2%	17.9%	17.4%
	3.6%	4.0%	3.6%
LIQUIDITY COVERAGE RATIO (LCR)⁴			
Total	355%	309%	349%
NOK	76%	9%	56%
EUR	148%	423%	625%
USD	381%	473%	248%
AUD	546%	Infinite	489%
JPY	445%	1 051%	Infinite
OTHER KEY FIGURES			
Green loans ⁵	20 531	13 232	18 800

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. The calculation method has been changed in the fourth quarter of 2018 and comparative figures for 2018 have been changed accordingly.

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.

GOOD EARNINGS FOR THE SECOND QUARTER

KBN's net interest income in the second quarter of 2019 was NOK 470 million as compared to NOK 465 million in the same period in 2018. KBN's lending margins remained stable and generated satisfactory earnings.

RESULTS

KBN's net interest income in the second quarter was NOK 470 million as compared to NOK 465 million in the same period in 2018. Its lending margins in the second quarter were virtually unchanged from the second quarter of 2018. Following the increase seen towards the end of 2018, the credit spreads on KBN's lending returned to the levels seen in the second quarter of 2018. Higher lending volume resulted in somewhat higher net interest income from lending activities, while KBN's earnings from its liquidity portfolio investments were lower and contributed only marginally to KBN's total earnings. This was because the margin KBN earned on its liquidity portfolio investments was lower than in the same period in 2018 as a result of a decrease in credit spreads in the international fixed income markets and changes to the composition of the portfolio.

TABLE 1
Profit for the period

	Q2 2019	Q2 2018	2018
Profit for the period	323	389	1 496
Net interest income	470	465	1 885
Fees and commission expenses	26	9	34
Net unrealised gain/(loss) on financial instruments	20	110	338
Expected credit loss	0	0	1
Net trading income	7	2	17
Total operating expenses	58	51	209
Income tax	92	130	499

Amounts in NOK 1 000 000

Profit for the quarter totalled NOK 323 million as compared to NOK 389 million in the same period in 2018. The decrease was due to higher unrealised gains on financial instruments in the second quarter of 2018 than in the same quarter this year. KBN recognised unrealised gains of NOK 20 million in the second quarter of 2019 as a result of increases in the value of assets carried at fair value.

Net interest income in the first six months of 2019 was NOK 929 million as compared to NOK 960 million in the first six months of 2018. The decrease was primarily due to less favourable prices for converting borrowings deno-

minated in foreign currencies into Norwegian kroner and lower margins on KBN's liquidity portfolio investments due to a decrease in credit spreads. KBN's result for the first six months of 2019 was a profit of NOK 487 million as compared to a profit of NOK 863 million in the first six months of 2018. The decrease was primarily due to changes in the value of hedging instruments held by KBN leading to unrealised losses on borrowings in 2019 as compared to unrealised gains in 2018.

KBN's core earnings totalled NOK 569 million in the first six months of 2019 as compared to NOK 602 million in the same period in 2018. Core earnings consists of earnings after tax minus unrealised gains/losses on financial instruments after tax. A provision totalling NOK 30 million was recognised for KBN's estimated accrued contribution for 2019 to a resolution fund. The provision is based on the Norwegian Ministry of Finance's assessment in Proposition to the Storting (Prop.) 159 L (2016-17) according to which KBN's activities are especially low risk in relation to the resolution fund.

Based on profit for the period, KBN achieved a return on equity after tax of 7.0% (annualised) in the first six months of 2019, compared to 13.5% in the first six months of 2018. Based on its core earnings, KBN achieved a return on equity after tax of 8.7%, compared to 9.7% in the first six months of 2018.

TABLE 2
Comprehensive income for the period

	Q2 2019	Q2 2018	2018
Total comprehensive income for the period	410	384	1 223
Profit for the period	323	389	1 496
Unrealised change in fair value of liabilities (and related financial derivatives) after tax due to changes in own credit risk	117	(6)	(365)
Actuarial gain/(loss) on defined benefit plan	0	0	1
Tax effect on positions in Statement of comprehensive income	(29)	1	91

Amounts in NOK 1 000 000

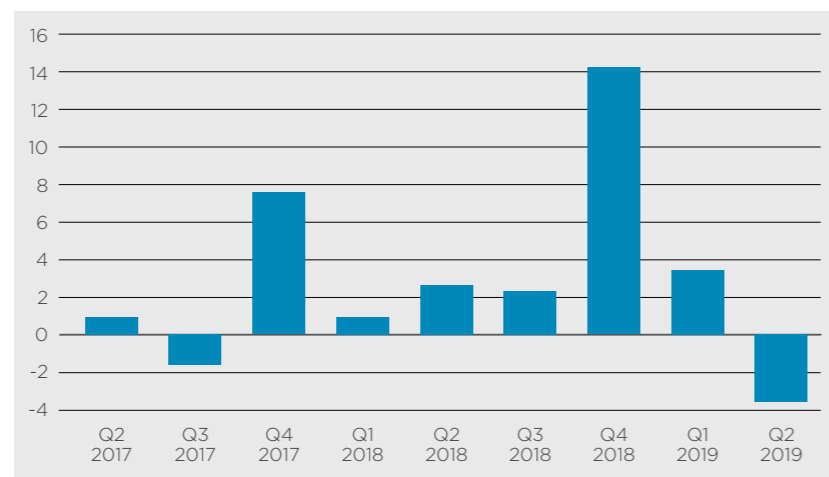
Total comprehensive income in the first six months of 2019 amounted to NOK 797 million, compared to NOK 682 million in the same period in 2018. This was due to unrealised gains after tax on KBN-issued bonds in 2019 totalling NOK 310 million, which were recognised as part of total comprehensive income. Equivalent changes in the fair value of KBN's debt in the first six months of 2018 led to unrealised losses of NOK 180 million in the period, as the fair value of KBN's bonds increased.

Total operating expenses for the first six months of 2019 were NOK 118 million, as compared to NOK 105 million in the same period in 2018. The increase was primarily due to higher expenses associated with the development of digital customer tools and IT infrastructure. Operating expenses (annualised) represented 0.05% of KBN's total assets.

LENDING

KBN's lending portfolio totalled NOK 302.0 billion at the end of the second quarter of 2019. In the second quarter of 2019 KBN's lending portfolio decreased by NOK 3.7 billion, equivalent to a decrease of 1.22%. KBN's lending portfolio grew by NOK 2.7 billion in the second quarter of 2018. Growth in KBN's lending portfolio was virtually flat in the first six months of the year, while in the first six months of 2018 it grew by 1.4%.

LENDING GROWTH
Amounts in
NOK 1 000 000 000



The change in the rate of growth was primarily due to a decrease in loans with maturities of 12 months or less. KBN continues to provide loans of this type, which are to be seen in the context of KBN's liquidity and balance sheet management activities. The second quarter saw an increase in new loans without repayment instalments before maturity but a decrease in long-term instalment-based lending products. With the exception of loans with maturities of 12 months or less, lending grew at the same rate as in 2018.

KBN's portfolio of green loans increased by NOK 0.8 billion in the second quarter and grew in total by NOK 1.7 billion in the first six months of the year. The equivalent figures for 2018 were NOK 0.5 billion and NOK 1.1 billion respectively.

KBN registered demand for new loans in the second quarter of 2019 totalling NOK 6.3 billion. This is NOK 3.8 billion less than in the same period in 2018. The level of demand in the first six months was NOK 16.7 billion as compared to NOK 20.8 billion in the first six months of 2018. The change was primarily due to a decrease in demand for financing for toll roads.

New loan disbursements totalled NOK 22.0 billion in the first six months of 2019 as compared to NOK 20.0 billion in the same period in 2018. These figures include both loans disbursed as new financing and as refinancing for existing loans.

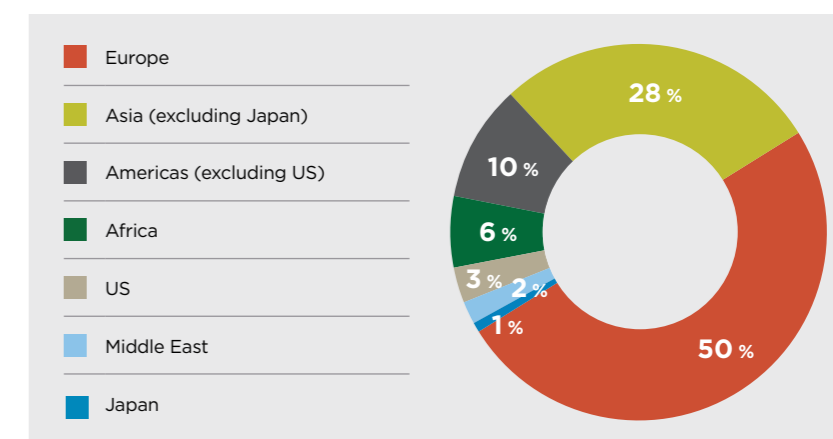
The rate of debt growth in the local government sector (according to Statistics Norway's C2 credit indicator) decreased somewhat in the quarter, and at the end of May 2019 growth over the previous twelve months was 6.8%, down from 7.6% at the end of April. KBN's own twelve-month lending growth to the end of June was 5.9%, and its lending growth to the end of May from the start of this year was 3.0%, as compared to 2.2% in 2018. As in 2018, the local government sector's borrowing in order to make loans from the Norwegian State Housing Bank represented a significant proportion of this growth. KBN's market share is approximately 48% at May 2019.

FINANCIAL MARKETS

FUNDING KBN's funding activities were somewhat more extensive in the second quarter of 2019 than in the second quarter of 2018 due to a greater need for refinancing. New borrowings totalled NOK 18 billion through 12 bond issues in six currencies, as compared to approximately NOK 12 billion in the same period in 2018.

The largest single bond issued by KBN in the second quarter of 2019 was a five-year USD 1.5 billion benchmark bond issued at the start of June, which was well received by the market and attracted a record large orderbook. KBN also issued a sizeable volume of debt in Swedish krona, with the total amount raised amounting to SEK 4.4 billion, primarily from Swedish institutional investors. A number of smaller transactions were also completed in the period in Norwegian kroner, New Zealand dollars and Australian dollars. With KBN continuing to focus on open, transparent markets, no funding was raised in the Japanese Uridashi market in the second quarter. New borrowings in the first six months of the year totalled NOK 53.2 billion as compared to NOK 65.9 billion in the same period in 2018.

FUNDING
Investor geography
second quarter 2019.



LIQUIDITY MANAGEMENT KBN's liquidity portfolio totalled NOK 107.6 billion at 30 June 2019 as compared to NOK 79.4 billion at the end of the second quarter of 2018.

The liquidity portfolio is principally held in zero-risk-weighted assets, and holdings in foreign currencies represent approximately 75% of the portfolio. Fluctuations in the value of the Norwegian krone will therefore cause KBN's liquidity reserve to fluctuate in value.

The credit margins for European countries, guaranteed financial institutions and covered bonds fell over the course of the second quarter. Falling credit margins reduce the return generated by the liquidity portfolio over time.

As expected, Norges Bank raised its key policy rate by one quarter of a percentage point to 1.25% in June 2019. The central bank pointed to the fact that Norway's economy was growing well, and it did not assess the uncertainty associated with weaker growth and the trade wars between various countries internationally as sufficiently high as to prevent an increase in its key policy rate. Norges Bank also signalled that it intends to increase the key policy rate further in 2019 before it levels off in 2020.

CAPITAL

KBN's total primary capital at the end of the second quarter was NOK 17.6 billion, its total Tier 1 capital was NOK 15.6 billion, and its total common equity Tier 1 capital was NOK 13.4 billion. KBN's capital structure was unchanged in the quarter. KBN's total assets were unchanged from the start of 2019.

At the end of the second quarter, KBN had a common equity Tier 1 capital adequacy ratio of 17.2%, a Tier 1 capital adequacy ratio of 20.0%, and a total capital adequacy ratio of 22.6%. The capital requirements imposed by the authorities at 30 June 2019, including the pillar 2 requirement, required KBN to have a common equity Tier 1 capital adequacy ratio of 15.4%, a Tier 1 capital adequacy ratio of 16.9%, and a total capital adequacy ratio of 18.9%. KBN is also required to have a leverage ratio of 3.0%. KBN's leverage ratio at 30 June 2019 was 3.6%.

KBN manages its operations to ensure it complies with the regulatory requirements in force at any time. With effect from 31 December 2019, the risk-weighted capital adequacy requirement will increase by 0.5% as the result of the countercyclical capital buffer requirement rising to 2.5%.

MARKET OUTLOOK

The UK's expected departure from the EU has necessitated changes to a number of the agreements that KBN has with third parties in order to ensure it will continue to comply with regulatory requirements and be able to operate as it does today. The possibility that British companies will lose the right to provide financial services to Norwegian professional customers/qualified counterparties has led to KBN setting up connections to new EU-based derivative counterparties.

KBN has been working in 2019 on a new digital solution that will provide customers with a greater level of self-service as well as access to relevant and current information that will provide added value to customers' own decision-making processes. The solution will be launched in the second half of 2019.

KBN expects the investment needs of the local government sector to be driven in future by its need to upgrade and strengthen its service offering. Greater attention to climate risk and the need for climate change adaptation will lead over time to greater investment in prevention, e.g. storm water management. The level of demand from the local government sector for financing was moderate in the first six months of 2019, as was the case in 2018. The local government sector's borrowing needs are characterised by seasonal variation, and feedback from KBN's customers gives reason to believe that the pattern seen last year will be repeated this year, with higher demand for loans coming in the second half of the year.

KBN is the Norwegian state's bank for the local government sector and was set up in order to provide cost-effective financing for investment in welfare services. In designing its regulations, the EU has to some extent taken low-risk financial institutions such as KBN into account. Several countries have issued suitably adapted regulations for financial institutions that lend to the public sector. A predictable environment and framework conditions that are adapted to KBN's distinctive nature are important to KBN's ability to fulfil the major role it plays in building a better society.

INTERIM CONDENSED FINANCIAL INFORMATION

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	April-June 2019	January-June 2019	April-June 2018	January-June 2018	2018
Interest income from assets measured at amortised cost		1 188	2 311	935	1 743	3 738
Interest income from assets measured at fair value		888	1 832	771	1 419	3 017
Total interest income		2 076	4 143	1 706	3 162	6 755
Total interest expense		1 606	3 214	1 241	2 202	4 871
Net interest income	1	470	929	465	960	1 885
Fees and commission expenses		26	47	9	23	34
Net unrealised gain/(loss) on financial instruments	2	20	(143)	110	315	338
Expected credit loss	6	0	0	0	0	1
Net trading income		7	11	2	4	17
Total other operating income	1	(179)	104	104	296	320
Salaries and administrative expenses		37	78	34	74	142
Depreciation on fixed assets		5	11	5	11	22
Other expenses		16	29	12	21	46
Total operating expenses		58	118	51	105	209
Profit before tax		415	632	518	1 150	1 996
Income tax		92	145	130	288	499
Profit for the period		323	487	389	863	1 496
Portion allocated to shareholder		310	462	376	839	1 448
Portion allocated to owners of additional Tier 1 capital		13	25	12	24	48

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	April-June 2019	January-June 2019	April-June 2018	January-June 2018	2018
Profit for the period		323	487	389	863	1 496
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	9	117	414	(6)	(240)	(365)
Actuarial gain/(loss) on defined benefit plan		0	0	0	0	1
Tax effect		(29)	(103)	1	60	91
Total other comprehensive income		88	310	(4)	(180)	(273)
Total comprehensive income for the period		410	797	384	682	1 223

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	30 June 2019	30 June 2018	31 December 2018
Assets				
Deposits with credit institutions	3,4	30 453	22 737	22 987
Instalment loans	3,4,5,6	303 730	286 772	303 571
Notes, bonds and other interest-bearing securities	3,4,6,7,8	111 244	80 183	116 519
Financial derivatives	3,4	11 643	10 618	14 497
Other assets		169	129	127
Total assets		457 239	400 440	457 701
Liabilities and equity				
Loans from credit institutions	3,4	2 872	4 966	12 085
Senior securities issued	3,4,9	409 733	353 405	402 916
Financial derivatives	3,4	25 363	24 092	24 051
Other liabilities		143	101	34
Current tax liabilities		0	489	0
Deferred tax liabilities		1 413	498	1 164
Pension liabilities		47	50	47
Subordinated debt	3,4	1 987	1 948	1 982
Total liabilities		441 555	385 549	442 279
Share capital		3 145	3 145	3 145
Additional Tier 1 capital		2 189	2 189	2 189
Retained earnings		9 863	8 695	10 088
Profit for the period		487	863	
Total equity	10	15 684	14 891	15 421
Total liabilities and equity		457 239	400 440	457 701

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)	1 January - 30 June 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	487	487
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	310	0	310
Other comprehensive income—actuarial gain/loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(53)	(53)
Dividends for 2018	0	0	0	(481)	(481)
Equity as of 30 June 2019	3 145	2 189	(324)	10 673	15 684

(Amounts in NOK 1 000 000)	1 January - 30 June 2018				
	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 2017	3 145	2 189	0	9 333	14 667
Effects 1 January 2018 due to transition to IFRS 9*	0	0	(360)	383	23
Equity as of 1 January 2018	3 145	2 189	(360)	9 716	14 691
Profit for the period	0	0	0	863	863
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	(180)	0	(180)
Other comprehensive income—actuarial gain/loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(39)	(39)
Dividends for 2017	0	0	0	(443)	(443)
Equity as of 30 June 2018	3 145	2 189	(540)	10 097	14 891

(Amounts in NOK 1 000 000)	1 January - 31 December 2018				
	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 2017	3 145	2 189	0	9 333	14 667
Effects 1 January 2018 due to transition to IFRS 9*	0	0	(360)	383	23
Equity as of 1 January 2018	3 145	2 189	(360)	9 716	14 691
Profit for the period	0	0	0	1 496	1 496
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	(274)	0	(274)
Other comprehensive income—actuarial gain/loss	0	0	0	(1)	(1)
Interest paid on Tier 1 capital	0	0	0	(48)	(48)
Dividends for 2017	0	0	0	(443)	(443)
Equity as of 31 December 2018	3 145	2 189	(634)	10 720	15 421

*See further information and specification of the transition effects in equity on 1 January 2018 relating to the implementation of IFRS 9 under Accounting Policies in the report for first quarter 2018.

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	January-June 2019	January-June 2018	2018
Cash flows from operating activities			
Interest received	4 065	3 097	6 529
Interest paid	(3 114)	(1 529)	(3 899)
Fees and commissions paid	(47)	(23)	(34)
Receipts from repurchase of issued securities	11	4	17
Cash payments to employees and suppliers	(104)	(105)	(209)
Income taxes paid	0	0	0
Net disbursement of loans to customers	230	(3 926)	(20 525)
Net (increase)/decrease in deposits with credit institutions	(16 838)	(11 719)	(4 492)
Net (increase)/decrease in notes, bonds and other interest-bearing securities	4 239	24 232	(6 370)
Net (increase)/decrease in other assets	(3)	6	8
Net increase/(decrease) in other liabilities	66	15	(55)
Net (increase)/decrease in financial derivatives	8 051	(8 075)	3 489
Net cash flows from operating activities	(3 443)	1 977	(25 542)
Cash flows from investing activities			
Net (purchase)/sales of property and equipment	(7)	1	2
Net cash flows from investing activities	(7)	1	2
Cash flows from financing activities			
Down payment on leasing obligation	(3)	0	0
Proceeds from issuance of commercial paper	17 647	0	0
Repayment of commercial paper	(17 671)	0	0
Proceeds from issuance of debt securities	53 167	65 917	104 845
Repayment of debt securities	(49 472)	(67 009)	(79 004)
Proceeds from issuance of additional Tier 1 capital	0	0	0
Interest paid on Tier 1 capital	(53)	(52)	(65)
Proceeds from issuance of subordinated debt	0	0	0
Repayment of subordinated debt	0	0	0
Dividends paid	(481)	(443)	(443)
Net cash flows from financing activities	3 134	(1 587)	25 333
Net cash flows	(316)	392	(208)
Effects of foreign exchange differences	297	(24)	396
Net cash flows after foreign exchange differences	(19)	368	189
Cash and cash equivalents at 1 January	276	87	87
Net change in cash and cash equivalents	(19)	368	189
Cash and cash equivalents at end of period	257	455	276
Whereof			
Deposits with credit institutions without agreed time to maturity	257	455	276
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 30 June 2019 are prepared in accordance with IAS 34 *Interim Financial Reporting*, and follow the same accounting policies as presented in the annual financial statements for 2018, except for the following:

The EU's Bank Recovery and Resolution Directive (BRRD) has been implemented in Norwegian law with effect from 1 January 2019. The transition is regulated by the provisions in the Financial Undertakings Act implementing BRRD in Norway, amongst others. KBN falls under the Directive and expects to be charged an annual recovery fee of about NOK 60 million in accordance with the Bill to Parliament concerning legislation to implement BRRD in Norway (Prop 159L (2016-2017)). In the first half year, NOK 30 million was recognised as an expense on the line Fees and commission expenses.

IFRS 16 *Leases* came into force on 1 January 2019. As a result of the new standard, an asset relating to the bank's office rental agreement, that conveys the right to control the use, of NOK 43 million has been recognised on the line Other assets. A corresponding lease liability amounting to NOK 43 million has been recognised on the line Other liabilities. When implemented, the modified retrospective method has been chosen, and therefore comparative figures for 2018 have not been restated. The implementation had no effect on equity.

IAS 12 *Income Taxes* has been amended with effect from 1 January 2019. The change means that tax deductions on interest expenses from Additional Tier 1 capital, that is classified as equity, are presented as a reduction of the Income tax in the Income statement. Prior to the change, that tax deduction was recognized directly in equity. The change entails a reduced Income tax in the Income statement of NOK 11.6 million compared to the previous accounting principle. Comparative figures have not been restated.

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

NOTE 1

NET INTEREST INCOME

(Amounts in NOK 1 000 000)

April-June 2019	At fair value					Amortised cost
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	(2)	0	0	0	0	(2)
Instalment loans	1 541	460	0	0	460	1 081
Notes, bonds and other interest-bearing securities	286	178	0	0	178	108
Financial derivatives	250	0	250	0	250	0
Total interest income	2 076	638	250	0	888	1 188
Loans from credit institutions	0	0	0	0	0	0
Senior securities issued	2 683	1 373	0	0	1 373	1 311
Financial derivatives	(1 093)	0	(1 153)	60	(1 093)	0
Subordinated debt	15	15	0	0	15	0
Total interest expenses	1 606	1 388	(1 153)	60	295	1 311
Net interest income	470	(750)	1 403	(60)	593	(123)

January-June 2019	At fair value					Amortised cost
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	2	0	0	0	0	2
Instalment loans	2 982	912	0	0	912	2 071
Notes, bonds and other interest-bearing securities	554	315	0	0	315	238
Financial derivatives	605	0	605	0	605	0
Total interest income	4 143	1 227	605	0	1 832	2 311
Loans from credit institutions	0	0	0	0	0	0
Senior securities issued	5 632	3 015	0	0	3 015	2 617
Financial derivatives	(2 448)	0	(2 670)	222	(2 448)	0
Subordinated debt	30	30	0	0	30	0
Total interest expenses	3 214	3 045	(2 670)	222	597	2 617
Net interest income	929	(1 819)	3 275	(222)	1 234	(306)

April-June 2018	At fair value					Amortised cost
	Total	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	1 259	400	0	0	400	859
Notes, bonds and other interest-bearing securities	208	136	0	0	136	71
Financial derivatives	235	0	235	0	235	0
Total interest income	1 706	536	235	0	771	935
Loans from credit institutions	2	1	0	0	1	0
Senior securities issued	2 799	1 430	0	0	1 430	1 368
Financial derivatives	(1 575)	0	(1 598)	24	(1 575)	0
Subordinated debt	16	16	0	0	16	0
Total interest expenses	1 241	1 447	(1 598)	24	(128)	1 369
Net interest income	465	(911)	1 833	(24)	898	(433)

January-June 2018	At fair value					Amortised cost
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	13	0	0	0	0	13
Instalment loans	2 399	793	0	0	793	1 606
Notes, bonds and other interest-bearing securities	322	199	0	0	199	123
Financial derivatives	427	0	427	0	427	0
Total interest income	3 162	992	427	0	1 419	1 743
Loans from credit institutions	3	1	0	0	1	1
Senior securities issued	5 390	3 127	0	0	3 127	2 263
Financial derivatives	(3 220)	0	(3 189)	(31)	(3 220)	0
Subordinated debt	31	31	0	0	31	0
Total interest expenses	2 202	3 158	(3 189)	(31)	(62)	2 264
Net interest income	960	(2 167)	3 617	31	1 481	(522)

2018	At fair value					Amortised cost
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	37	0	0	0	0	37
Instalment loans	5 000	1 616	0	0	1 616	3 384
Notes, bonds and other interest-bearing securities	755	437	0	0	437	317
Financial derivatives	964	0	964	0	964	0
Total interest income	6 755	2 053	964	0	3 017	3 738
Loans from credit institutions	3	1	0	0	1	1
Senior securities issued	10 707	6 124	0	0	6 124	4 583
Financial derivatives	(5 900)	0	(6 017)	117	(5 900)	0
Subordinated debt	61	61	0	0	61	0
Total interest expenses	4 871	6 186	(6 017)	117	286	4 584
Net interest income	1 885	(4 133)	6 981	(117)	2 731	(846)

NOTE 2

Net unrealised gain/(loss) on financial instruments

(Amounts in NOK 1 000 000)	April-June 2019	January-June 2019	April-June 2018	January-June 2018	2018
Instalment loans	137	261	187	(555)	(420)
Notes, bonds and other interest-bearing securities	491	824	(78)	(219)	44
Financial derivatives	3 916	8 486	(4 865)	(8 895)	(8 084)
Loans from credit institutions	0	0	0	0	0
Senior securities issued	(4 508)	(9 680)	4 882	9 953	8 771
Subordinated debt	(16)	(35)	(16)	30	27
Net unrealised gain/(loss) on financial instruments	20	(143)	110	315	338

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.

Net unrealised gains in the second quarter of 2019 amounting to NOK 20 million come from Instalment loans and Notes, bonds and other interest-bearing securities and related derivatives contracts due to a reduction in credit spreads.

KBN has expanded its methods for calculation of interest rate sensitivity. KBN calculates sensitivity using the EVE and the NII methods. The EVE method provides a sensitivity-estimate for a change in market value related to a change in market interest rates of 1 percentage point. The bank's sensitivity to unrealised value changes (EVE method) related to a change in market interest rates of 1 percentage point is estimated at NOK 142 million as at 30 June 2019. In the calculation different currencies are not netted. The calculations do not affect the period's income statement and Statement of Financial Position. The bank's sensitivity to net interest income (NII method) based on a change in the market interest rate of 1 percentage point over a horizon of 3 months is estimated at NOK 32 million as of 30 June 2019. In the calculation different currencies are not netted. The NII method estimates possible changes to the period's profit and loss, while the EVE method estimates the possible effect on market value on all of the bank's balance sheet items.

NOTE 3

Classification of financial instruments

(Amounts in NOK 1 000 000)

At 30 June 2019

	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Deposits with credit institutions	30 453	0	0	0	30 453
Instalment loans	303 730	87 841	0	0	215 889
Notes, bonds and other interest-bearing securities	111 244	77 392	0	0	33 853
Financial derivatives	11 643	0	8 912	2 732	0
Total financial assets	457 071	165 233	8 912	2 732	280 195
Loans from credit institutions	2 872	0	0	0	2 872
Senior securities issued	409 733	176 425	0	0	233 308
Financial derivatives	25 363	0	25 155	207	0
Subordinated debt	1 987	1 987	0	0	0
Total financial liabilities	439 954	178 412	25 155	207	236 180

At 30 June 2018

	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Deposits with credit institutions	22 737	0	0	0	22 737
Instalment loans	286 772	82 129	0	0	204 643
Notes, bonds and other interest-bearing securities	80 183	59 214	0	0	20 969
Financial derivatives	10 618	0	10 618	0	0
Total financial assets	400 310	141 343	10 618	0	248 349
Loans from credit institutions	4 966	0	0	0	4 966
Senior securities issued	353 405	149 950	0	0	203 455
Financial derivatives	24 092	0	21 797	2 295	0
Subordinated debt	1 948	1 948	0	0	0
Total financial liabilities	384 411	151 898	21 797	2 295	208 421

At 31 December 2018

	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Deposits with credit institutions	22 987	0	0	0	22 987
Instalment loans	303 571	87 296	0	0	216 275
Notes, bonds and other interest-bearing securities	116 519	87 670	0	0	28 849
Financial derivatives	14 497	0	13 838	659	0
Total financial assets	457 574	174 966	13 838	659	268 111
Loans from credit institutions	12 085	0	0	0	12 085
Senior securities issued	402 916	167 949	0	0	234 967
Financial derivatives	24 051	0	22 322	1 730	0
Subordinated debt	1 982	1 982	0	0	0
Total financial liabilities	441 035	169 931	22 322	1 730	247 052

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 30 June 2019 are distributed in the following way in the fair value hierarchy:

(Amounts in NOK 1 000 000)	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	0	0	0
Instalment loans	0	15 231	72 610	87 841
Notes, bonds and other interest-bearing securities	59 988	13 307	4 096	77 392
Financial derivatives	0	9 597	2 046	11 643
Total financial assets measured at fair value	59 988	38 136	78 752	176 876
Loans from credit institutions	0	0	0	0
Senior securities issued	11 337	89 410	75 678	176 425
Financial derivatives	0	9 803	15 559	25 362
Subordinated debt	0	0	1 987	1 987
Total financial liabilities measured at fair value	11 337	99 213	93 224	203 774

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 2018	71 496	3 616	75 822	1 982	(17 106)
Purchase	0	6 854	0	0	4 046
Sale	0	0	(8)	0	0
Issue	13 989	0	2 188	0	0
Settlement	(12 981)	(5 035)	(5 305)	0	(138)
Transfer into Level 3	1 072	35	0	0	0
Transfer out of Level 3	(676)	(2 224)	0	0	0
Gain/(loss) recognised in the period	(289)	849	2 982	5	(315)
Carrying amount at 30 June 2019	72 610	4 096	75 678	1 987	(13 513)

Holdings amounting to NOK 491 million have been transferred from Level 2 to Level 1 in the first half year of 2019. There are net transfers of NOK 1.8 billion out of Level 3 during the first half year. 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 30 June 2019:

	30 June 2019
Instalment loans	(245)
Notes, bonds and other interest-bearing securities	(10)
Financial derivatives	(375)
Senior securities issued	377
Subordinated debt	0
Total	(253)

NOTE 5

Instalment loans

(Amounts in NOK 1 000 000)	30 June 2019	30 June 2018	31 December 2018
Principal amount	302 002	285 632	302 232
Accrued interest	1 249	1 057	1 121
Fair value adjustment	490	94	229
Expected credit loss	(11)	(10)	(11)
Total instalment loans	303 730	286 772	303 571

NOTE 6

Expected credit loss

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)	30 June 2019		31 December 2018	
	Carrying amount	Expected credit loss	Expected credit loss	Expected credit loss
Instalment loans	215 889	(11)	(11)	(11)
Notes, bonds and other interest-bearing securities	33 854	(1)	(1)	(1)
Total	249 743	(12)	(12)	(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)	April-June 2019	January-June 2019
Instalment loans	58	(30)
Notes, bonds and other interest-bearing securities	(52)	(142)
Total	6	(171)

The following table shows an allocation of KBN's expected credit losses as at 30 June 2019 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 2018 annual report for a description of the allocation to stages and the model for calculation of expected credit loss.

	Stage 1	Stage 2	Stage 3
Instalment loans	(11)	0	0
Notes, bonds and other interest-bearing securities	(1)	0	0
Total expected credit loss	(12)	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	30 June 2019	30 June 2018	31 December 2018
Domestic			
Issued by other borrowers	18 474	8 206	15 274
Foreign			
Issued by public bodies ¹	90 321	68 690	98 567
Issued by other borrowers	2 450	3 288	2 679
Total notes, bonds and other interest-bearing securities	111 244	80 183	116 519

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	30 June 2019	30 June 2018	31 December 2018
Under 1 year	49 319	51 889	76 078
1-5 years	52 377	23 076	33 224
Over 5 years	9 548	5 219	7 217
Total notes, bonds and other interest-bearing securities	111 244	80 183	116 519
Average time to maturity (years)	1.91	1.26	1.41

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 30 June 2019									Total
	< 1 year				> 1 year					
Risk class	A-1	A-2	A-3	Not rated	BBB	A	AA	AAA	Not rated	
Sovereigns and central banks	6 266	0	0	0	0	2 503	21 303	1 199	0	31 272
Multilateral development banks	1 097	0	0	0	0	0	461	4 081	0	5 638
Regional authorities	17 406	0	0	5 317	0	0	10 282	1 414	1 032	35 451
Financial institutions	4 640	0	0	0	0	0	0	174	0	4 813
Securitisation	0	0	0	0	0	0	0	6	0	6
Covered bonds	6 944	0	0	7 649	0	0	1 311	18 159	0	34 064
Total	36 353	0	0	12 967	0	2 503	33 356	25 033	1 032	111 244

NOTE 9

Senior securities issued

(Amounts in NOK 1 000 000)

	30 June 2019	30 June 2018	31 December 2018
Senior securities issued (nominal amounts) as at 1 January	414 603	373 816	373 816
New issuance	53 167	65 917	104 844
Redemptions	(50 363)	(67 606)	(80 143)
Amortisation	892	597	1 138
Translation differences	(5 646)	(5 525)	14 947
Senior securities issued (nominal amounts) as at end of period	412 652	367 199	414 603
Accrued interest	3 974	3 672	4 474
Fair value adjustment	(6 894)	(17 466)	(16 160)
Of which value change that is due to change in own credit risk	432	(721)	845
Of which value change that is due to other reasons	(7 325)	(16 745)	(17 005)
Total senior securities issued	409 733	353 405	402 916

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 10

Primary capital

(Amounts in NOK 1 000 000)

	30 June 2019	30 June 2018	31 December 2018
<i>Common equity Tier 1 capital</i>			
Share capital	3 145	3 145	3 145
Retained earnings	9 863	8 695	8 591
Profit for the period included in Tier 1 capital	487	863	1 496
Pension funds above pension commitments	0	0	0
Deferred tax asset*	0	0	0
Intangible assets	(116)	(121)	(116)
Dividends payable	(255)	(241)	(481)
Other additions/deductions in common equity Tier 1 capital	297	517	609
Share of nulled unamortised estimate differences	0	0	0
Total common equity Tier 1 capital	13 422	12 857	13 244
Other approved Tier 1 capital	2 189	2 189	2 189
Total Tier 1 capital	15 611	15 046	15 433
<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	17 611	17 046	17 433

*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 11

Capital adequacy

(Amounts in NOK 1 000 000)

	30 June 2019		30 June 2018		31 December 2018
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Minimum capital requirements	Minimum capital requirements
Credit risk					
Sovereigns and central banks	31 272	0	0	0	0
Regional governments and local authorities	332 021	61 167	4 893	4 638	4 892
<i>Of which are Norwegian municipalities</i>	303 701	61 167	4 893	4 638	4 892
Public sector entities	7 128	0	0	0	0
Multilateral development banks	5 638	0	0	0	0
Financial institutions	39 542	7 683	615	508	522
<i>Of which counterparty exposure on derivatives</i>	6 379	1 488	119	122	109
Claims secured by residential property	29	29	2	3	3
Covered bonds	34 064	3 406	273	97	216
Other assets	14	14	1	1	1
Securitisation	6	6	1	1	1
Credit Valuation Adjustment	198	2 474	198	205	180
Total credit risk	449 912	74 780	5 982	5 452	5 814
Market risk	0	0	0	0	0
Operational risk—Basic Indicator Approach		3 299	264	290	264
Minimum capital requirements		78 079	6 246	5 743	6 078
Total capital ratio			22.6%	23.7%	22.9 %
Tier 1 capital adequacy ratio			20.0%	21.0%	20.3 %
Common equity Tier 1 capital adequacy ratio			17.2%	17.9%	17.4 %
Leverage ratio			3.6%	4.0%	3.6 %

STATEMENT BY THE BOARD OF DIRECTORS

We hereby confirm that the half-yearly report for the period 1 January 2019 to 30 June 2019 has, to the best of our knowledge, been prepared in accordance with IAS 34 Interim Financial Reporting, and that the information contained in the accounts provides a true and fair view of the company's assets, liabilities, financial position and results as a whole.

We also confirm that, to the best of our knowledge, the interim report provides a true and fair overview of important events during the accounting period and their effects on the half-yearly accounts, and also of the material risks and uncertainties facing the company during the next accounting period.

Oslo, 31 July 2019

The Board of Directors of Kommunalbanken AS

