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Ratings

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KBN Kommunalbanken Norway

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KBN Kommunalbanken Norway

This report does not constitute a rating action.

Credit Highlights

Issuer Credit Rating
AAA/Stable/A-1+

Overview

Enterprise risk profile	Financial risk profile
The Norwegian local government sector exhibits key structural features that support high credit quality, although a high and rising debt burden points to a weakening trend.	Very strong capitalization and liquidity position provide financial buffers.
Very strong management and governance is supported by compliance with strict banking regulatory standards.	Sustained high levels of capitalization combined with no significant concentration on its lending portfolio translate into a very strong risk-adjusted capital (RAC) ratio
Kommunalbanken's market position remains robust, underpinned by a diversified revenue base.	Excellent name recognition and active usage of green financing solutions support broad market access and a deep investor base.

We see a weakening trend for the Norwegian institutional framework for local and regional governments (LRGs), triggered by a persistent mismatch between revenues and total expenditures. The sector's growing debt burden, resulting from insufficient grant coverage relating to LRG investments, undermines our view on the predictability of the local government financial position. The LRG sector is grappling with challenges arising from demographic shifts, such as an ageing population and an increasing dependency ratio. That said, this is being counterbalanced by automatic revenue stabilizers in the central government grant framework, and a far-reaching equalization system that supports the high credit quality in the sector. Moreover, very strong management and a robust market position are offsetting factors and support the strong enterprise risk profile.

We expect Kommunalbanken to maintain a very strong financial profile supported by compliance with banking regulatory standards. KBN operates under a relatively strict regulatory standard set by Norway's Financial Supervisory Authority (FSA). We expect the bank to remain compliant with all regulatory requirements, supporting a very strong financial risk profile.

In our view, there is an extremely high likelihood that Kommunalbanken will receive timely and sufficient extraordinary support from the central government owner in the event of financial distress. We believe KBN has a very important role and integral link with Norway's central government, resulting in an extremely high likelihood of receiving extraordinary support in the unlikely event of financial distress.

Outlook

The stable outlook reflects our view that, despite the weakening trend we see for Norwegian LRGs' institutional framework, there is limited risk that KBN's market relevance, ownership structure, or implicit support from the Norwegian government will change in the next few years.

Downside scenario

We could lower our ratings if we thought KBN's public policy role was subsiding, or if there were a change to its ownership, resulting in a lower likelihood of extraordinary support from the Norwegian government. The ratings could also come under pressure if KBN's financial indicators weakened significantly, or if management failed to achieve its strategy and experienced a structural reduction of its market share, limiting its ability to fulfill its mandate.

Rationale

The rating on KBN is supported by our view that the bank will remain a key financier of the Norwegian local government sector. KBN has a long track record of fulfilling its public policy role and has been active under adverse market conditions, as demonstrated most recently during the pandemic.

KBN operates under a regulatory framework that we consider stricter than those in other Nordic countries. We expect the bank will remain compliant with all regulatory requirements, supporting its very strong financial risk profile. KBN's management has considerable expertise, prudently handles risks, and consistently complies with the regulatory requirements under which it operates.

The 'AAA' rating on KBN is two notches higher than the stand-alone credit profile (SACP) because we think the bank has a very important role and integral link with the Norwegian government. Therefore, we think there is an extremely high likelihood that the Norwegian government would provide timely and sufficient extraordinary support to KBN in the event of financial distress.

Enterprise risk profile: Low-risk municipal sector, very strong management and governance, and strong market position. KBN has a long track record of fulfilling its public policy role of providing affordable financing to Norwegian local governments. KBN was established in 1926 by an act of parliament and assumed its current organizational structure in 1999 via a conversion act. The bank was 80% owned by the Norwegian government and 20% owned by Kommunal Landspensjonskasse (KLP) until 2009, when the Norwegian government bought KLP's shares and became the sole owner. Over the years, the Norwegian government has made capital injections into the bank several times, most recently during the pandemic, to ensure that the bank can fulfil its mandate.

Our low risk Public Industry Country Risk Assessment for Norway is supported by its wealthy economy. After a broad slowdown in 2023, when real GDP growth dropped to 0.5%, we anticipate economic growth will rebound to 1% in 2024 partly on recovering consumption and increasing investments. Wealth levels remain among the highest in Europe. Our view is also supported by the advanced financial system in Norway and the tight link between the local government sector and the 'AAA' rated sovereign. Moreover, the central government's close oversight of local governments provides a basis for timely actions to address financial issues arising in the sector.

However, we see a weakening trend for the Norwegian institutional framework, triggered by a persistent mismatch between revenues and total expenditures, particularly in the capital accounts. Consequently, LRG sector debt has been increasing over more than 10 years as capital projects often require recourse to debt. Debt as a percentage of the sector's revenues increased to 105% in 2022 from 95% in 2015, and we project continued debt uptake will cement the ratio at similarly high levels in the medium term.

Despite this weakening trend, we continue to regard the institutional framework as extremely predictable and supportive, with key responsibilities supported by automatic revenue stabilizers in the central government grant framework, and a far-reaching equalization system. We view the balanced budget requirement as a strength, as it steers toward operating surpluses. This is supported by central government grants, and a far-reaching equalization system that balances the otherwise weak financial flexibility. We also view as positive the central government's extensive control framework and its intervention mechanisms preventing defaults.

Kommunalbanken's public-sector mandate is to provide long-term funding to, or guarantees by, Norwegian LRGs. KBN aims to complement market participants and, as a result, tries to maintain a market share at about 50%. Lending from banks to the LRG sector is decreasing, while funding from the capital markets has increased in the last five years. Husbanken (the state housing bank), which directly funds social housing, is also becoming more active. KBN's market share increased marginally to 51.1% in 2023 compared to 49.9% a year before.

KBN's capacity to act as a countercyclical lender further demonstrates its broad access to the markets. Its innovative product offering, which responds to changing market and customer needs, has enabled KBN to remain relevant to its customers. The bank strives to be a leading financial institution for sustainable financing solutions and, at the end of 2023, just over 15% of its total lending portfolio was green loans. Moreover, in April 2024, S&P Global Ratings published a second party opinion (SPO) on KBN's green bond framework (see "Kommunalbanken Green Bond Framework"). Shortly thereafter, KBN issued its most oversubscribed Euro trade to date under the updated framework.

In our view, KBN's management team is experienced and key members generally have long tenure with the funding agency. Robust risk-management policies and practices mitigate key risks in the bank's operations. Management's policies and practices are prudent and oversight from the Norwegian FSA ensures continuity of managerial practices and mitigates key risks, a distinctive feature when compared with most of its global peers. KBN's organizational structure allows it to respond appropriately to stakeholder needs and requirements. Additionally, the Ministry of Local Government and Regional Development's participation in supervisory board meetings increases oversight.

Financial risk profile: Very strong capitalization and liquidity position support KBN's credit quality.

KBN's risk-adjusted capital (RAC) ratio before adjustments remained very high at 70% as of March 31, 2024. The capital position strengthened after the central government's capital injection of Norwegian krone (NOK) 750 million in April 2020. In June 2023, the bank replaced part of its subordinated loan with additional Tier 1 (ATI) instruments to ensure a margin against regulatory leverage ratio requirements. We assess the hybrid instrument to have intermediate equity content and we therefore include it in our total adjusted capital (TAC) calculation. The instruments are perpetual and have a call date of at least five years from issuance. In addition, they do not contain a coupon step-up and have loss-absorption features on a going-concern basis. Although we expect the Norwegian government would prevent a conversion to equity of these AT1 capital notes, they are available to KBN to provide equity if triggered.

When factoring in our adjustment for single-name concentration in underlying borrowers, KBN's S&P Global Ratings-adjusted RAC ratio remains a very strong 32%. As with its Nordic peers, concentration is relatively high, with the top 22 largest borrowers representing about 32% of the total loan book. However, the largest single exposure, City of Oslo, represents only about 4.5% of the portfolio and KBN has funded every municipality in Norway.

KBN has never experienced any losses and has no past due or impaired exposures. Risk management remains very robust and KBN uses internal models for capital requirements for market, liquidity, and operational risks. The bank also implements strong credit risk monitoring of all its customers and processes for granting loans, and is gradually incorporating environmental, social, and governance (ESG) considerations. A new credit assessment model was introduced in March 2024 and will be used starting this summer.

KBN's compliance with regulatory capital requirements supports our expectation that its S&P Global Ratings-adjusted RAC ratio will stay comfortably above our 15% threshold and remain a key feature of its financial risk profile. As of December 2023, KBN's common equity Tier 1 capital adequacy (CET1) ratio of 17.4% was well above the minimum regulatory Tier 1 capital ratio of 14.8%. The risk weights applied in the Norwegian FSA framework are significantly higher than those used under our RAC methodology. Therefore, KBN's adjusted RAC ratio is higher than its CET1 ratio.

KBN's excellent name recognition and deep investor base supports our view of its solid funding profile. The bank has a diversified funding strategy but with a focus on benchmark issuance in strategic markets. It has also been active in the green bond market for more than 10 years, which has further expanded the investor base. At the end of 2023, Kommunalbanken had green bonds outstanding in five currencies--almost 9% of the bank's total borrowings.

As of March 2024, KBN's funding ratio remains very solid at above 2x and is still very strong after including its undrawn lending commitments. The majority of KBN's funding instruments are plain vanilla and it has reduced its exposure to callable funding and Japanese retail Uridashi funding.

KBN remains proactive in its liquidity management and has very strong liquidity buffers. Its policy is to hold minimum liquidity equal to the projected payment obligations over the coming 12 months without access to funding. In line with our expectations, all KBN's derivative counterparties have now moved to bilateral credit support annexes with a daily exchange of collateral.

Our 12-month liquidity ratio was 2.3x as of March 2024 after including undrawn loan commitments. This indicates that KBN, with a comfortable margin, would be able to cover all committed lending and debt repayments for at least one year, even under extremely stressed market conditions and without access to the capital markets.

Extremely high likelihood of support from the Norwegian government.

The 'AAA' rating on KBN is two notches higher than the SACP because we think the bank has a very important role and integral link with the Norwegian government. Therefore, we foresee an extremely high likelihood that the central government would provide timely and sufficient extraordinary support to KBN. The government has shown its proactive willingness to support several times over the years, although KBN not has experienced financial distress because the government has made capital injections--in 2008, 2012, and 2015. Most recently, in 2020 the bank's mandate was reinforced by a capital injection from the central government to support KBN's capacity to respond to municipalities' funding needs during the pandemic.

Our assessment is based on our view of KBN's:

- Very important role for the Norwegian government as a vehicle to limit the cost of debt for Norway's LRG sector. Acting largely as a state instrument, KBN performs an important public policy function in providing low-cost funding to the Norwegian LRG sector and in promoting competition in the municipal loan market; and
- Integral link with the Norwegian government, its sole owner since 2009. Through a letter of support, the central government has formalized its relationship with KBN and expressed its clear intention of extending timely support should the company find itself in financial distress. The central government confirmed its supportive stance toward KBN in November 2011 and ratified it in 2017 to avoid negative reputational effects associated with Eksportfinans losing its government mandate to provide state-subsidized export credit.

Issue Ratings--Subordination Risk Analysis

We rate two of KBN's AT1 capital notes 'A+' and its subordinated bond 'AA+'. The starting point for these issue ratings is our 'AAA' issuer credit rating on KBN given our view of the extremely high likelihood of KBN receiving extraordinary support from its owner in case of financial distress. We also note that the above-mentioned letter of support, which states that the government will support KBN to fulfill its financial obligations, does not exclude hybrids. As such, we believe that the Norwegian government would provide financial support to prevent loss absorption and especially that it could step in early to prevent a conversion.

We derive the four-notch difference between the 'A+' issue ratings on the AT1 notes and the issuer credit rating on KBN as follows:

- One notch for subordination;
- Two notches for Tier 1 regulatory capital status; and
- One notch because the instruments allow for a full or partial temporary write-down.

The 'AA+' issue rating on KBN's subordinated bond reflects the bond's subordination to KBN's senior unsubordinated debt. We do not apply further notching for a full or partial temporary write-down because we regard this as contradicting our view of government support for KBN.

Key Statistics

Table 1

KBN Kommunalbanken Norway -- Selected Indicators					
	--Year ended Dec. 31--				
(Mil. NOK)	**2023**	**2022**	**2021**	**2020**	**2019**
Business Position					
Total adjusted assets	522,041	492,307	472,924	498,088	460,652
Customer loans (gross)	352,267	324,584	323,696	321,900	310,923
Growth in loans (%)	9.00	0.27	0.56	4.00	2.00
Net interest revenue	2,105	1,866	1,585	1,672	1,874
Noninterest expenses	325	270	255	256	251

Table 1

KBN Kommunalbanken Norway -- Selected Indicators (cont.)					
	--Year ended Dec. 31--				
(Mil. NOK)	**2023**	**2022**	**2021**	**2020**	**2019**
Capital & Risk Position					
Total liabilities	500,520	473,547	453,983	479,681	444,377
Total adjusted capital*	20,470	17,832	16,484	16,577	15,639
Assets/capital	30	30	30	31	33
RAC ratio before diversification (%)*	69.6	70.5	69.9	67.2	46.0
RAC ratio after diversification (%)*	32.4	31.1	30.7	29.5	25.0
Funding and Liquidity					
Liquidity ratio with loan disbursement (one year)*	2.3	2.3	2.2	2.0	1.6
Liquidity ratio without loan disbursement (one year)*	2.4	2.4	2.2	2.0	1.7
Funding ratio (one year)*	1.9	2.1	2.3	1.9	1.5

*As of the first quarter of the fiscal year. NOK--Norwegian krone. N.A.--Not available. RAC--Risk-adjusted capital.

Rating Score Snapshot

Table 2

KBN Kommunalbanken Norway--Ratings score snapshot	
Issuer credit rating	AAA/Stable/A-1+
Stand-alone credit profile	aa
Enterprise risk profile	Strong (2)
PICRA	Strong (2)
Business position	Strong (2)
Management and governance	Very Strong (1)
Financial risk profile	Very Strong (1)
Capital adequacy	Very Strong (1)
Funding and liquidity	Positive and Very Strong (1)
Support	(2)
GRE support	(2)
Group support	0
Additional factors	0

GRE--Government-related entity. PICRA--Public Sector Industry Risk And Country Assessment.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Rising Debt Points To A Weakening Trend For Norwegian LRGs, March 21, 2024
- Norway, March 11, 2024

Ratings Detail (As Of June 26, 2024)*	
KBN Kommunalbanken Norway	
Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	
Foreign Currency	A-1+
Junior Subordinated	A+
Senior Unsecured	AAA
Short-Term Debt	A-1+
Subordinated	AA+
Issuer Credit Ratings History	
03-Mar-2000	AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.