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Eika Boligkreditt AS

First Time Ratings

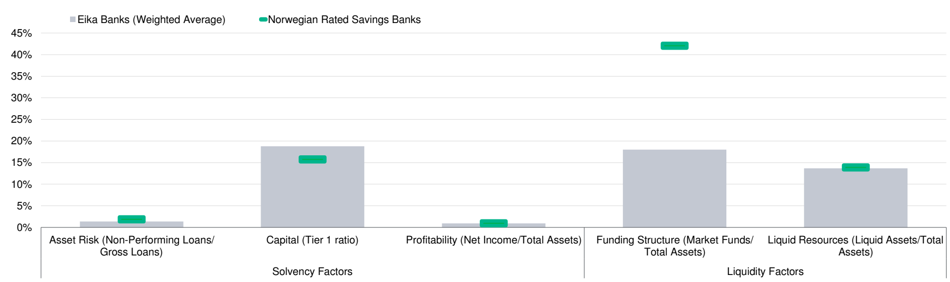
Summary Rating Rationale

On 2 June, Moody's assigned a first time long-term Baa1 issuer rating and a Counterparty Risk Assessment (CRA) of A3(cr)/Prime-1(cr) to Eika Boligkreditt, a specialized covered bond issuer owned by an alliance of 72 Norwegian savings banks.

The assigned ratings reflect our view of the credit risk profiles of the individual banks forming the Eika alliance, as well as our assessment of the likelihood that these banks will support Eika Boligkreditt in case of need.

The key drivers of Eika Boligkreditt's Baa1 issuer rating are: 1) the predominantly investment grade credit profiles of the banks that form the Eika alliance which is also reflected in the high quality assets the banks transfer to Eika Boligkreditt; and 2) Moody's assessment of the likelihood that member banks would provide support to Eika Boligkreditt in case of need, taking into account the balance of their obligations and incentives to do so under the Eika structure.

Exhibit 1
Eika Alliance Banks Key Financial Metrics
As of September 2016



Source: Eika Boligkreditt, Moody's Financial Metrics

Credit Strengths

» The strong, predominantly investment grade credit profiles, of the banks that own Eika Boligkreditt which form the starting point for Eika's ratings

» The strong operating environment in Norway where Eika and the alliance banks operate

» The member banks' commitment to safeguard Eika Boligkreditt's access to sufficient liquidity and capital

Credit Challenges

» High concentration of the individual banks and Eika Boligkreditt in the Norwegian real estate market

» Lack of an explicit guarantee by the owner banks of Eika Boligkreditt's obligations

Rating Outlook

The stable outlook assigned to Eika Boligkreditt's issuer rating reflects our expectation that the banks' financial profiles and their capacity and willingness to support Eika Boligkreditt will remain broadly in line with their current standing over the next 12 to 18 months.

Factors that Could Lead to an Upgrade

» Positive pressure would develop on the ratings following improvements in the risk profile of a significant proportion of the owner banks, as evidenced by improving asset quality metrics and reduced concentration to CRE. A full guarantee of Eika Boligkredit's obligations by the owner banks would also result in an upgrade.

Factors that Could Lead to a Downgrade

» The ratings would be downgraded if the credit profile of a significant portion of the banks weakens significantly, as evidenced by worsening financial fundamental including profitability, asset quality and capital, or a reduced likelihood of the banks supporting Eika Boligkredit, as indicated by a loosening in the support agreements between Eika Boligkreditt and the banks that are currently in place.

Key Indicators

Exhibit 2

Eika Boligkreditt AS (Consolidated Financials) [1]

	9-16[2]	12-15[2]	12-14[2]	12-13[2]	12-12[2]	CAGR/Avg.[3]
Total Assets (NOK billion)	93	90	81	70	56	14.4[4]
Total Assets (EUR million)	10,369	9,353	8,961	8,353	7,655	8.4[4]
Total Assets (USD million)	11,653	10,160	10,843	11,510	10,092	3.9[4]
Tangible Common Equity (NOK billion)	3.8	3.7	3.0	2.5	1.8	22.1[4]
Tangible Common Equity (EUR million)	422	385	333	294	245	15.7[4]
Tangible Common Equity (USD million)	475	418	403	404	323	10.8[4]
Tangible Common Equity / Risk Weighted Assets (%)	13.2	13.5	12.0	11.4	10.5	12.1[5]
Net Interest Margin (%)	0.5	0.7	1.0	1.0	0.7	0.8[6]
PPI / Average RWA (%)	0.8	1.2	0.5	0.2	0.7	0.7[5]
Net Income / Tangible Assets (%)	0.2	0.3	0.1	0.0	0.1	0.1[6]
Cost / Income Ratio (%)	19.8	15.2	32.1	64.0	27.7	31.8[6]
Market Funds / Tangible Banking Assets (%)	51.0	51.6	52.0	51.2	56.9	52.5[6]

Liquid Banking Assets / Tangible Banking Assets (%)	17.0	16.6	14.3	12.6	14.3	15.0[6]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of Basel II periods presented [6] Simple average of periods presented for the latest accounting regime.
Source: Moody's Financial Metrics

Detailed Rating Consideration

Eika Boligkreditt's primary business purpose is to provide access to the international debt markets to its owners, 72 Norwegian savings banks belonging to the Eika alliance, the third largest banking group in Norway with 10.2% combined market share of retail lending and 6.5% of total banking system assets. Although individual members operate independently from each other, we note that the Eika alliance provides various benefits such as a shared information technology infrastructure, marketing and credit risk monitoring, which act as incentives for member banks to remain members of the Eika alliance and support Eika Boligkreditt.

The predominantly investment grade credit profiles of the banks that own Eika Boligkreditt form the starting point for the company's ratings

The credit profiles of the banks that collectively form the alliance and own Eika Boligkreditt's are underpinned by three key components: 1) the individual member banks' standalone credit profiles, as established by their respective business models, geographic areas of operations, financial characteristics and any relevant qualitative factors; 2) their capacity and willingness to help each other in case of failure of one or more members; and 3) the application of Moody's Loss Given Failure analysis of the individual members' liability structures in order to assess the extent to which junior debt classes could cushion the impact of any regulatory "bail in" of the banks' creditors.

1). The alliance banks' strong standalone credit risk profiles

To establish a view on the credit risk profile of the alliance banks we conducted a credit analysis of the member banks. The majority of the alliance banks maintain relatively strong financial fundamentals, with limited variations in overall credit quality amongst individual members.

Asset quality tends to be better than domestic peers, as reflected in the weighted average ratio of non-performing loans (NPLs include 90 days past due loans plus impaired loans) to gross loans of 1.35% as of September 2016, as opposed to 1.85% for rated Norwegian banks. The member banks' strong asset performance reflects their retail banking focus with retail loans, mainly in the form of mortgages, making up on average 74.6% of the banks' total loan book as of September 2016 (80.5% if we include the loans transferred to Eika Boligkreditt). We expect this sector to remain resilient in the next 12-18 months because despite the long-term risks from an increasing level of household indebtedness, we expect Norway's households to continue to service their debts as interest rates remain low and unemployment benefits remain generous.

The main source of asset risk is structural, in that the banks' concentration to the broad housing and commercial real estate sector making up on average 14.3% of the banks' total loans. However, the member banks have no exposure to the vulnerable shipping and oil sectors and large exposures to single borrowers are generally not a concern.

Capital levels for the Eika alliance banks are robust and on average higher to their rated Norwegian peers. The weighted average Tier 1 ratio of Eika alliance banks stood at 18.8% as of September 2016 (including interim profit) versus 17.7% as of December 2016 for Norwegian rated banks. Eika banks generally use the more conservative so-called standard approach to risk weight assets and therefore increase in mortgage risk-weights will not impact their capital levels. The majority of the member banks rely on earnings retention to improve their buffers and finance growth. Less than half of the banks have listed equity certificates.

Profitability of the Eika alliance banks is broadly in line with their domestic peers, as reflected in the weighted average ratio net profits to total assets of 0.91% as of September 2016, as opposed to 0.9% for rated Norwegian banks. We expect the profitability of the alliance banks' and for the banking system to improve over the next 12 months. Net interest margins are stabilising as funding costs are coming down, and banks have increased the rates they charge on loans including mortgages. Furthermore the member banks benefit from significant operational efficiencies when they join the Eika alliance, such as common IT systems and platforms that the Eika Group develops as well as risk policies and procedures which the banks customize according to their risk preference. Nevertheless, the smaller banks have an inflexible cost base which we see as a potential threat to their profitability

The alliance banks also maintain stable liquidity buffers and their reliance on potentially volatile wholesale funding is lower than peers. The alliance banks' weighted average market funds ratio was 18% of total assets (25% when we include covered bonds issued through Eika Boligkredit), below the 42% market funds to tangible banking assets of Norwegian rated peers.

2. Our assessment of the banks' credit strength does not incorporate any mutual support uplift among member banks

Although there are strong incentives for the banks to support each other in case of stress and there exist past examples of such mutual assistance, our assessment of the banks' credit profiles does not result in any rating uplifts for the purpose of establishing the collective strength of the banks behind the Eika alliance. We note that the banks do not have a legally binding commitment to support each other in case of need. Further, there is limited benefit that can be incorporated in the banks' ratings given the small variations in credit quality among banks. Instead, the banks are more likely to allocate their resources in support of Eika Boligkreditt itself, which is captured in the CRA of A3(cr).

3. The application of Moody's LGF analysis lifts the banks' credit profiles

In line with our methodology our assessment of the member banks' credit risk profile incorporates an analysis of individual banks' liability waterfalls in line with Moody's Loss Given Failure analysis. As part of this analysis and given the banks' small size and more retail and SME focus, we assume that 10% of the banks' deposit base is made of so-called "junior" deposits (i.e., more loss absorbing) rather than the standard assumption of 26%. The results of the LGF analysis varies, ranging from one to two negative notch(es) at their respective issuer rating levels, depending on the liability structure of individual banks.

We note that the banks' credit profiles do not benefit from a rating uplift due to government support, reflecting our assumption of a low likelihood of support from the government in case of need. Our expectation of a low likelihood of government support is driven by the banks' small individual national market shares.

The strong operating environment where Eika and the owner banks operate

Norwegian banks benefit from operating in an affluent and developed country with very high economic, institutional and government financial strength, as well as low susceptibility to event risk. Although at a somewhat slower rate, the country's well diversified economy is growing, demonstrating resilience to the ongoing weakness in the oil sector. The main risks to the banking system stem from the high level of household indebtedness, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are largely offset by the strength of households' ability to service debt, banks' sizeable capital buffers and the relatively small size of the banking system compared with GDP.

The Macro Profile assigned to Norway is Very Strong-.

Though there isn't a guarantee of Eika Boligkreditt's obligations by the owner banks, there are agreements to safequard Eika Boligkreditt's access to sufficient capital and liquidity

The Baa1 issuer rating assigned to Eika Boligkredit and its A3(cr) CR Assessment incorporate our view of the likelihood that the owner banks will support Eika Boligkreditt.

While there is no explicit commitment from the banks to directly support Eika's obligations vis-à-vis its bondholders, we note that legal and publicly-available agreements currently in place between the banks and Eika Boligkreditt safeguard Eika Boligkreditt's own access to adequate liquidity and capital. Moreover, in case one or more of Eika's owners are not able to provide their share of capital or liquidity, the remaining banks may be required by Eika Boligkredit to increase their contribution up to a maximum of twice their initial allocation.

Additionally, our view also reflects other factors that contribute in its assessment such as the absence of any provision to avoid payment under the agreement, Eika Boligkreditt's strategic fit and strong operational integration with the alliance banks, as well as the reputational and operational risks associated to the sharing of a common brand and a common technology platform.

Eika Boligkreditt's A3(cr) CR Assessment is an important input in the rating process of the covered bond instruments as our rating methodology for covered bonds relies on an Anchor Rating, which is based on the Specialised Covered Bond Issuer's CR Assessment.

SOURCE OF FACTS AND FIGURES CITED IN THIS REPORT

Unless otherwise noted, data to system ratios refer to weighted average of Norwegian rated banks. The data presented in Exhibit 1 refer to the weighted average ratios for Eika Alliance banks. Exhibit 2 presents the data of EIka Boligkreditt. The numbers discussed in the text mainly relate to the alliance banks.

Ratings

Exhibit 3

Category	Moody's Rating
EIKA BOLIGKREDITT AS	
Counterparty Risk Assessment	A3(cr)/P-1(cr)
Issuer Rating -Dom Curr	Baa1

Source: Moody's Investors Service

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