

CREDIT OPINION

15 May 2017

Update

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RATINGS

OBOS-banken AS

Domicile	Norway
Long Term Debt	Not Assigned
Type	Not Assigned
Outlook	Not Assigned
Long Term Deposit	Baa1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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OBOS-banken AS

Semiannual update with year-end 2016 financials

Summary Rating Rationale

We assign a baa3 baseline credit assessment (BCA) and Baa1 long-term deposit and issuer ratings to [OBOS-banken AS](#). We also assign a long- and short-term Counterparty Risk Assessment (CRA) of A3(cr)/Prime-2(cr) to the bank. The long term ratings carry a stable outlook.

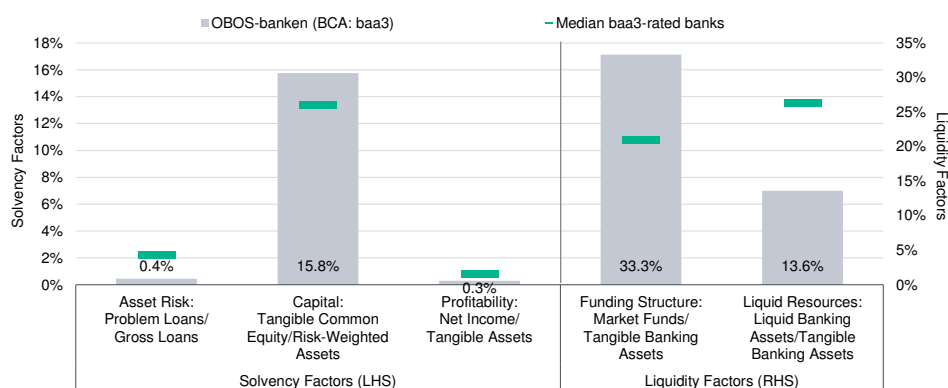
OBOS-banken is a Norwegian bank focused on retail mortgages and lending to housing co-ops in Norway. Although the bank is relatively small with total assets of NOK27.8 billion at year-end 2016, it is part of the OBOS Group (unrated), one of the largest property developers in the Nordics. While the OBOS Group's lending activities date back to 1929, OBOS-banken received its full banking license only in 2013 and continues to develop its business and risk management profiles.

OBOS-banken's ratings are underpinned by: (1) OBOS-banken's baa3 baseline credit assessment (BCA); (2) the results of our Advanced Loss Given Failure (LGF) analysis, which lead to a Preliminary Rating Assessment (PRA) for both deposits and senior unsecured debt two notches above the BCA; and (3) a low expectation of government support, resulting in no uplift above the PRA for both the deposit and issuer ratings.

Exhibit 1

Rating Scorecard - Key Financial Ratios

OBOS-banken's scorecard ratios compared to the median for banks with baa3 BCA



Source: Moody's Financial Metrics

The baa3 BCA reflects the bank's: (i) strong asset quality metrics supported by a low problem loan ratio; (ii) solid capital metrics, although constrained by the fast loan growth; and (iii) comfortable liquidity position, supported by a portfolio of high-quality liquid assets. These

strengths are balanced against OBOS-banken's: (i) historical and expected loan growth at above market average rates within an increasingly competitive environment; (ii) geographical concentration in Oslo and Akershus; (iii) limited ability to raise capital externally; (iv) low profitability; (v) high reliance on wholesale funding; and (vi) monoline business model.

Credit Strengths

- » Strong asset quality metrics offset by significant loan growth and geographical concentration
- » Solid capital metrics, expected to decline slightly but remain adequate to support growth
- » Very low loss-given-failure for deposits and senior unsecured debt
- » OBOS-banken's BCA is supported by Norway's Very strong- macro profile

Credit Challenges

- » Modest profitability, partly constrained by monoline business model
- » High reliance on wholesale funding partially mitigated by sound liquidity position

Rating Outlook

The outlook on the long-term deposits and issuer ratings is stable. The stable outlook reflects our forward looking view that OBOS-banken's profitability will remain low over the next 12-18 months, while market funding will continue to be a major funding source despite deposit growth. Our outlook also incorporates that we expect significant lending growth over the outlook period, which will restrain growth in capitalisation metrics.

Factors that Could Lead to an Upgrade

OBOS-banken's BCA could be upgraded by: (i) a sustainable improvement in profitability; (ii) reduced reliance on market funding; and/or (iii) a longer track record of successfully operating as a bank-licensed entity. A higher BCA would likely lead to an upgrade of the long-term ratings.

Factors that Could Lead to a Downgrade

OBOS-banken's BCA could be downgraded because of: (i) unexpected deterioration in asset quality metrics; (ii) weakening of the capital position beyond our expectations; or (iii) reduced liquid assets held on balance sheet. A downward movement in OBOS-banken's BCA would likely result in a downgrade of the long-term ratings.

A downgrade to the bank's deposit and issuer ratings could also be triggered by increased expected loss-given-failure. Although the current and forecasted liability structure supports a very low loss-given-failure, balance sheet growth exceeding our expectations, combined with an increasing proportion of covered bonds in favour of senior unsecured debt, could lead us to reassess our LGF analysis.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

OBOS-banken AS (Consolidated Financials) [1]

	12-16 ²	12-15 ²	12-14 ²	12-13 ²	2012	Avg.
Total Assets (NOK billion)	28	23	17	13	-	27.5 ³
Total Assets (EUR million)	3,063	2,357	1,856	1,604	-	24.1 ³
Total Assets (USD million)	3,230	2,560	2,246	2,210	-	13.5 ³
Tangible Common Equity (NOK billion)	1.8	1.5	1.3	1.3	-	12.4 ³
Tangible Common Equity (EUR million)	199	153	145	152	-	9.4 ³
Tangible Common Equity (USD million)	210	166	176	210	-	0.1 ³
Problem Loans / Gross Loans (%)	0.2	0.4	0.7	-	-	0.4 ⁴
Tangible Common Equity / Risk Weighted Assets (%)	15.4	15.0	16.4	19.8	-	16.6 ⁵
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.0	5.1	8.6	-	-	5.6 ⁴
Net Interest Margin (%)	0.9	1.1	1.1	0.1	-	0.8 ⁴
PPI / Average RWA (%)	1.1	1.2	1.6	0.2	-	1.0 ⁵
Net Income / Tangible Assets (%)	0.3	0.3	0.5	0.1	-	0.3 ⁴
Cost / Income Ratio (%)	52.8	54.0	47.1	50.1	-	51.0 ⁴
Market Funds / Tangible Banking Assets (%)	33.3	42.6	23.9	16.1	-	29.0 ⁴
Liquid Banking Assets / Tangible Banking Assets (%)	13.6	12.7	6.2	10.5	-	10.8 ⁴
Gross Loans / Due to Customers (%)	169.5	175.4	137.8	119.4	-	150.5 ⁴

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Compound Annual Growth Rate (%). Any interim period amounts presented are assumed to be fiscal year end amounts for calculation purposes [4] Simple average of periods presented [5] Simple average of Basel III periods presented
Source: Moody's Financial Metrics

Detailed Rating Considerations

The financial data in the following sections are sourced from OBOS-banken's financial statements or Moody's Financial Metrics, unless otherwise stated.

Strong asset quality metrics offset by significant loan growth and geographical concentration

The a1 asset risk score we assign to OBOS-banken takes into account the bank's very low problem loan ratio and low risk business, but is also informed by the bank's significant loan growth, strong geographical concentration in Oslo and Akershus and limited track record in risk management as a bank-licensed institution.

OBOS-banken's main risk is credit risk through its loan book, which accounted for around 85.8% of reported assets at year-end 2016. At just 0.2% at the same date, the bank's problem loan ratio (defined as impaired loans and non-impaired loans 32 days overdue as a percentage of gross loans) is better than peers because of the: (i) low risk business in which the bank operates; (ii) limited seasoning of the loan book; and (iii) material growth in lending, both organically and through external acquisitions. The bank's average annual compounded loan growth rate was 26% since its establishment in 2013.

The bank's loan book is almost entirely exposed to the domestic mortgage market and the majority of the lending portfolio is to housing co-operatives (54.4% as of year-end 2016). OBOS-banken is predominantly exposed to the Oslo and Akershus regions (around 81% of retail lending and 86% of corporate lending – mostly co-operative housing – at end-2016).

We note that over half of the bank's problem loans stem from a NOK1.5bn loan portfolio (8% of gross loans at end-2015) acquired from BNP Paribas Fortis SA/NV in 2014, indicating that the quality of these assets was probably lower than initially expected and suggesting some weaknesses in OBOS-banken's still developing risk assessment capacity.

Finally, similarly to other recently established banks, OBOS-banken's through-the-cycle performance has not yet been demonstrated, which reduces the predictability of performance. Longer time performance trends will illustrate whether the bank will maintain adequate underwriting standards and a balanced risk appetite while increasing its market share and expanding its business offer. In mitigation, we positively note that OBOS-banken's management is experienced in the sector.

Solid capital metrics expected to decline slightly but remain adequate to support lending growth

We view OBOS-banken's capital position as adequate in the context of the bank's growth ambitions, resulting in an assigned capital score of a1, a relative strength for the rating.

OBOS-banken reported a CET1 ratio of 15.2% and a regulatory leverage ratio of 6.2% at year-end 2016. Under Moody's definition, the bank's tangible Common Equity (TCE)/ Risk Weighted Assets (RWA) was 15.4% and TCE/Tangible Assets and contingent liabilities was 6.5% at year-end 2016, in line with peers. While, going forward, we expect OBOS-banken's capital ratios to decline as its RWA and balance sheet increase, the bank plans to maintain a CET1 ratio of 14.5%, in line with the targets of other Norwegian banks.

OBOS-banken is fully owned by OBOS Group, which we consider an overall positive for the bank because it provides good access to the group's customers and capital injections to sustain the bank's ambitious growth plans. For example, in 2016, OBOS-banken received a NOK300 million capital injection from its parent to establish OBOS-banken Boligkreditt AS, a covered bond issuer, positively impacting the bank's capital ratios. Nevertheless, while the bank remains central to the group's core strategy and we expect the parent company to support its banking subsidiary in its expansion plan, we consider that, given its sole ownership, OBOS-banken has less options to raise external capital in case of need compared to other banking peers.

Modest profitability, partly constrained by monoline business model

Profitability is a relative weakness for OBOS-banken, primarily because the bank's priority is to support the OBOS Group's strategy through funding the sale of the real estate projects undertaken by the parent. However, over the long-term, the bank is committed to deliver a sound risk-adjusted return for its shareholder. Our assigned profitability score of ba2 captures these factors.

OBOS-banken's net income relative to tangible assets - as calculated by Moody's - was 0.4% on average for the 2013–2015 period, and stood at 0.34% in 2016. In order to represent the bank's profitability on a comparable basis to other Norwegian savings banks that fund through jointly owned covered bond companies, we further adjust the tangible assets to include all off-balance sheet lending. When we consider this adjustment, the profitability ratio declines slightly to 0.27%.

The bank reported a pre-tax income of NOK124 million in 2016 against NOK100 million during 2015. During the period net interest income declined slightly by 1.3% year on year, reflecting reduced interest rates and increased competitive pressures, largely offset by increased lending volumes. Net fee and commissions declined by 57.9% year-on-year because the bank no longer distributes loans to Eika Boligkreditt AS (Eika, Aa1 covered bond rating), a jointly-owned funding vehicle, resulting in reduced fee income. The reduction in interest and fee income was offset by positive result from valuation of financial instruments. In addition, during 2016, the bank recorded loan loss provisions of NOK2.1 million compared to NOK4.6 million booked in 2015.

Although we expect some moderate improvement following the expected growth in lending, we believe that OBOS-banken's internal capital generation capacity will remain limited. Finally, given that OBOS-banken's business activity is, at the moment, limited to mortgage lending, we include a one-notch negative qualitative adjustment to reflect this monoline focus in respect of business diversification.

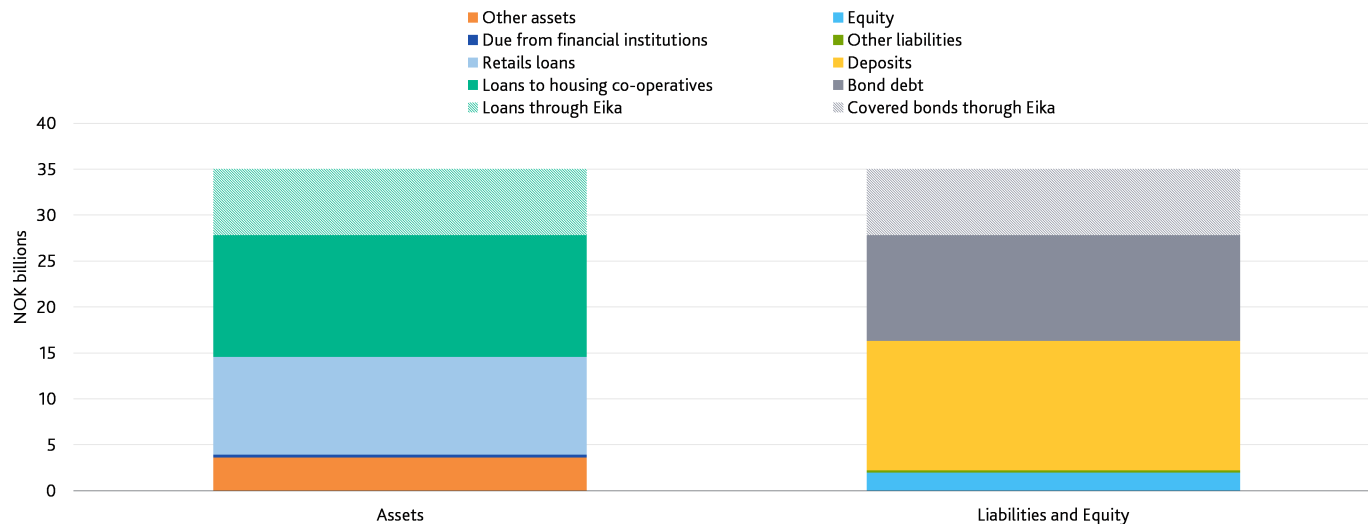
High reliance on wholesale funding partially mitigated by sound liquidity position

We consider OBOS-banken's high reliance on wholesale markets to fund its operations a credit weakness, as reflected in our funding structure score. As of year-end 2016, market funds accounted for 33.3% of tangible banking assets. Including the covered bonds issued through Eika, the ratio increases to 47% (see Exhibit 3 for full balance sheet structure including Eika), which we capture through a one-notch negative adjustment to the baa3 macro adjusted score, resulting in the b1 assigned score. Positively, we note that the bank has a well-spread maturity profile and successfully issued its first covered bonds through its newly established subsidiary, OBOS-banken Boligkreditt. Going forward, we expect OBOS-banken to focus more on deposits and covered bonds issued through its own Boligkreditt to fund -lending growth.

Exhibit 3

OBOS-banken's Assets and Liabilities Including Eika Boligkreditt, year-end 2016

Significant off-balance sheet assets and liabilities, we expect gradual migration to own balance sheet going forward



Source: Company reports

The high reliance on market funding is further mitigated by a sound liquidity position with liquid assets at 13.6% as of year-end 2016 to tangible banking assets at , as reflected in our baa3 assigned score for liquid resources. The bank's liquidity reserve primarily composed of cash with the central bank and highly-rated covered bonds. Despite some volatility, we do not expect the stock of liquid assets held on balance sheet to change substantially over the outlook period.

OBOS-banken's BCA is supported by Norway's Very Strong- macro profile

As a domestically oriented bank, OBOS-banken's operating environment is in Norway. We therefore align the bank's macro profile with that of the country at Very Strong-. Banks in Norway (Aaa stable) benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength as well as low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrates resilience to the ongoing weakness in the oil sector. The main risks to the system stem from the high level of household indebtedness, rapidly growing real estate prices and domestic banks' extensive use of market funding. However, these risks are offset by the strength of households' ability to service debt, banks' adequate capitalization and the relatively small size of the banking system compared with GDP.

Notching Considerations**Loss Given Failure**

We expect that Norway will transpose the EU Bank Recovery and Resolution Directive (BRRD) into local legislation and as such we consider the country an Operational Resolution Regime. In accordance with our methodology we therefore apply our Advanced LGF analysis, considering the risks faced by different debt and deposit classes across the liability structure should the bank enter resolution. In our LGF analysis we assume residual TCE of 3%, losses post-failure of 8% of TBA, a 25% run-off in "junior" wholesale deposits, and a 5% run-off in preferred deposits. We assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions. In line with other mortgage lenders, we assume the proportion of deposits considered junior to be 10% for OBOS-banken, different to the standard EU-wide assumption of 26%, due to the bank's largely retail-oriented deposit base.

Our Advanced LGF analysis indicates that OBOS-banken's deposits and senior unsecured debt are likely to face very low loss-given-failure, due to the loss absorption provided by the senior unsecured debt, as well as the volume of junior deposits themselves. This results in a PRA for OBOS-banken's deposits and senior unsecured debt two notches above the BCA.

Government Support

Given the limited interconnection with other financial institutions and the relatively small size of its operations, we believe there is a low probability of government support for OBOS-banken's deposits and senior unsecured debt, resulting in no uplift to the PRA.

Rating Methodology and Scorecard Factors

Exhibit 4

OBOS-banken AS

Macro Factors

Weighted Macro Profile	Very Strong -	100%
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Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.4%	aa1	← →	a1	Loan growth	Geographical concentration
Capital						
TCE / RWA	15.4%	aa2	← →	a1	Access to capital	
Profitability						
Net Income / Tangible Assets	0.3%	ba2	← →	ba2	Earnings quality	
Combined Solvency Score		a1		a3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	33.3%	baa3	← →	b1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	13.6%	baa3	← →	baa3	Stock of liquid assets	
Combined Liquidity Score		baa3		ba2		
Financial Profile				baa2		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				baa2-ba1		
Assigned BCA				baa3		
Affiliate Support notching				0		
Adjusted BCA				baa3		

Balance Sheet	in-scope (NOK million)	% in-scope	at-failure (NOK million)	% at-failure
Other liabilities	5,687	20.5%	6,673	24.1%
Deposits	14,080	50.8%	13,094	47.2%
Preferred deposits	12,672	45.7%	12,038	43.4%
Junior Deposits	1,408	5.1%	1,056	3.8%
Senior unsecured bank debt	6,884	24.8%	6,884	24.8%
Dated subordinated bank debt	150	0.5%	150	0.5%
Preference shares (bank)	100	0.4%	100	0.4%
Equity	832	3.0%	832	3.0%
Total Tangible Banking Assets	27,733	100%	27,733	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + Subordination	Sub-ordination	Instrument volume + Subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	32.5%	32.5%	32.5%	32.5%	3	3	3	3	0	a3 (cr)
Deposits	32.5%	3.9%	32.5%	28.7%	2	3	2	2	0	baa1

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Deposits	2	0	baa1	0	Baa1	Baa1

Source: Moody's Financial Metrics

Ratings

Exhibit 5

Category	Moody's Rating
OBOS-BANKEN AS	
Outlook	Stable
Bank Deposits	Baa1/P-2
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A3(cr)/P-2(cr)
Issuer Rating	Baa1
ST Issuer Rating	P-2

Source: Moody's Investors Service

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