

**Credit Opinion: Kommuninvest i Sverige Aktiebolag**

**Kommuninvest i Sverige Aktiebolag**

*Orebro, Sweden*

**Ratings**

<b>Category</b>	<b>Moody's Rating</b>
Outlook	Stable
Issuer Rating	Aaa
Senior Unsecured	Aaa
Bkd Commercial Paper	P-1
Bkd Other Short Term	P-1

**Contacts**

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**Key Indicators**

**Kommuninvest i Sverige Aktiebolag**

	<b>2008 (Jun 30)</b>	<b>2007</b>	<b>2006</b>	<b>[1]2005</b>	<b>[1]2004</b>	<b>[2]Avg/CAGR</b>
Total assets (SEK bn)	<b>105.55</b>	<b>109.92</b>	<b>102.54</b>	<b>91.15</b>	<b>67.98</b>	<b>11.63</b>
Total assets (USD bn)	<b>17.65</b>	<b>17.18</b>	<b>14.93</b>	<b>11.45</b>	<b>10.29</b>	<b>14.44</b>
Total capital funds (SEK bn)	<b>0.38</b>	<b>0.41</b>	<b>0.34</b>	<b>0.29</b>	<b>0.23</b>	<b>14.28</b>
Return on average assets (%)	<b>0.00</b>	<b>0.02</b>	<b>0.02</b>	<b>0.04</b>	<b>0.02</b>	<b>0.02</b>
Recurring earning power (%) [3]	<b>0.01</b>	<b>0.03</b>	<b>0.03</b>	<b>0.07</b>	<b>0.03</b>	<b>0.03</b>
Net interest margin (%)	<b>0.08</b>	<b>0.08</b>	<b>0.11</b>	<b>0.15</b>	<b>0.12</b>	<b>0.11</b>
Cost / income ratio (%)	<b>90.45</b>	<b>72.41</b>	<b>73.13</b>	<b>52.40</b>	<b>71.75</b>	<b>72.03</b>
Problem loans % gross loans	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
Tier 1 ratio (%)	<b>17.10</b>	<b>14.99</b>	<b>18.81</b>	<b>17.08</b>	<b>16.35</b>	<b>16.81</b>

[1] Numbers for 2005 and 2004 are on GAAP Accounting Standard [2] Compound Annual Growth Rate for total assets [3] Preprovision income % average assets

**Opinion**

**Credit Strengths**

- Joint and several guarantee of the liabilities of Kommuninvest by its members.
- Lending restricted to Kommuninvest members and to entities that are majority-owned and guaranteed by a member.
- Strong asset quality enhanced by the central government's implicit support to the local government sector.
- Prudent asset and liability management with a policy of matching interest rates, currencies and maturities, and limiting exposures to investment and derivative counterparties.

**Credit Challenges**

- Kommuninvest is allowed to pre-fund loans, but the proceeds have to be invested in highly rated securities. The

substantial but reducing exposure to financial institutions poses some concentration of systemic risk. This has been mitigated by prudent management and limited exposures to counterparties.

- Use of derivatives such as swaps, futures and options to meet the various funding requirements and for hedging purposes of funding, lending and the investment portfolio. All derivatives have to be directly related to Kommuninvest's funding and are closely monitored.

### **What Could Change the Rating - Down**

The strength of the joint-and-several pledge makes it difficult to see a weakening of the Aaa rating, but any change in the support mechanisms for Kommuninvest's liabilities would result in downward rating pressure. No such change has been discussed.

### **Rating Rationale**

In accordance with Moody's GRI rating methodology, the Aaa/P-1 ratings of Kommuninvest reflect the combination of the following inputs:

- Baseline credit assessment of 3 (on a scale of 1 to 21, where 1 represents lowest credit risk)
- Strong credit profile of its member local governments
- High support
- Low dependence

The baseline credit assessment of 3 is underpinned by Kommuninvest's strong franchise with a solid market share in lending to its member local governments, combined with good financial fundamentals, strong asset quality and prudent asset liability management.

Lending is restricted to local authorities that are members of the Kommuninvest Co-operative Society ("the Society") and to entities that are majority-owned and fully guaranteed by one or more members. Kommuninvest's loan portfolio is made up of short-, medium- and long-term loans to local authorities, whose main sources of revenues consist of local income taxes (set independently by each municipality), fees and central government grants. There are no restrictions on local government borrowing, although it is understood that it should only be for capital expenditure. Kommuninvest is a not-for-profit organisation, and is an important player in Sweden's municipal lending market, having provided its members with approximately 46% of their total borrowings at the end of 2007.

For Kommuninvest, which raises funds on both the domestic and international markets, funding and lending must match on a portfolio basis from a predefined amount of possible pre-funding. Lending backed by short-term funding cannot be matched perfectly on a line-by-line basis; ultimately, interest rate risk to Kommuninvest must therefore be managed at the portfolio level. The institution uses derivatives for hedging purposes of funding and the investment portfolio and matches currency and interest rate risk in its funding and lending. The derivative positions are closely monitored and follow internal guidelines. Moody's also notes that Kommuninvest has prudent liquidity management with adequate liquidity lines.

High support reflects the local governments' legal obligations to support Kommuninvest on a several and joint basis.

Low dependence reflects the high number of members of the Society (216 municipalities and 7 county councils) and a very low probability that a large number of members would ever be in default simultaneously within the members' joint and several obligations.

Kommuninvest's guarantee allows it to operate with a very thin level of capital, but an material increase in lending which is not matched by an increase in capital could undermine its standalone credit strength (the baseline credit assessment (BCA)). A relaxation of the entity's currently good asset liability management or liquidity management might also exert pressure on the BCA. A change of the BCA would not result in a change in the Aaa rating.

### **Recent Results and Developments**

Kommuninvest has weathered the financial turmoil well. Kommuninvest's strong credit quality in combination with its prudent asset and liability management has limited the impact to the balance sheet and income statement. It has retained access to the markets in spite of difficult circumstances within international financial markets.

The adverse market conditions has in practice restrained Kommuninvest's competition and has highlighted its franchise as a leading lender to the local government sector. As a consequence, several new members have

joined, with others in the process of joining. Lending in the second half of 2008 is estimated to have increased significantly, with continuing strong demand from its members.

On the 11th of November, Kommuninvest and the Swedish bank Swedbank (Aa3/P-1/C+) announced that they are to initiate a collaboration for short term financing to Swedish RLGs of up to SEK 33 billion. This will expand Kommuninvest's market position going forward, increase its loan portfolio of 0% risk-weighted assets, and is also anticipated to increase its membership. As part of the programme, Kommuninvest expects to increase its access to short term borrowing so that it may provide increased opportunities for short term lending to its clients.

However, in order to ensure its liquidity target of 12 months of continued activity without access to the capital markets, Kommuninvest has expanded its liquidity arrangements.

New members have provided and will provide new capital as a condition of joining. However, the magnitude of the potential new lending going forward is such that it could reduce Kommuninvest's total capital ratio (without adjustment for risk weightings), which is already relatively low, compared to its peers. Whilst its Tier-1 ratio remains well in excess of required regulatory ratios, Kommuninvest's total capital ratio is the lowest of the Nordic specialized lenders.

The strength of Kommuninvest's joint-and-several pledge makes it difficult to see a weakening of its Aaa rating. Moody's will monitor the impact of any dilution on Kommuninvest's capital position, were it to occur, in regard to its standalone credit strength within the baseline credit assessment.

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