Landkreditt Bank AS
Issuer Rating Report

SCOPE A- STABLE

Scope's credit view (summary)

The **A- issuer rating** of Landkreditt Bank reflects the credit fundamentals of the cooperative group, Landkreditt SA, a leading provider of financial services to Norway's agricultural sector. The bank is the main operating company of the group. In recent years, management has pursued a growth strategy in the agricultural segment as well as with retail customers to achieve greater scale and to diversify the business. The aim is for a roughly equal balance between the two customer segments although management currently sees more opportunities with its historic customer base of farmers.

While a digital bank since its founding, ongoing investments are being made to further digitalise customer interactions and automate processes. At the same time, management is working on how it can best support farmers meet their sustainability targets.

The bank maintains a low risk profile, with over 99% of lending secured by residential property or agricultural property and land. Asset quality has been little impacted by the Covid-19 pandemic although management has made additional loss provisions to cover potential long-term consequences. The bank's ownership structure further reinforces a fairly low risk business, with cooperative members understanding the need to ensure the group's solidity.

The **A- issuer rating** of Landkreditt Boligkreditt, a wholly owned subsidiary, is aligned with that of Landkreditt Bank. Through the issuance of covered bonds, Landkreditt Boligkreditt provides secured funding for its parent. The covered bonds of Landkreditt Boligkreditt are rated AAA.

Outlook

The **Stable Outlook** reflects the ongoing resilience of the bank's business and operating performance in a challenging operating environment.

Credit strengths	Credit weaknesses
• Ownership structure and strategic purpose underpin a relatively low risk business • Strong asset quality • Reassuring solvency metrics	• Low interest rates pose a headwind to earnings • Reliance on market funding, including covered bonds

Positive rating-change drivers	Negative rating-change drivers
• Growing the business while keeping risks under control and sustainably increasing returns	• Greater than expected credit losses which materially impair profitability • Business expansion which increases the group's risk profile

Ratings & Outlook

Issuer rating	A-
Senior unsecured debt rating	BBB+
Outlook	Stable

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Issuer profile

Landkreditt Bank is the main operating company of the Landkreditt SA group which was founded as a credit union in 1915. The group is the leading provider of financial services to Norway's agricultural sector, serving one in four farmers. In addition to banking, the group provides insurance, asset management and real estate brokerage services. Customers of Landkreditt Bank with a loan secured by agricultural property or with an agricultural production operating credit become members of the cooperative, Landkreditt SA. As of YE 2020, there were nearly 9,000 cooperative members. The group is part of the Federation of Norwegian Agricultural Cooperatives.

Ownership structure and strategic purpose support a relatively low risk business generating reasonable returns

As a cooperative, management's focus is on providing attractive financial services for members and customers, with earnings being used to ensure the group's solidity. As of year-end 2020, the group had about 9,000 cooperative members. Representation at the annual general assembly, the cooperative's highest body, is determined through regional elections conducted electronically. During the 2021 annual general assembly, 29 member representatives were responsible for electing five of the group's seven board members, with the remaining two elected by employee representatives.

Expanded service offering for agricultural customers

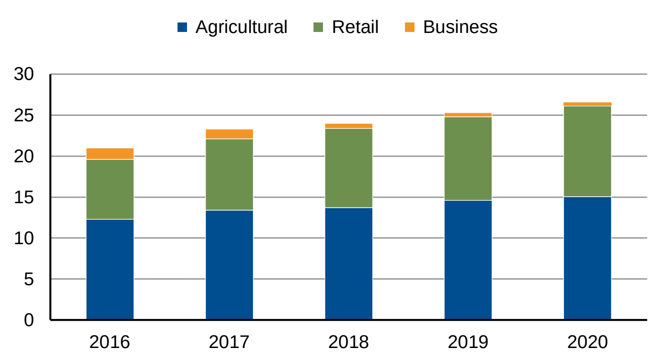
Landkreditt aims to be the leading provider of financial services to farmers. In recent years, the service offering has been expanded through the acquisition of an insurer originally established to serve agricultural cooperatives and a real estate broker focused on agricultural property.

Integrating and increasing the cooperation amongst the various businesses is a management priority. Efforts are being supported by the roll-out a new IT platform later this year and the opening of offices in key agricultural regions staffed with personnel from the bank, the insurance company, and the real estate broker.

Ambition to support sustainability efforts of farmers

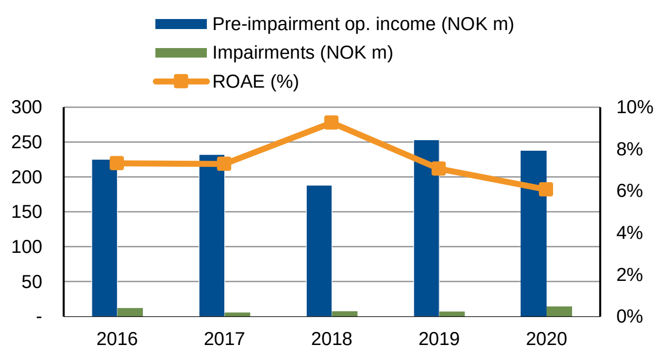
As well as advocating for the financial support of the Norwegian agricultural sector, the group aims to support farmers as they make changes to operate more sustainably. This year, management will further define how it intends to move forward on these goals, including making a commitment to the UN's principles for responsible banking.

Figure 1: Loans by customer type (NOK bn)



Note: Business lending is gradually being discontinued. Source: Company data, Scope Ratings.

Figure 2: Bank group performance



Notes: Bank group refers to Landkreditt Bank and its subsidiaries. 2018 return on average equity included a NOK 101m gain from the sale of stake in leasing company, Landkreditt Finans. Source: Company data, Scope Ratings.

Share of retail loans has grown steadily

Alongside the focus on farmers, management has been pursuing a strategy to grow personal retail volumes to gain greater scale and a more diversified business. While the goal is to achieve a roughly equal balance, management recognises the increasingly competitive conditions in the retail market and foresees more growth in the agricultural segment. The retail business is essentially mortgage lending. Non-agricultural customers currently account for about 42% of credit exposures (Figure 1).

Asset quality has been little impacted by pandemic

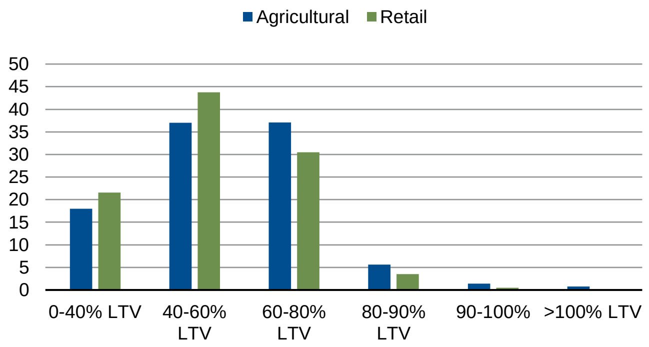
Management has demonstrated its ability to grow the loan portfolio while maintaining low credit losses. With agricultural customers, credit decisions benefit from the bank's in-depth knowledge and expertise in the sector. As of year-end 2020, problem loans accounted for 0.6% of total gross loans.

Due to the Covid-19 pandemic, a small number of customers were granted payment deferrals, but most have returned to making normal repayments. As of year-end 2020, only NOK 70m of the NOK 26.6bn total loan portfolio was still subject to payment deferrals.

Nearly all credit exposures are secured

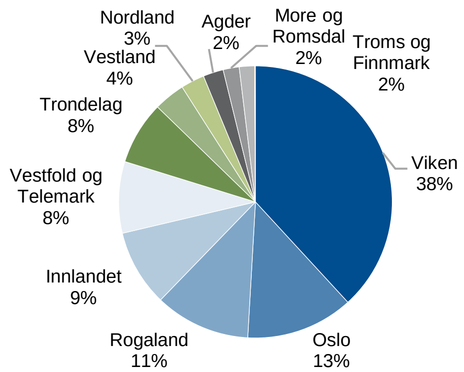
Nearly all credit exposure is secured by residential property or agricultural buildings and land, with more than 90% of loans having LTVs below 80%. About half of the credit exposure is in the greater Oslo region, with the remainder spread throughout the country.

Figure 3: LTV profile of credit exposures (%)



Note: Data as of YE 2020. Agricultural and retail exposures of NOK 15.1bn and NOK 11bn, respectively. Source: Company data, Scope Ratings.

Figure 4: Geographical distribution of credit exposures (%)



Source: Data as of YE 2020.
Source: Company data, Scope Ratings.

Management's continued focus on high efficiency underpinned by a digital distribution model

Digital bank with no legacy branch network

Since its founding in 2002, Landkreditt Bank has been a digital bank and therefore is not burdened by a legacy branch network. Nearly all the bank's employees operate out of a single building in Oslo. The group, however, sees advantages to having a local presence in key agricultural regions and is opening a small number of offices to offer a combination of banking, insurance, and agricultural real estate brokerage services.

Established IT systems

A key part of the strategy is further digitalisation to increase efficiency. The group invests in established IT infrastructure, and systems are essentially outsourced. In February 2018, a NOK 150m five-year agreement was concluded with TietoEVRY, a leading IT services and software provider used by many other Norwegian banks. TietoEVRY is expected to deliver next-generation core banking and payment solutions, including further improvements in respect to client self-servicing and automation in credit processes.

Reliance on market funding

Customer deposits are primary source of funding

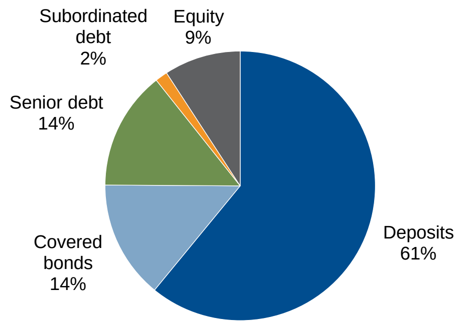
Customer deposits remain the primary source of funding (Figure 5). However, the pace of lending generally outstrips deposit growth, with deposits being insufficient to support lending activities. Recognising the importance of maintaining a sound liquidity profile, management targets a minimum deposit-to-loan ratio of 70% This is generally above the level of larger domestic peers.

To diversify funding sources, a fully owned covered bond issuer, Landkreditt Boligkreditt, was established in 2010. Nearly NOK 5bn in loans have been sold to Landkreditt Boligkreditt, accounting for approximately 19% of the banking group's total loans as of year-end 2020. Covered bonds account for nearly 50% of outstanding debt.

Covered bonds an additional important funding source

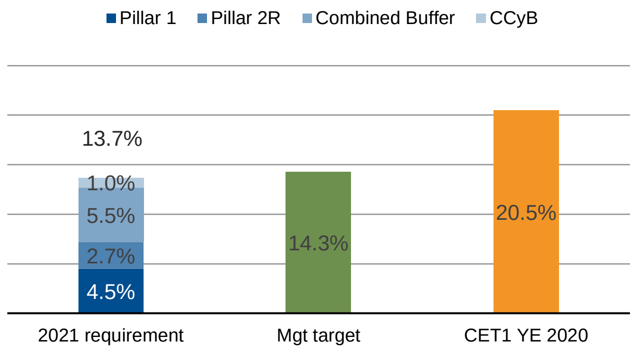
Landkreditt is a regular issuer in the domestic bond market, issuing secured, senior, and subordinated debt. In 2020, despite market volatility, NOK 1.8bn in market funding was raised. Investors include Norwegian pension funds, asset managers and insurance companies. As of year-end 2020, the average maturity of outstanding debt was about three years while the average interest rate was 0.7%. The bank group's LCR and NSFR metrics were strong at 391% and 151%, respectively as of year-end 2020.

Figure 5: Bank group - funding profile (%)



Notes: Data as of YE 2020. Bank group refers to Landkreditt Bank and its subsidiaries.
Source: Company data, Scope Ratings.

Figure 6: Bank group - actual CET1 vs management target and requirement



Notes: Bank group refers to Landkreditt Bank and its subsidiaries. Combined buffer comprises 2.5% capital conservation buffer and 3% systemic risk buffer. CCyB = countercyclical capital buffer.
Source: Company data, Scope Ratings.

Reassuring solvency metrics driven by regulatory demands

The group manages its capital position to ensure solid buffers above requirements while supporting business growth. In the past, Landkreditt Bank has received capital contributions from its parent (NOK 130m in 2014, NOK 300m in 2016). According to management, cooperative members understand the need to grow and solidify the bank's position and have not asked for earnings distributions. We view this positively considering the bank's ownership structure. If further capital were needed, management would consider managing growth downwards.

Capital position comfortably above requirements

With a CET1 capital ratio of 18.8% as of year-end 2020, the bank group comfortably meets its current requirements and is well positioned against expected future requirements. The current CET1 requirement is 13.7%, which includes a 3% systemic risk buffer, a 2.5% capital conservation buffer, a 1% countercyclical capital buffer and a 2.7% Pillar 2 requirement.

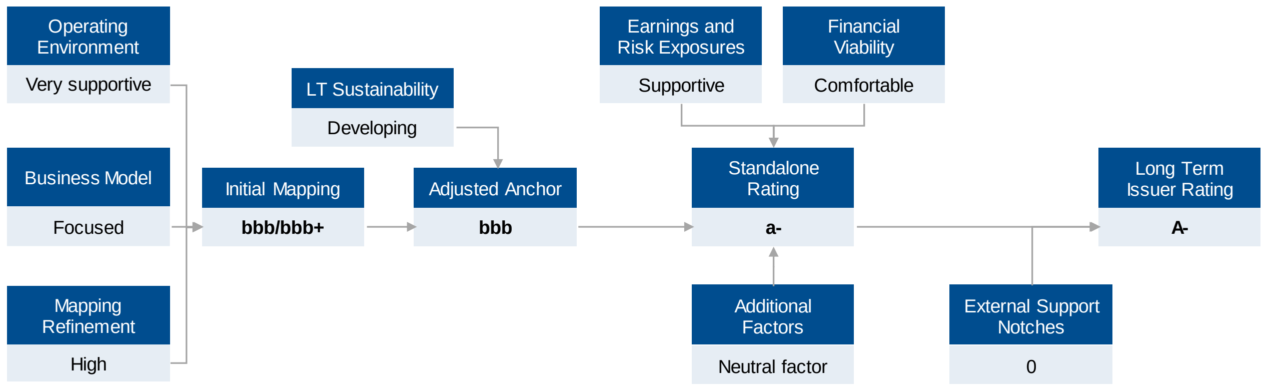
At the group level of Lankdreditt SA, the CET1 capital requirement is nearly the same. The sole difference is the Pillar 2 requirement which stands at 2.8% vs. 2.7% for the bank. As of year-end 2020, the group's CET1 capital ratio stood at 20.5%. For both the bank and the group, management aims for a buffer of at least 0.5% above requirements.

Capital planning includes expected increase in buffers

As part of the measures implemented to mitigate the impact of the pandemic, the countercyclical capital buffer was lowered to 1% from 2.5% in March 2020. Management expects a return to the level of 2.5% as the economy recovers and has incorporated this into its capital planning. In addition, for banks like Landkreditt using standardised models for credit risk, the systemic risk buffer will increase to 4.5% from 3% with effect from year-end 2022.

As of year-end 2020, the bank group's leverage ratio was 9% which compares well to both domestic and international peers. All Norwegian banks must hold a buffer of at least 2% above the minimum requirement of 3%. In addition, management intends to maintain a further buffer of 1%.

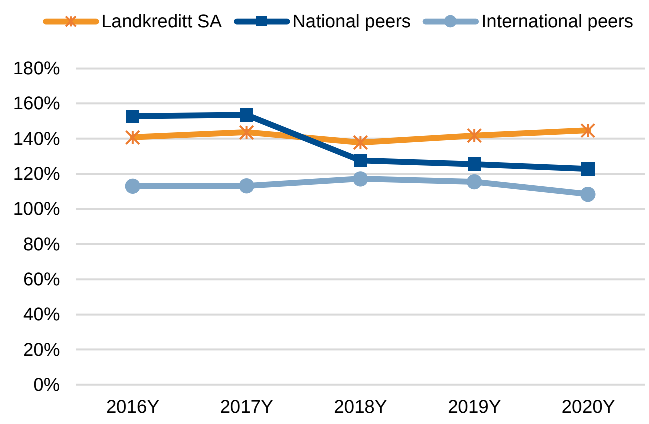
I. Appendix: Overview of the rating process



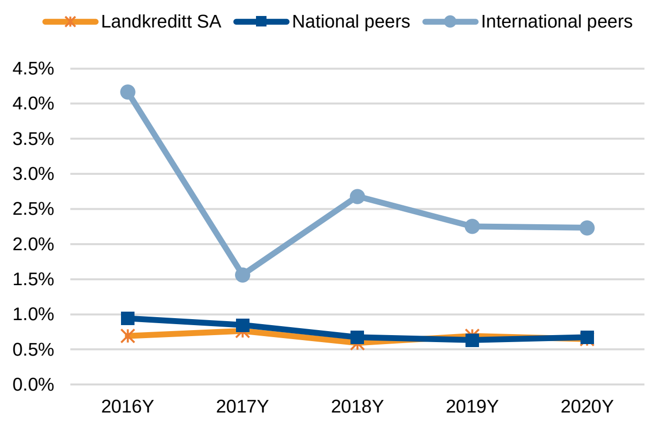
Step		Assessment	Summary rationale
STEP 1	Operating environment	Very supportive	• Wealthy economy with well-developed capital markets and a solid track record of economic resilience to shocks • Supportive competitive environment • Relatively stringent and active regulator
		Supportive	
		Moderately supportive	
		Constraining	
		Very constraining	
	Business model	Very resilient	• Cooperative model underpins relatively low risk business • Focus on agricultural customers • Developing service offering to include insurance and real estate brokerage
		Resilient	
		Consistent	
		Focused	
		Narrow	
	Mapping refinement	High	• Track record of solid operating performance
		Low	
	Initial mapping	**bbb/bbb+**	
	Long-term sustainability	Best in class	• Developing plans to support the sustainability efforts of farmers • Continuing focus on digitalisation and automation
		Advanced	
		Developing	
		Lagging	
	Adjusted anchor	**bbb**	
STEP 2	Earnings capacity & risk exposures	Very supportive	• Resilient earnings • Largely secured loan portfolio with history of low credit losses
		Supportive	
		Neutral	
		Constraining	
		Very constraining	
	Financial viability management	Ample	• Comfortably meets regulatory requirements • Good access to wholesale funding markets, including covered bonds
		Comfortable	
		Adequate	
		Limited	
		Stretched	
		At risk	
	Additional factors	Significant support factor	• No further considerations
		Material support factor	
		Neutral	
		Material downside factor	
		Significant downside factor	
	Standalone	**a-**	
STEP 3	External support	Not applicable	
Issuer rating		**A-**	

II. Appendix: Peer comparison

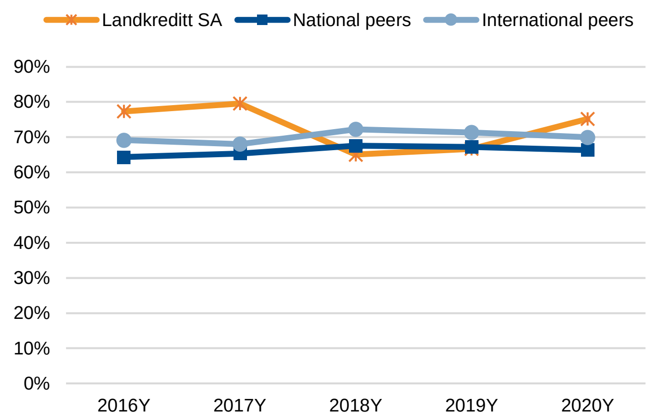
Net customer loans % Deposits



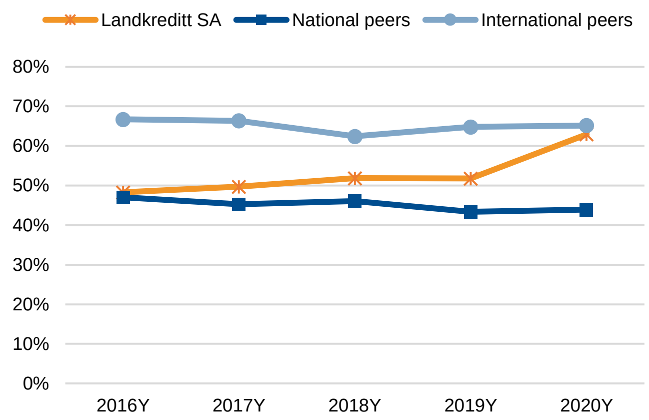
Problem loans % Gross loans



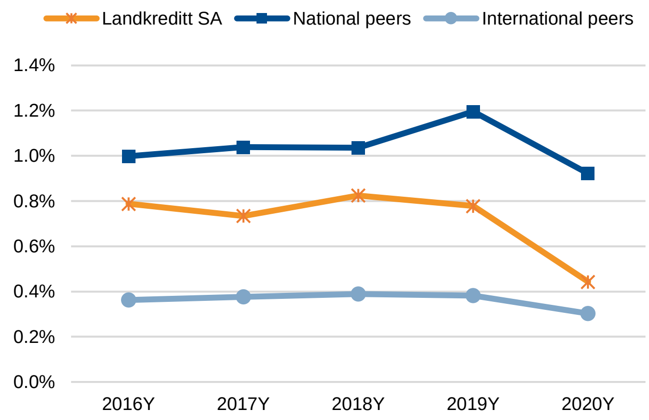
Net interest income % Operating income



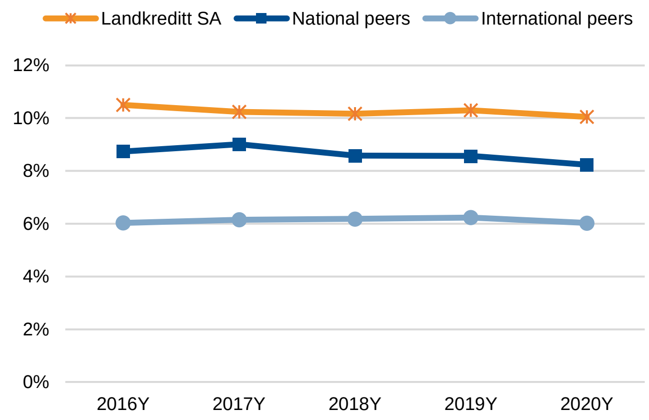
Costs % Income



Return on average assets (%)



Leverage ratio (%)



National peers: BN Bank, DNB, Jaeren Sparebank, Sandnes Sparebank, Totens Sparebank, SpareBank 1 Nordvest, SpareBank 1 SMN, Sparebanken Vest, SpareBank 1 Ostlandet.
International peers: Achmea Bank NV, Bausparkasse Wustenrot AG, Banca Popolare di Sondrio, de Volksbank NV, Kutxabank, Nationwide Building Society, Coventry Building Society, Sparbanken Skane AB, Credit Mutuel Arkea.
Note: 2020 data unavailable for Bausparkasse Wustenrot.
Source: SNL

III. Appendix: Selected Financial Information – Landkreditt SA group

	2016Y	2017Y	2018Y	2019Y	2020Y
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	977	759	993	931	1,246
Total securities	1,786	2,453	3,391	3,188	3,338
of which, derivatives	0	0	0	0	0
Net loans to customers	21,076	23,293	24,054	25,421	26,635
Other assets	183	227	500	614	742
Total assets	**24,022**	**26,732**	**28,938**	**30,155**	**31,961**
Liabilities					
Interbank liabilities	0	15	16	0	0
Senior debt	6,021	7,272	7,069	7,580	8,665
Derivatives	0	0	0	0	0
Deposits from customers	14,963	16,208	17,443	17,931	18,405
Subordinated debt	175	175	331	331	331
Other liabilities	177	170	1,066	1,079	1,195
Total liabilities	**21,337**	**23,840**	**25,925**	**26,922**	**28,596**
Ordinary equity	2,437	2,599	2,795	3,012	3,145
Equity hybrids	149	199	199	199	199
Minority interests	98	94	19	22	20
Total liabilities and equity	**24,022**	**26,732**	**28,938**	**30,155**	**31,961**
Core tier 1/ common equity tier 1 capital	*2,487*	*2,651*	*2,795*	*2,934*	*3,052*
Income statement summary (NOK m)					
Net interest income	355	379	380	411	410
Net fee & commission income	43	53	72	98	117
Net trading income	32	28	92	48	-30
Other income	30	16	40	59	48
Operating income	**459**	**476**	**585**	**615**	**545**
Operating expenses	221	237	303	319	343
Pre-provision income	**237**	**239**	**281**	**297**	**202**
Credit and other financial impairments	12	6	8	7	16
Other impairments	0	0	0	0	0
Non-recurring income	NA	NA	NA	NA	NA
Non-recurring expense	NA	NA	NA	NA	NA
Pre-tax profit	**225**	**234**	**274**	**290**	**186**
Income from discontinued operations	0	0	0	0	0
Income tax expense	48	46	40	59	47
Other after-tax Items	0	0	0	0	0
Net profit attributable to minority interests	12	10	5	3	-1
Net profit attributable to parent	**165**	**178**	**229**	**228**	**141**

Source: SNL

IV. Appendix: Selected Financial Information – Landkreditt SA group

	2016Y	2017Y	2018Y	2019Y	2020Y
Funding and liquidity					
Net loans/ deposits (%)	141%	144%	138%	142%	145%
Liquidity coverage ratio (%)	294%	248%	238%	283%	NA
Net stable funding ratio (%)	NA	NA	NA	NA	NA
Asset mix, quality and growth					
Net loans/ assets (%)	87.7%	87.1%	83.1%	84.3%	83.3%
Problem loans/ gross customer loans (%)	0.7%	0.8%	0.6%	0.7%	0.6%
Loan loss reserves/ problem loans (%)	32.4%	27.8%	52.6%	42.9%	47.4%
Net loan growth (%)	18.7%	10.5%	3.3%	5.7%	4.8%
Problem loans/ tangible equity & reserves (%)	5.4%	6.1%	4.7%	5.5%	5.2%
Asset growth (%)	18.0%	11.3%	8.3%	4.2%	6.0%
Earnings and profitability					
Net interest margin (%)	1.6%	1.5%	1.4%	1.4%	1.3%
Net interest income/ average RWAs (%)	2.9%	2.8%	2.7%	2.8%	2.7%
Net interest income/ operating income (%)	77.3%	79.6%	65.0%	66.7%	75.2%
Net fees & commissions/ operating income (%)	9.3%	11.2%	12.4%	15.9%	21.4%
Cost/ income ratio (%)	48.3%	49.7%	51.9%	51.8%	62.9%
Operating expenses/ average RWAs (%)	1.8%	1.8%	2.1%	2.2%	2.3%
Pre-impairment operating profit/ average RWAs (%)	2.0%	1.8%	2.0%	2.1%	1.3%
Impairment on financial assets / pre-impairment income (%)	5.2%	2.3%	2.8%	2.4%	7.8%
Loan loss provision/ average gross loans (%)	0.1%	0.0%	0.0%	0.0%	0.1%
Pre-tax profit/ average RWAs (%)	1.8%	1.7%	1.9%	2.0%	1.2%
Return on average assets (%)	0.8%	0.7%	0.8%	0.8%	0.4%
Return on average RWAs (%)	1.5%	1.4%	1.6%	1.6%	0.9%
Return on average equity (%)	6.8%	6.7%	7.9%	7.4%	4.3%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	19.5%	18.7%	19.8%	20.3%	20.5%
Tier 1 capital ratio (%, transitional)	20.7%	20.1%	21.2%	21.7%	21.8%
Total capital ratio (%, transitional)	22.1%	21.4%	23.0%	23.5%	23.5%
Leverage ratio (%)	10.5%	10.2%	10.2%	10.3%	10.1%
Asset risk intensity (RWAs/ total assets, %)	53.0%	53.0%	48.8%	47.8%	46.6%

Source: SNL

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