Landkreditt Bank AS
Issuer Rating Report

SCOPE A- STABLE

Scope's credit view (summary)

Landkreditt Bank's **A- issuer rating** 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.

While a digital bank since its founding, ongoing investments are being made to further digitalise customer interactions and automate processes. In addition, the bank has started incorporating ESG considerations into its credit procedures and aims to support the sustainability efforts of farmers.

Reflecting its cooperative business model and low risk culture, Landkreditt generates relatively stable but somewhat lower returns than domestic peers. Earnings, nevertheless, are more than sufficient to absorb credit costs. Asset quality remains sound with nearly all lending secured by residential property or agricultural property and land.

Landkreditt maintains reassuring solvency metrics and continues to be well positioned against current and future expected capital requirements. As well, cooperative members understand the need to support the group's solidity. Like with other Norwegian banks, Landkreditt relies on market funding, including relatively stable covered bonds. The bank maintains comfortable liquidity buffers and regular access to the domestic debt market.

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 Scope's expectation that the group's business and operating performance will remain resilient.

What could move the rating up:

- Growing the business while maintaining risks under control and sustainably increasing returns

What could move the rating down:

- Deterioration in earnings which impedes the group's business development and resilience
- Business expansion which increases the group's risk profile

Ratings & Outlook

Issuer rating	A-
Senior unsecured debt rating	A-
Non-preferred 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 year-end 2021, there were nearly 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.

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

Expanded service offering for agricultural customers

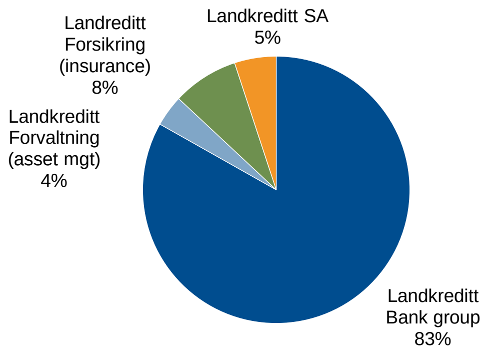
Landkreditt aims to be the leading provider of financial services to farmers. In recent years, the service offering has been expanded through the acquisition of an insurer originally established to serve agricultural cooperatives and a real estate broker focused on agricultural property (Figure 1).

Integrating and increasing the cooperation amongst the various businesses is a management priority. Efforts are being supported by IT investments as well as a small number 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

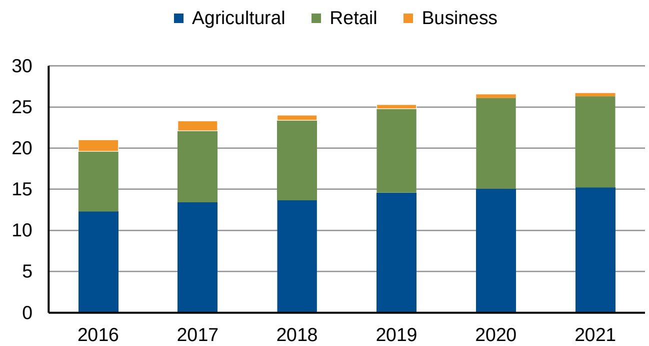
In addition to advocating for financial support of the Norwegian agricultural sector, the group seeks to support farmers as they make changes to operate more sustainably. Last year, the bank launched green agricultural loans, providing favourable terms for investments that contribute to climate friendly food production. This year, the group will continue to develop sustainable products and services as well as find ways to measure progress in this area.

Figure 1: Net profit by business



Note: Data for FY 2021. Group net profit of NOK 224m. Bank group comprises Landkreditt Bank and its subsidiaries, Landkreditt Boligkreditt and Landkreditt Eiendom. Source: Company data, Scope Ratings.

Figure 2: Loans by customer type (NOK bn)



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

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. The aim is for a roughly equal balance between the two customer segments. The retail business is essentially mortgage lending and currently accounts for about 42% of credit exposures (Figure 2).

Nearly all credit exposure is secured

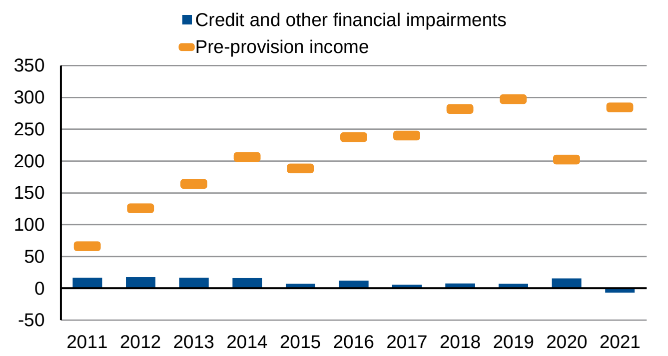
The group has demonstrated its ability to grow the loan portfolio while maintaining low credit losses. Nearly all credit exposure is secured by residential property or agricultural buildings and land. Compared to local and regional savings banks, the group's credit exposure is more geographically diversified. Around half of credit exposure is in the greater Oslo region, with the remainder spread throughout the country.

Credit decisions involving agricultural customers benefit from the bank's in-depth knowledge and expertise in the sector. Environmental factors such as flood risks are a part of the credit process. In addition, the group assesses whether its agricultural customers adopt and follow nationally recognised ESG initiatives. In the future, the bank aims to incorporate these considerations and assessments into its pricing.

Earnings more than sufficient to absorb credit costs

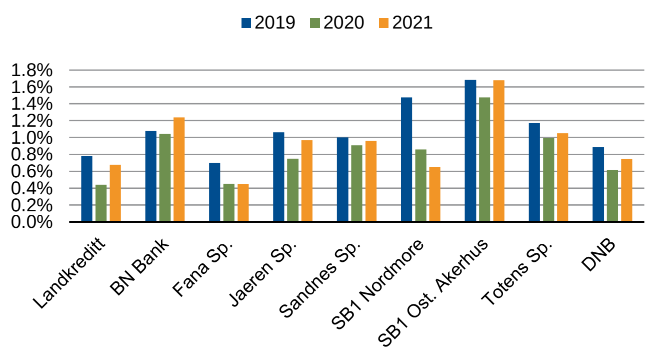
As a cooperative, management's focus is on providing attractive financial services for members and customers, with earnings being used to ensure the group's solidity. Due to the relatively low risk nature of the agricultural sector, the group faces ongoing competition and margin pressure. Reflecting its cooperative business model and low risk culture, Landkreditt generates relatively stable but somewhat lower returns than domestic peers. Earnings, nevertheless, are more than sufficient to absorb credit costs (Figure 3).

Figure 3: Pre-provision income vs impairments (NOK m)



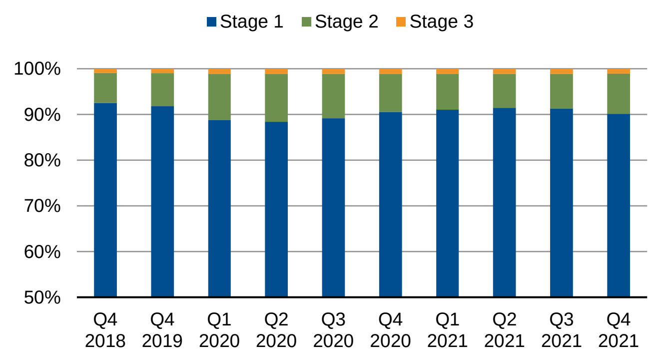
Source: Company data, Scope Ratings.

Figure 4: Return on avg. assets (%) – peer comparison



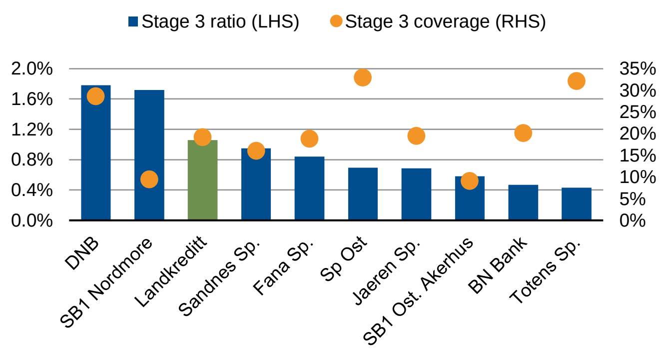
Source: Company data, Scope Ratings.

Figure 5: Loan portfolio by IFRS 9 stage classification (%)



Source: Company data, Scope Ratings.

Figure 6: Stage 3 ratio and coverage (%) – peer comparison



Note: Data as of YE 2021. 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 has established 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

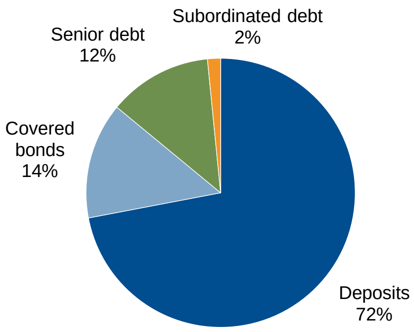
Customer deposits remain the primary source of funding (Figure 7). However, the pace of lending generally outstrips deposit growth, with deposits being insufficient to support lending activity. Recognising the importance of maintaining a sound liquidity profile, management targets a minimum deposit-to-loan ratio of 70% This is above the level of many domestic peers.

To diversify funding sources, a fully owned covered bond issuer, Landkreditt Boligkreditt, was established in 2010. Nearly NOK 4.7bn in loans have been sold to Landkreditt Boligkreditt, accounting for approximately 18% of the banking group's total loans as of year-end 2021. Covered bonds account for around 50% of outstanding debt.

Covered bonds an additional important funding source

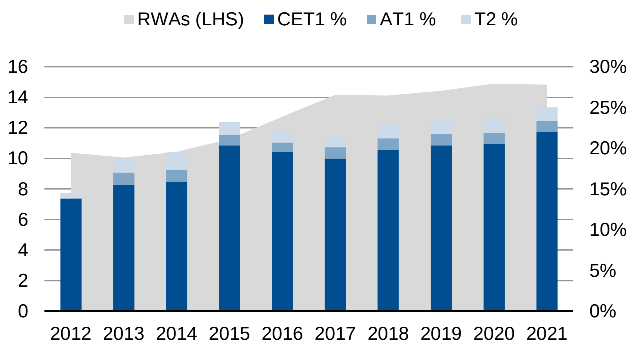
Landkreditt is a regular issuer in the domestic bond market, issuing secured, senior unsecured, and subordinated debt. Investors include Norwegian pension funds, asset managers and insurance companies. As of year-end 2021, the average maturity of outstanding debt was about three years while the average interest rate was 1.1%. The bank group's LCR and NSFR metrics were sound at 293% and 156%, respectively as of year-end 2021.

Figure 7: Funding profile – bank group (%)



Notes: Data as of YE 2021. Bank group refers to Landkreditt Bank and its subsidiaries.
Source: Company data, Scope Ratings.

Figure 8: Capital ratios and RWA (NOK bn) development



Source: Company data, Scope Ratings.

Reassuring solvency metrics

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.

Capital position comfortably above requirements

With a CET1 capital ratio of 20.2% as of year-end 2021, 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.

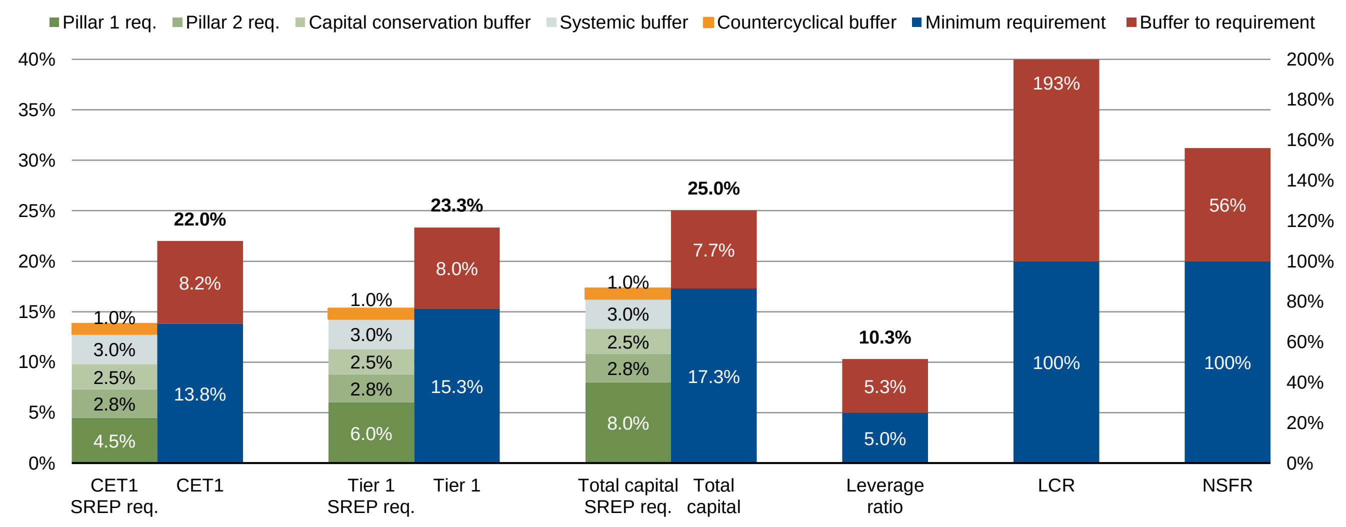
At the group level of Landkreditt SA, the CET1 capital requirement is nearly the same. The sole difference is the Pillar 2 requirement which stands at 2.8% vs. 2.7% for the bank. Management aims for a buffer of at least 0.5% above requirements.

Capital planning includes future increases 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. The countercyclical capital buffer rate will now gradually revert to 2.5% by March 2023. 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. Management has incorporated these increases into its capital planning.

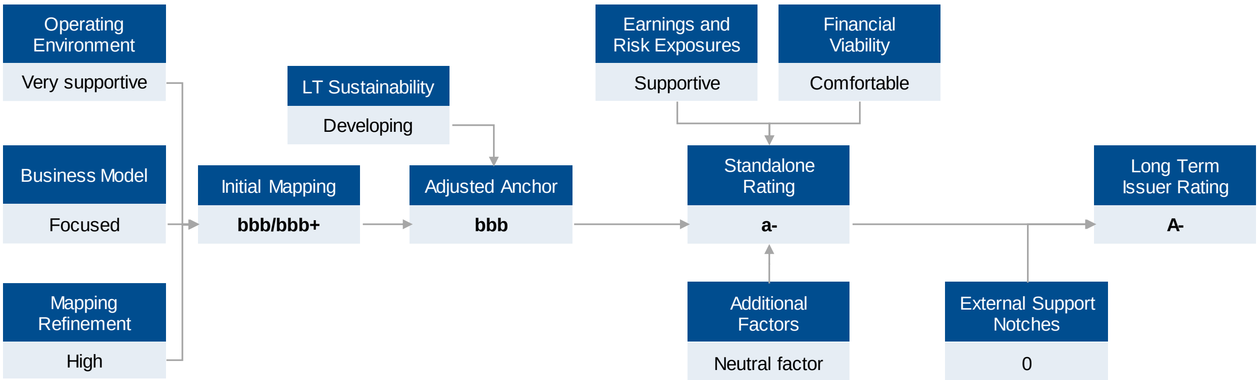
As of year-end 2021, the group's leverage ratio was 10.3% which compares well to both domestic and international peers. All Norwegian banks must hold a buffer of at least 2% above the minimum requirement of 3%. In addition, management intends to maintain a further buffer of 1%.

Figure 9: Overview of Landkreditt SA's position against minimum regulatory requirements – YE 2021



Source: Company data, Scope Ratings.

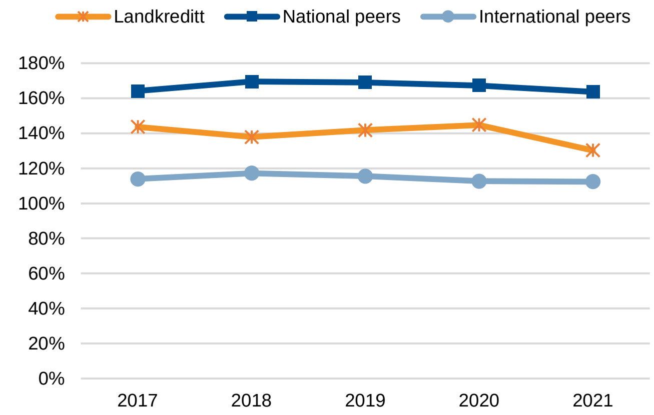
I. Appendix: Overview of the rating process



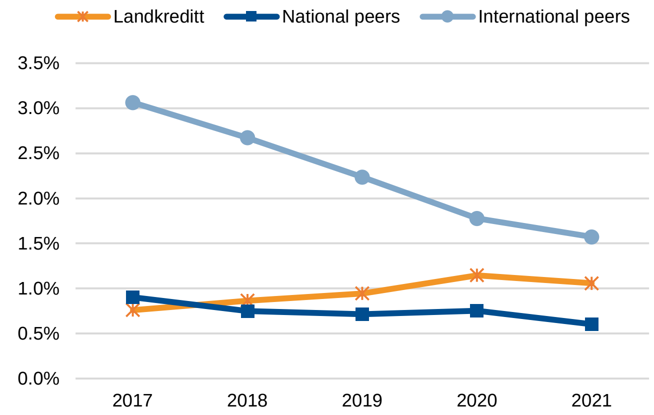
Step		Assessment	Summary rationale
STEP 1	Operating environment	**Very supportive**	• Wealthy economy with well-developed capital markets and a solid track record of economic resilience to shocks • Supportive competitive environment • Relatively stringent and active regulator
		Supportive	
		Moderately 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	• Beginning to incorporate ESG considerations in credit process as well as supporting 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	• Reflecting cooperative business model and low risk culture, relatively stable but somewhat lower earnings than domestic peers • Earnings more than sufficient to cover credit costs • Largely secured loan portfolio with history of low credit losses
		Supportive	
		Neutral	
		Constraining	
		Very constraining	
	Financial viability management	Ample	• Maintains reassuring prudential metrics. 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

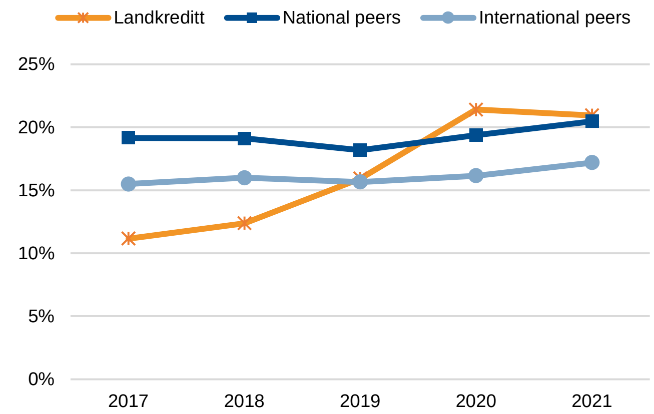
Net customer loans % Deposits



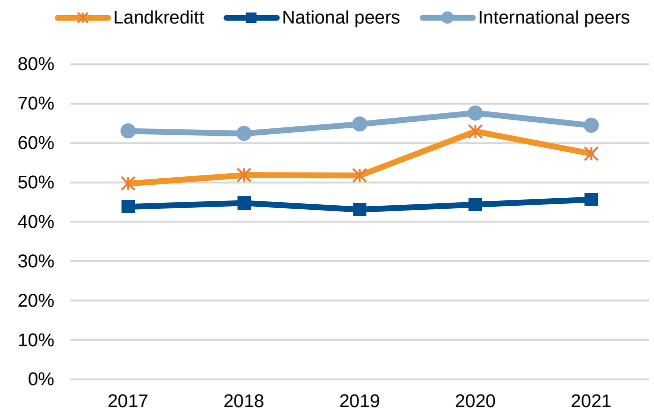
Problem loans % Gross loans



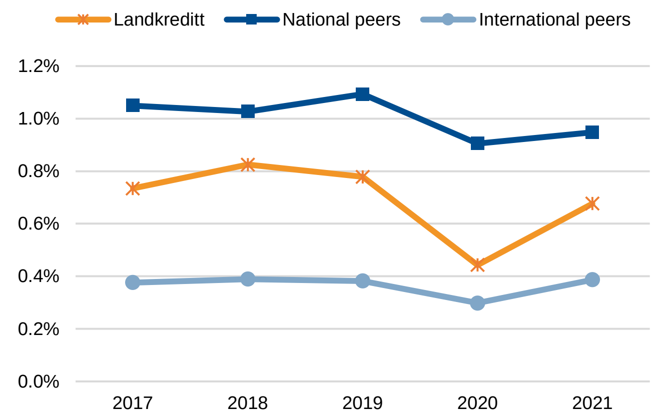
Net fee and commission income % Operating income



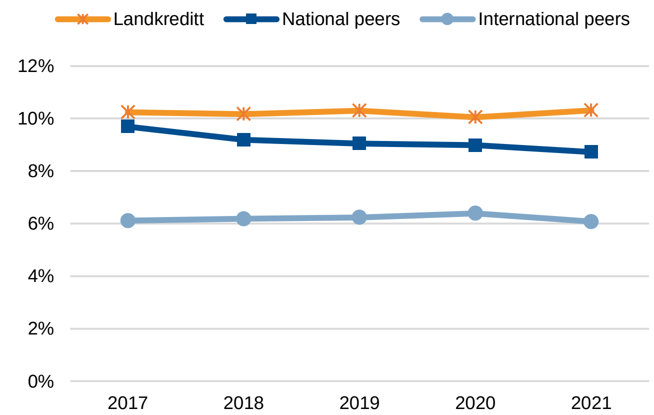
Costs % Income



Return on average assets (%)



Leverage ratio (%)



National peers: BN Bank, DNB, Fana Sparebank, Jaeren Sparebank, Sandnes Sparebank, Totens Sparebank, SpareBank 1 Nordmore, SpareBank 1 Ostfold Akerhus, Sparebanken Ost.
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: 2021 data unavailable for Bausparkasse Wustenrot.
Source: SNL

III. Appendix: Selected Financial Information – Landkreditt SA group

	2017	2018	2019	2020	2021
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	759	993	931	1,246	1,306
Total securities	2,453	3,391	3,188	3,338	4,322
of which, derivatives	0	0	0	0	0
Net loans to customers	23,293	24,054	25,421	26,635	26,841
Other assets	227	500	614	742	782
Total assets	**26,732**	**28,938**	**30,155**	**31,961**	**33,251**
Liabilities					
Interbank liabilities	15	16	0	0	0
Senior debt	7,272	7,069	7,580	8,665	7,456
Derivatives	0	0	0	0	0
Deposits from customers	16,208	17,443	17,931	18,405	20,608
Subordinated debt	175	331	331	331	331
Other liabilities	170	1,066	1,079	1,195	1,273
Total liabilities	**23,840**	**25,925**	**26,922**	**28,596**	**29,668**
Ordinary equity	2,599	2,795	3,012	3,145	3,360
Equity hybrids	199	199	199	199	199
Minority interests	94	19	22	20	23
Total liabilities and equity	**26,732**	**28,938**	**30,155**	**31,961**	**33,251**
Core tier 1/ common equity tier 1 capital	*2,651*	*2,795*	*2,934*	*3,052*	*3,262*
Income statement summary (NOK m)					
Net interest income	379	380	411	410	430
Net fee & commission income	53	72	98	117	139
Net trading income	28	92	48	-30	5
Other income	16	40	59	48	91
Operating income	**476**	**585**	**615**	**545**	**665**
Operating expenses	237	303	319	343	381
Pre-provision income	**239**	**281**	**297**	**202**	**284**
Credit and other financial impairments	6	8	7	16	-7
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	**234**	**274**	**290**	**186**	**291**
Income from discontinued operations	0	0	0	0	0
Income tax expense	46	40	59	47	66
Other after-tax Items	0	0	0	0	0
Net profit attributable to minority interests	10	5	3	-1	1
Net profit attributable to parent	**178**	**229**	**228**	**141**	**223**

Source: SNL

IV. Appendix: Selected Financial Information – Landkreditt SA group

	2017	2018	2019	2020	2021
Funding and liquidity					
Net loans/ deposits (%)	144%	138%	142%	145%	130%
Liquidity coverage ratio (%)	243%	223%	263%	391%	293%
Net stable funding ratio (%)	NA	NA	NA	NA	156%
Asset mix, quality and growth					
Net loans/ assets (%)	87.1%	83.1%	84.3%	83.3%	80.7%
Problem loans/ gross customer loans (%)	NA	0.9%	0.9%	1.1%	1.1%
Loan loss reserves/ problem loans (%)	NA	36.2%	31.4%	26.7%	28.3%
Net loan growth (%)	10.5%	3.3%	5.7%	4.8%	0.8%
Problem loans/ tangible equity & reserves (%)	NA	6.9%	7.5%	9.2%	8.1%
Asset growth (%)	11.3%	8.3%	4.2%	6.0%	4.0%
Earnings and profitability					
Net interest margin (%)	1.5%	1.4%	1.4%	1.3%	1.3%
Net interest income/ average RWAs (%)	2.8%	2.7%	2.8%	2.7%	2.9%
Net interest income/ operating income (%)	79.6%	65.0%	66.7%	75.2%	64.6%
Net fees & commissions/ operating income (%)	11.2%	12.4%	15.9%	21.4%	20.9%
Cost/ income ratio (%)	49.7%	51.9%	51.8%	62.9%	57.3%
Operating expenses/ average RWAs (%)	1.8%	2.1%	2.2%	2.3%	2.6%
Pre-impairment operating profit/ average RWAs (%)	1.8%	2.0%	2.1%	1.3%	1.9%
Impairment on financial assets / pre-impairment income (%)	2.3%	2.8%	2.4%	7.8%	-2.4%
Loan loss provision/ average gross loans (%)	0.0%	0.0%	0.0%	0.1%	0.0%
Pre-tax profit/ average RWAs (%)	1.7%	1.9%	2.0%	1.2%	2.0%
Return on average assets (%)	0.7%	0.8%	0.8%	0.4%	0.7%
Return on average RWAs (%)	1.4%	1.6%	1.6%	0.9%	1.5%
Return on average equity (%)	6.7%	7.9%	7.4%	4.3%	6.5%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	18.7%	19.8%	20.3%	20.5%	22.0%
Tier 1 capital ratio (%, transitional)	20.1%	21.2%	21.7%	21.8%	23.3%
Total capital ratio (%, transitional)	21.4%	23.0%	23.5%	23.5%	25.0%
Leverage ratio (%)	10.2%	10.2%	10.3%	10.1%	10.3%
Asset risk intensity (RWAs/ total assets, %)	53.0%	48.8%	47.8%	46.6%	44.6%

Note: Liquidity coverage ratio and net stable funding ratio figures are for the bank group which comprises Landkreditt Bank and its subsidiaries.
Source: SNL

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