

RatingsDirect®

KommuneKredit

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Credit Highlights

Issuer Credit Rating

AAA/Stable/A-1+

Overview

Enterprise risk profile	Financial risk profile
Low-risk municipal lending, very high market share, and a strong management team support credit quality.	Very strong capitalization and liquidity position provide financial buffers.
Very competitive lending terms underpin the agency's public-policy role and robust market position.	Strong liquidity position supports the likelihood that it could maintain scheduled loan disbursements to its members without external funding in a stressed scenario.
Denmark's wealthy and resilient economy, its well-developed financial sector, and the local and regional government (LRG) sector's strong ties to the 'AAA' rated sovereign are credit strengths.	KommuneKredit has broad access to diversified funding and a track record of positive funding gaps.

S&P Global Ratings expects KommuneKredit to benefit from conservative management and Danish municipalities' robust credit quality. We expect Danish local and regional governments to maintain very strong credit quality thanks to strong central government oversight and track record of timely fiscal support. We do not expect potential pressure from challenging macroeconomic conditions to alter this outlook. KommuneKredit's own prudent risk management and low-risk lending activities will continue to provide the foundation for its financial strength. Furthermore, we expect the agency's management will remain committed to strong liquidity coverage and capitalization.

We believe that KommuneKredit's largest members would provide timely and extraordinary support to the agency if needed. KommuneKredit's municipal members have strong credit profiles and are subject to a joint and several liability scheme that makes them liable for the agency's obligations. That legally binding guarantee enhances KommuneKredit's important role in providing funding for the Danish municipal sector and ensures an integral link to its LRG members. We assess the likelihood of KommuneKredit receiving extraordinary government support as extremely high.

We consider the new legislation governing KommuneKredit, coming into force on July 1, 2023, to continue to support the creditworthiness of the agency. Under the new legislation, the agency will be subject to some of the funding and liquidity requirements that apply to other financial institutions in Denmark. We believe this additional oversight from the Danish Financial Supervisory Authority (FSA) would support the agency in maintaining strong financial metrics. The new legislation also allows KommuneKredit to provide loans to Greenlandic and Faroese municipalities and certain Greenlandic and Faroese municipal entities in the future. As the Danish state will provide a full guarantee to all such lending, we believe it would potentially further strengthen KommuneKredit's lending quality. These municipalities will not become KommuneKredit members.

Outlook

The stable outlook reflects our expectation that the Danish municipal sector will maintain its strong credit quality. It also reflects our view that the members' guarantee to KommuneKredit will not change, while the agency will maintain its solid capital position, very strong funding, and robust liquidity profile. Moreover, we expect that KommuneKredit will continue to manage risk so that its lending services, and ultimately its public policy role, are not affected.

Downside scenario

We could downgrade KommuneKredit if the agency's capitalization declined such that its risk-adjusted capital (RAC) ratio fell below 15%. This could result from a significant expansion of the agency's lending book or if its loans became increasingly concentrated among its largest clients and members. We could also lower the ratings if we perceived a diminished likelihood that KommuneKredit might receive extraordinary support from its LRG members, or if there was a structural deterioration in the municipal sector's creditworthiness.

Rationale

Enterprise risk profile: The dominant lender to the low-risk municipal sector with an important public policy mandate

KommuneKredit's public-policy mandate is to provide funding to its Danish LRG members. It fulfills this mandate by lending directly to municipalities, regions, and to companies with a municipal guarantee. KommuneKredit's loan book contains only Danish LRG risk. The agency's share of the market for LRG sector loans is close to 100%.

The public-policy mandate is underpinned by KommuneKredit's public ownership, its LRG-backed support structure, its role as a niche lender, and its nonprofit status. KommuneKredit plays an important role in financing the Danish LRG sector by ensuring stable and advantageous funding in national and international capital markets.

KommuneKredit's willingness to provide long-term support to the LRG sector is key to its public-policy relevance. The Danish LRG sector is distinguished by its long-term borrowing, and more than 40% of KommuneKredit's loans mature after five years. The agency has call options on its loans, which could provide flexibility, though we believe that its public-policy role and close ties to the LRG sector means it is unlikely to exercise those options.

We expect KommuneKredit to slightly expand its lending book in nominal terms despite a negative valuation effect. The agency's total loans and leasing portfolio dropped by Danish krone (DKK) 20 billion and totaled DKK174.9 billion at end-2022. The substantial rise in interest rates in 2022 resulted in a negative value adjustment of lending of DKK24.9 billion. If calculated in nominal terms, the net lending and leasing increased by DKK4.8 billion over 2022. KommuneKredit disbursed more than 700 new loans totaling DKK25 billion, of which about DKK 7 billion was to municipalities and regions, DKK7 billion to district heating, and DKK4.5 billion to water and wastewater. The agency projects another DKK5 billion increase for the lending and leasing portfolio in 2023.

KommuneKredit also plays an important role in the Danish government's efforts to phase out fossil fuels, particularly in efforts to reduce household reliance on gas boilers through their replacement with district-heating systems and heat pumps. KommuneKredit will likely finance most of Denmark's transition to district-heating systems via support for the

municipalities, which will likely cover about 10% of all Danish households.

New legislation governing KommuneKredit will come into force on July 1, 2023. The change will place KommuneKredit under the supervision of the Danish FSA, aligning the agency's oversight with that of Danish commercial credit institutions. The change also implies that KommuneKredit will be subject to some of the requirements that apply to other credit institutions, like the LCR (liquidity coverage ratio) and NSFR (net stable funding ratio) requirements, stemming from EU regulation. The purpose is to manage and limit both short- and long-term liquidity risks. There will be no change in capital requirements. According to KommuneKredit's management, it already complies with the requirements in all of these areas. Nevertheless, we believe the additional oversight provides further assurance that KommuneKredit will maintain strong financial metrics.

Under the new legislation, KommuneKredit will also expand the geographic scope of its lending to include Greenland and the Faroe Islands, with loans backed by a 100% central government guarantee. We understand that the project to lend to Greenland is at a more advanced stage than that of the Faroe Islands. The estimated volume of lending to Greenland is about DKK4 billion in the medium to long term, corresponding to about 2% of KommuneKredit's total lending. The agency's loan book would therefore be little affected by lending to Greenland, though the expanded mandate further illustrates KommuneKredit's public-policy role, in our view. This may also be positive for reducing the concentration in the loan book. Currently, the loans to the top 10 borrowers account for about 36% of the total lending.

We view KommuneKredit's overall financial management and governance as strong, but not as robust as that of its Nordic peers. This is particularly relevant to credit assessment, where KommuneKredit relies on the Danish Ministry for Economic Affairs and the Interior to monitor LRGs, and does not perform its own credit analysis of borrowers, unlike Norway's Kommunalbanken, Finland's Municipality Finance, and Sweden's Kommuninvest.

The Danish LRG sector's structural features support a strong credit standing, and it is our view that the Danish public sector industry risk and country risk assessment are also both strongly supportive. Denmark has a wealthy economy, an advanced financial system, and an LRG sector that benefits from low leverage and a strong legal and operating framework. There are close links between the LRG sector and the 'AAA' rated sovereign. Government oversight of LRG finances is incorporated into, and supports, our assessment of the institutional framework of the Danish LRG sector as extremely strong. We do not anticipate any major fallout for LRGs from the Russia-Ukraine conflict, nor from increased inflation and interest rates. That assessment is largely based on support from automatic fiscal stabilizers built into the Danish financing system for LRGs, and it reflects our expectation that the central government will compensate Danish LRGs if weak economic conditions lead to lower revenue or increased costs.

Financial risk profile: Very strong capitalization and liquidity position provide financial buffers

KommuneKredit continues to maintain very strong capital ratios. Our pre-adjustment RAC ratio for KommuneKredit was a very strong 60.0% on Dec. 31, 2022, compared with 55.8% a year earlier. The increase was triggered by the drop in the loan portfolio to DKK175 billion at the end of 2022 from DKK195 billion at year-end 2021. The substantial rise in interest rates in 2022 resulted in a negative value adjustment provided that KommuneKredit uses market values for accounting purposes. Applying adjustments specific to public sector funding agencies, and to account for KommuneKredit's business concentration in Danish municipalities, leaves the agency with an S&P Global Ratings-adjusted RAC ratio of 23.4% at the end of 2022, which is up from 21.0% a year earlier, and above the 15.0%

threshold for the current capital assessment. Loans to the top 10 borrowers accounted for about 36% of the agency's loan book. We expect KommuneKredit will maintain its very strong capitalization and it has a sufficient buffer in its S&P Global Ratings-adjusted RAC to absorb the lending concentration.

KommuneKredit's funding strategy focuses on benchmark issuance in strategic markets, including green bonds. As part of its effort to diversify its investor base and funding profile, KommuneKredit issued, in May 2022, its first green bond under the updated Green Bond framework totaling €500 million. KommuneKredit has access to all relevant capital markets because of its excellent brand recognition and deep investor base. We expect KommuneKredit to continue to issue primarily standard funding instruments, as it has done since early 2018, when it switched from principally using structured notes.

The agency's funding ratio was 1.75x on Dec. 31, 2022 (compared with 1.40x on March 31, 2022), improving further from levels around 1x observed prior to 2019. We expect the entity's funding sources will adequately cover maturing debt over all relevant time periods. As a result, we consider the agency's funding profile to be solid.

We calculated the agency's liquidity coverage to be 1.25x on Dec. 31, 2022, and note that the ratio has been consistently above 1.2x since 2018. Our calculations, which include stressed market conditions and an assumption that the agency would not have access to the capital markets, indicate that KommuneKredit has a very strong liquidity position, can meet its financial obligations over a one-year period, and could do so while maintaining a liquidity buffer. KommuneKredit's strong liquidity position is further supported, in our view, by the use of bilateral credit support annexes (CSAs), which provide certainty through standardization of credit agreements.

KommuneKredit's liquidity portfolio is invested in liquid fixed-income securities that are issued at the state, regional, and local levels of government, as well as multilateral development banks and financial institutions rated 'AA-' or higher.

KommuneKredit hedges risk using derivatives. This creates material counterparty exposure to financial institutions, though we believe that this risk is adequately captured in our adjusted RAC calculations and our funding and liquidity metrics. The agency manages this risk with prudent counterparty strategies and by using contracts that aim to reduce risk, including International Swaps and Derivatives Association master agreements and CSAs.

Securities issued by KommuneKredit qualify as collateral in the Danish central bank's monetary policy operations, and the agency's foreign currency issues are eligible to be counted as collateral by the European Central Bank. However, KommuneKredit's lending book is not eligible to be considered as collateral, and as such we do not consider that its liquidity position is enhanced by the securities' eligibility to be considered collateral.

Extremely high likelihood of extraordinary support via a joint and several guarantee from its highly creditworthy members

KommuneKredit's members are responsible for its obligations through a joint and several liability mechanism, which amounts to an explicit, statutory liability borne by all member municipalities and regions, and ultimately the central government. We assess the guarantee's structure as predictable and immediately enforceable by law, and note that it dictates that members will have to inject capital into KommuneKredit if its capital ratio, calculated as equity to total liabilities excluding equity, falls below 1%. We understand that any holder of KommuneKredit debt can demand that a

guaranteeing member pay a claim on KommuneKredit, and that such a demand can be made without having to secure a court order. The largest LRG members, whose creditworthiness we assess as slightly below the sovereign, thus have an extremely strong incentive to provide support to KommuneKredit before the triggering of the guarantee mechanism.

The legal enforceability of the guarantee underpins our assessment of an integral link between KommuneKredit and its members, which is also reinforced by KommuneKredit's very important role in providing cost-efficient funding to its members. We therefore believe there is an extremely high likelihood that the largest LRG members would support KommuneKredit should it experience financial distress, and likely before the guarantee mechanism is triggered.

We expect that KommuneKredit's other LRG members would also be liable and able to support the agency in the event of financial distress. This underpins our view that KommuneKredit benefits from support from the wider Danish municipal sector, in addition to extraordinary support from its largest members. The combination of these factors means that we add two notches of uplift to our 'aa' stand-alone credit profile on KommuneKredit, leading to an issuer credit rating of 'AAA'.

Key Statistics

Table 1

KommuneKredit--Selected indicators					
	--Year ended Dec. 31--				
(Mil. DKK)	2022	2021	2020	2019	2018
Business position					
Total adjusted assets	237,052.0	249,077.0	233,872.0	236,935.0	226,609.0
Customer loans (gross)	174,980.0	194,950.0	192,459.0	184,967.0	177,454.0
Growth in loans (%)	(10.2)	1.3	4.0	4.0	2.0
Net interest revenues	339.0	383.0	440.0	495.0	441.0
Noninterest expenses	224.0	140.0	130.0	126.0	127.0
Capital and risk position					
Total liabilities	227,286.0	240,302.0	225,475.0	228,756.0	218,873.0
Total adjusted capital	9,766.0	8,775.0	8,397.0	8,179.0	7,736.0
Assets/capital	24.3	28.4	28.0	29.0	29.0
RAC ratio before diversification (%)*	60.0	55.8	60.0	55.0	41.0
RAC ratio after diversification (%)*	23.4	21.0	20.0	19.0	17.0
Gross nonperforming assets/gross loans	0.0	0.0	0.0	0.0	0.0
Funding and liquidity§					
Liquidity ratio with loan disbursement (1 year)	1.3	1.3	1.7	1.4	1.3
Liquidity ratio without loan disbursement (1 year)	1.4	1.4	2.3	1.5	1.4
Funding ratio (1 year)	1.8	1.4	1.5	1.4	1.1

*RAC ratios for 2018 as of end-March 2019, and 2019 - 2022 as of end-December. §Funding and liquidity ratios for 2018 are as of end-June 2019, and for 2019, 2020 and 2021 as of end-March 2020, 2021 and 2022, respectively, and for 2022 as of end-December 2022. Funding ratio is without loan disbursements. RAC--Risk-adjusted capital. DKK--Danish krone.

KommuneKredit--Ratings score snapshot

Issuer Credit Rating	AAA/Stable/A-1+
SACP	aa
Enterprise risk profile	Strong (2)
PICRA	Strong (2)
Business position	Very strong (1)
Management and governance	Strong (2)
Financial risk profile	Very strong (1)
Capital adequacy	Very strong (1)
Funding and liquidity	Positive and Very Strong (1)
Support	1
GRE support	1
Group support	0
Additional factors	1

PICRA--Public-Sector Industry Risk And Country Risk Assessment.

Related Criteria

- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions , May 22, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology , July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions , March 25, 2015
- General Criteria: Principles Of Credit Ratings , Feb. 16, 2011

Related Research

- Subnational Debt 2023: The Best-Placed Local And Regional Governments To Handle Rising Interest Rates, March 2, 2023
- Denmark, Feb. 14, 2023
- Banking Industry Country Risk Assessment: Denmark, June 9, 2022
- Institutional Framework Assessment: Danish Regions And Municipalities, Feb. 3, 2021

Ratings Detail (As Of June 26, 2023)*

KommuneKredit	
Issuer Credit Rating	AAA/Stable/A-1+
Commercial Paper	
<i>Foreign Currency</i>	A-1+
Senior Unsecured	AAA
Short-Term Debt	A-1+

Ratings Detail (As Of June 26, 2023)*(cont.)

Issuer Credit Ratings History

24-Jul-2019	<i>Foreign Currency</i>	AAA/Stable/A-1+
26-Jul-2018		AA+/Stable/A-1+
27-Feb-2001		AAA/Stable/A-1+
24-Jul-2019	<i>Local Currency</i>	AAA/Stable/A-1+
26-Jul-2018		AA+/Stable/A-1+
24-Mar-1997		AAA/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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