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# KommuneKredit

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## Table Of Contents

# KommuneKredit

| 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 unique market position. | Its 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. |

***We expect that KommuneKredit will benefit from conservative management and Danish municipalities' robust credit quality.*** We expect Danish LRGs to maintain very strong credit quality thanks to strong central government oversight, a track record of timely fiscal support, and ample cash reserves. 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 provide the foundation for its financial strength. Furthermore, we expect the agency's management will remain committed to strong liquidity coverage and capitalization.

***We think 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. The 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 that the new legislation governing KommuneKredit, which came into force on July 1, 2023, will support the creditworthiness of the agency.*** Under the new legislation, the agency is subject to some of the funding and liquidity requirements that apply to other financial institutions in Denmark (AAA/Stable/A-1+). We think this additional oversight from the Danish Financial Supervisory Authority supports the agency 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. As the Danish state will provide a full guarantee to all such lending, we think it would potentially further strengthen KommuneKredit's lending quality. These municipalities will not become KommuneKredit members and will therefore not be liable for KommuneKredit's liabilities.

## Outlook

The stable outlook reflects our view that there are limited downside risks to the Danish municipal sector's strong credit quality.

### 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 of 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%.

KommuneKredit's public ownership, its LRG-backed support structure, its role as a niche lender, and its nonprofit status underpins the public-policy mandate. 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. Long-term borrowing distinguishes the Danish LRG sector, with more than 40% of KommuneKredit's loans maturing after five years. The agency has call options on its loans, which could provide flexibility. However, we think that its public-policy role and close ties to the LRG sector means it is unlikely to exercise those options.

We expect KommuneKredit to moderately expand its lending book in 2024. The agency's total loans and leasing portfolio increased to Danish krone (DKK) 187 billion at end-2023 from DKK174.9 billion at end-2022. Construction loans granted to district heating companies, which are currently establishing or expanding district heating areas, primarily drove the increase in lending. All the loans to the district heating companies are guaranteed by a respective municipal government.

KommuneKredit 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 from the municipalities.

New legislation governing KommuneKredit came into force on July 1, 2023. The change implies that KommuneKredit is now subject to some of the requirements that apply to other credit institutions, like the liquidity coverage ratio and net stable funding ratio requirements, stemming from EU regulation. We think the additional oversight provides further assurance that KommuneKredit will maintain strong financial metrics.

Under the new legislation, KommuneKredit has expanded the geographic scope of its lending to include Greenland and the Faroe Islands, with loans backed by a 100% central government guarantee. The Danish State has provided a guarantee for a total loan amount of DKK4 billion for loans to Greenlandic local authorities, corresponding to about 2% of KommuneKredit's total lending. The loans may be granted from January 2024 to December 2031. No new loans have been disbursed to Greenlandic municipalities, nor to the Faroe Islands so far. We think that this new lending might 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. It does not perform its own independent credit analysis of borrowers, unlike Norway's Kommunalbanken, Finland's Municipality Finance, and Sweden's Kommuninvest i Sverige.

The Danish LRG sector's structural features support a strong credit standing. We view the Danish public sector industry risk and country risk assessment as strongly supportive of the credit standing. 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 are incorporated into, and support, our assessment of the institutional framework of the Danish LRG sector as extremely strong. We did not see any major effect on LRGs from the Russia-Ukraine conflict, nor from increased inflation and interest rates. The assessment is largely based on support from automatic fiscal stabilizers built into the Danish financing system for LRGs, reflecting 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 maintains very strong capital ratios. Our pre-adjustment RAC ratio for KommuneKredit was a very strong 64.5% on Dec. 31, 2023, compared with 60.0% at end-2022. The increase was triggered by the growth in total equity. By applying adjustments specific to public sector funding agencies and accounting for KommuneKredit's business concentration in Danish municipalities, the agency's S&P Global Ratings-adjusted RAC ratio is 23.7% as of end-2023. This is largely on par with the 23.4% as of end-2022, and well above the 15.0% threshold for the current capital assessment. We expect that KommuneKredit will maintain its very strong capitalization and that it has a sufficient buffer in its S&P Global Ratings-adjusted RAC to absorb the potential increase in lending as well as the concentration.

KommuneKredit's funding strategy focuses on benchmark issuance in strategic markets, including green bonds. The agency had issued a total of DKK27.9 billion in green bonds as of end-2023, which is 12% of the total bond portfolio. KommuneKredit has access to all relevant capital markets because of its excellent brand recognition and deep investor base. We anticipate that it will 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 1.72x as of Dec. 31, 2023 (compared with 1.75x as of Dec 31, 2022), an improvement from levels at about 1.0x observed before 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 1.3x on Dec. 31, 2023, 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. In our view, KommuneKredit's strong liquidity position is further supported 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 think 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 Assn. Inc. 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. The guarantee 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. Therefore, we think that 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 a long-term issuer credit rating on KommuneKredit of 'AAA'.

## Key Statistics

**Table 1**

## KommuneKredit--Selected indicators

| | --Year ended Dec. 31-- | | | | |
|---|---|---|---|---|---|
| **(Mil. DKK)** | **2023** | **2022** | **2021** | **2020** | **2019** |
| **Business position** | | | | | |
| Total adjusted assets | 242,612.0 | 237,052.0 | 249,077.0 | 233,872.0 | 236,935.0 |
| Customer loans (gross) | 187,144.0 | 174,980.0 | 194,950.0 | 192,459.0 | 184,967.0 |
| Growth in loans (%) | 1.1 | 0.9 | 1.3 | 4.0 | 4.0 |
| Net interest revenues | 467.0 | 339.0 | 383.0 | 440.0 | 495.0 |
| Noninterest expenses | 193.0 | 224.0 | 140.0 | 130.0 | 126.0 |
| **Capital and risk position** | | | | | |
| Total liabilities | 232,432.0 | 227,286.0 | 240,302.0 | 225,475.0 | 228,756.0 |
| Total adjusted capital | 10,180.0 | 9,766.0 | 8,775.0 | 8,397.0 | 8,179.0 |
| Assets/capital | 23.8 | 24.3 | 28.4 | 28.0 | 29.0 |
| RAC ratio before diversification (%) | 64.5 | 60.0 | 55.8 | 60.0 | 55.0 |
| RAC ratio after diversification (%) | 23.7 | 23.4 | 21.0 | 20.0 | 19.0 |
| 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 | 1.3 | 1.7 | 1.4 |
| Liquidity ratio without loan disbursement (1 year) | 1.5 | 1.4 | 1.4 | 2.3 | 1.5 |
| Funding ratio (1 year) | 1.7 | 1.8 | 1.4 | 1.5 | 1.4 |

§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 |

SACP--Stand-alone credit profile. PICRA--Public-Sector Industry Risk And Country Risk Assessment. GRE--Government-related entity.

## 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

- Research Update: Denmark 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Feb. 9, 2024
- Banking Industry Country Risk Assessment: Denmark, Dec. 7, 2023
- Danish LRGs Can Rely On Central Government Support, Despite Economic Stresses, Feb. 6, 2023

| Ratings Detail (As Of June 10, 2024)* | | |
|---|---|---|
| **KommuneKredit** | | |
| Issuer Credit Rating | | AAA/Stable/A-1+ |
| Commercial Paper | | |
| *Foreign Currency* | | A-1+ |
| Senior Unsecured | | AAA |
| Short-Term Debt | | A-1+ |
| **Issuer Credit Ratings History** | | |
| 24-Jul-2019 | *Foreign Currency* | AAA/Stable/A-1+ |
| 26-Jul-2018 | | AA+/Stable/A-1+ |
| 27-Feb-2001 | | AAA/Stable/A-1+ |
| 24-Jul-2019 | *Local Currency* | 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.