Sandnes Sparebank
Issuer Rating Report

A- STABLE

Scope's credit view (summary)

The **A- issuer rating** reflects Sandnes Sparebank's (Sandnes) well established local savings bank franchise in south-west Norway, solid and resilient earnings capabilities as well as sound prudential metrics.

Following de-risking efforts and a focus on rebuilding the business franchise in recent years, Sandnes in 2021 generated solid results despite the low interest rate environment and increased IT spending. Asset quality remains sound, with earnings continuing to be more than sufficient to cover credit costs. While operating in a region more exposed to the country's oil and gas industry, the group's direct exposure is immaterial.

Management is executing on its 2021-2024 strategic plan, with sustainability being a key component of the business strategy. Further, the bank is upgrading its IT infrastructure to meet evolving client needs and improve overall efficiency.

Scope expects the bank to maintain prudent buffers above regulatory requirements. Minimum solvency requirements for Norwegian banks are comparatively high and are set to rise following announced increases in the countercyclical buffer rate and the systemic risk buffer for banks like Sandnes using standardized models. At year-end 2021, the bank's CET1 capital and leverage ratios were 16.6% (proportional consolidation basis) and 9.2%, respectively.

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

Outlook

The **Stable Outlook** reflects Scope's expectation that the bank's business and operating performance will remain resilient.

What could move the rating up:

- Sustained strengthening of market position and increased geographical diversification accompanied by consistent earnings generation and sound prudential metrics

What could move the rating down:

- A deterioration in the operating environment which materially impacts earnings
- An inability to balance developing the business further with maintaining sufficient buffers above regulatory capital requirements

Ratings & Outlook

Issuer rating	A-
Preferred senior unsecured debt rating	A-
Non-preferred senior unsecured debt rating	BBB+
Outlook	Stable

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Bloomberg: RESP SCOP

Issuer profile

Founded in 1875, Sandnes Sparebank is a local savings bank operating in the county of Rogaland in south-west Norway. The bank serves about 42,000 personal and 5,000 business customers from its head office and branch in Sandnes as well as a branch in Stavanger. The bank is the second largest savings bank in Rogaland, competing amongst SpareBank 1 SR-Bank, DNB Bank, Danske Bank, and others.

Since October 2015, the bank has been part of the Eika Alliance and is its largest member. This enables Sandnes to meet customer needs with a broad range of products and services, including asset management, insurance, credit cards, car loans and leasing. Being a member of the alliance further supports cost efficiency, particularly in banking operations and IT infrastructure.

The bank has its own covered bond entity, SSB Boligkreditt, and owns 60% of real estate broker Aktiv Eiendomsmegling Jaeren AS. In February 2020, the bank acquired a 49.5% stake in a local accounting firm.

Sandnes has equity capital certificates (ECC) outstanding and has been listed on the Oslo Stock Exchange since 1995. As of year-end 2021, the ECC ratio was about 63%.

Further strengthening of the bank’s franchise

Operations concentrated in Rogaland

Following a return to its savings bank roots, the bank remains focused on further strengthening its franchise. Measures of customer satisfaction continue to improve, and the bank has realized above market growth in the retail business.

Last year, the bank changed its brand name to ‘Den Gule Banken’ (The Yellow Bank) to appeal to customers in a broader geographic area within its market. The rebranding is expected to further enhance the bank’s visibility and attract new customers. Sandnes Sparebank remains the bank’s legal name.

Savings bank business model means numerous stakeholders

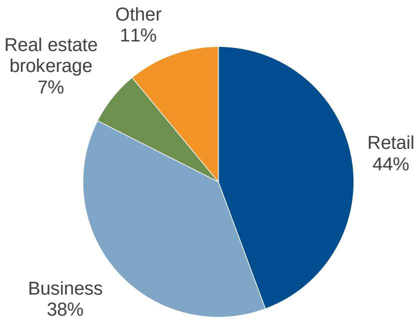
Management is executing on the 2021-2024 strategic plan which builds on the achievements of the last few years. The focus remains on enhancing the customer experience to generate profitable growth. Reflecting the bank’s business model, the plan incorporates the priorities of various stakeholders, including employees and the local community. Management believes that integrating sustainability and social responsibility within the business will eventually lead to outperformance.

In conjunction with the Eika Alliance, the bank is developing capabilities to evaluate potential ESG risks in its lending activities. All business customers with exposures above NOK 10m undergo an ESG assessment. By year-end 2022, the bank aims to report on the GHG emissions in its loan portfolio. At the same time, the bank is helping business customers improve their understanding of sustainability considerations and offers green business and transition loans.

Improving digital capabilities is a strategic priority

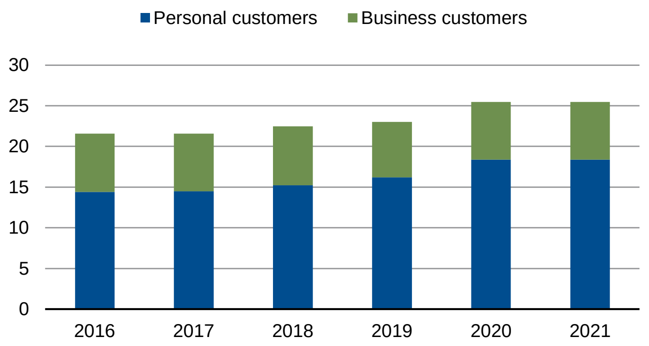
In addition, Sandnes is upgrading its digital infrastructure to meet the evolving demands of customers and increase the efficiency of internal operations. The conversion to a new technology provider and core platform is being done through the Eika Alliance. Once fully implemented in 2024, management expects NOK 15-20m in annual savings.

Figure 1: Operating income by business segment (%)



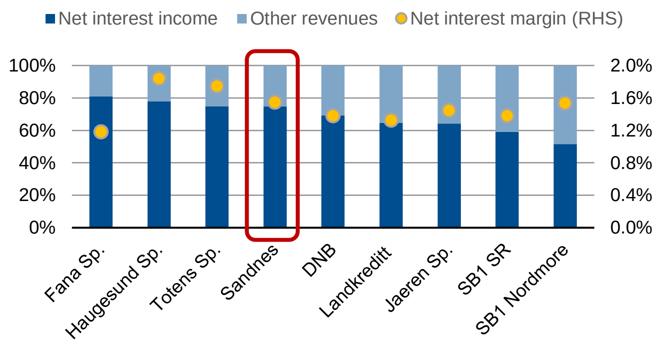
Note: Data for FY 2021.
Source: Company data, Scope Ratings

Figure 2: Loan portfolio by business segment (NOK bn)



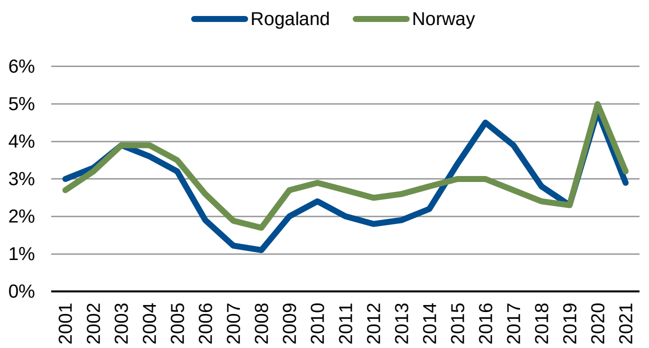
Source: Company data, Scope Ratings

Figure 3: Operating income and NIM – peer comparison



Note: Data for FY 2021.
Source: SNL, Scope Ratings.

Figure 4: Unemployment rates (%) – Rogaland vs Norway



Source: NAV, Scope Ratings.

Reduced risk profile supports earnings resilience

Along with actions taken to strengthen the bank's franchise, management has addressed issues arising from previous more aggressive and riskier business practices. For example, Sandnes no longer has a trading portfolio and FX loans are no longer actively marketed to existing or potential clients. Consequently, revenue generation has become more consistent while impairments have fallen (Figure 5).

Focus on retail customers and mortgage lending

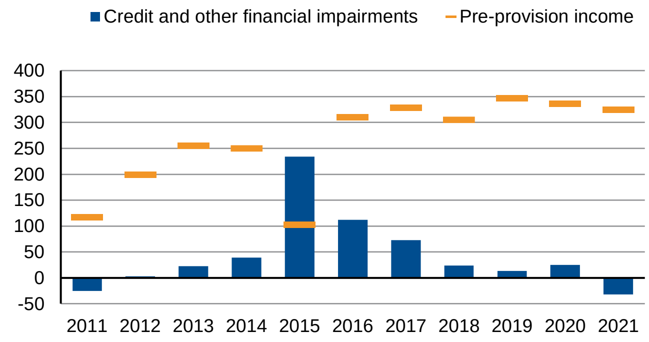
The loan book has become more granular as the share of lending to personal customers (primarily mortgages) has increased to more than 70%. Further, the magnitude and concentration of large business loan exposures have been significantly reduced. Management's policy to avoid direct exposure to the oil and gas industry as well as to more cyclical industries such as hotels and restaurants has also supported asset quality.

Close management of business risk exposures

With the de-risking of the loan book over the last few years and the close monitoring of risk exposures, asset quality remains sound. There was a small increase in Stage 3 exposures in 2Q 2020, but this had returned to pre-pandemic levels by year-end 2020. As of year-end 2021, the Stage 3 ratio stood at 0.9%. which compares well to peers (Figure 8).

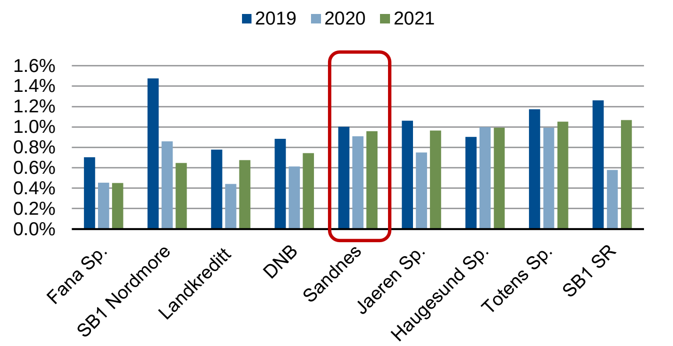
Macroeconomic indicators in Rogaland, the bank's primary market, remain relatively supportive. The local unemployment rate has moved in line with the national average, unlike in the economic downturn of 2014-2016 (Figure 4). House prices are amongst the lowest in the country and there are signs of improved activity in the housing market. The outlook for commercial real estate is more uncertain but so far has not been a driver of credit losses for Norwegian banks.

Figure 5: Pre-provision income vs impairments (NOK m)



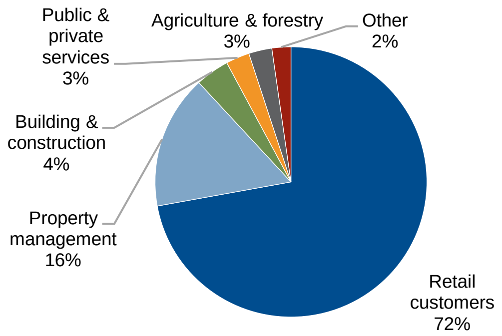
Source: Company data, Scope Ratings.

Figure 6: Return on average assets (%) – peer comparison



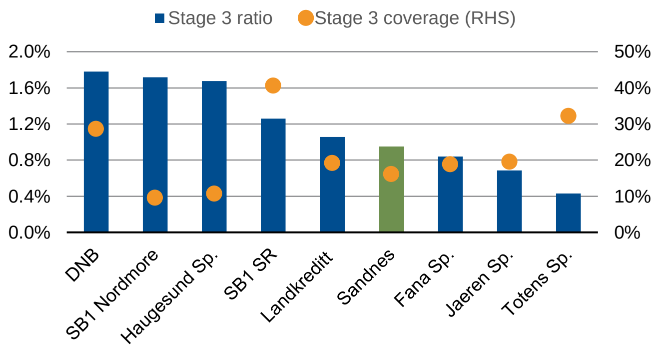
Source: SNL, Scope Ratings.

Figure 7: Loan portfolio breakdown



Note: Gross loans of NOK 25.5bn as of YE 2021.
Source: Company data, Scope Ratings.

Figure 8: Stage 3 ratio and coverage – peer comparison



Note: Data as of YE 2021.
Source: SNL, Scope Ratings.

Sound prudential metrics

CET1 requirements increasing

The current minimum CET1 capital requirement for Norwegian banks is a relatively high 11%, which includes a 3% systemic risk buffer and a countercyclical buffer of 1%. In response to the Covid-19 pandemic, the countercyclical buffer rate was lowered to 1% from 2.5% in March 2020. In addition, Sandnes is subject to a Pillar 2 requirement of 2.1%.

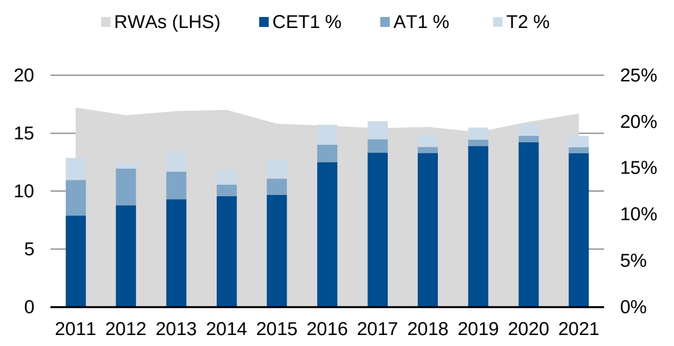
By year-end 2022 the countercyclical buffer is set to rise to 2% from 1% before fully reverting to 2.5% in March 2023. In addition, the systemic risk buffer will increase to 4.5% from 3% at year-end 2022 for banks like Sandnes using the standardised approach.

Management buffer of at least 1% above requirements

As of year-end 2021, Sandnes' CET1 capital ratio was 16.6% (proportional consolidation basis) while the leverage ratio was 9.2%, compared to requirements of 13.1% and 5%, respectively. Management targets a buffer of at least 1% above minimum requirements.

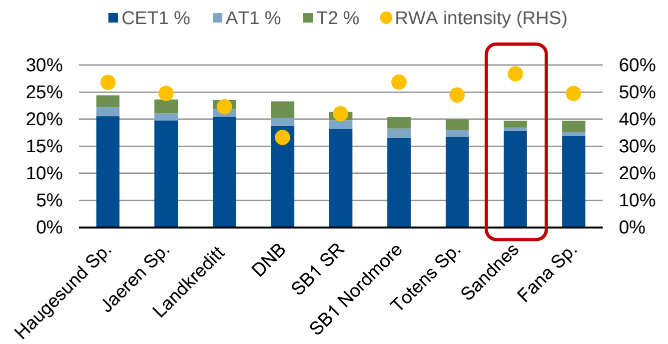
In addition to retained earnings, two factors will help Sandnes meet pending increases in CET1 requirements. In February 2022, the bank committed to buying additional shares in Eika Gruppen AS. Consequently, the bank's stake as of year-end 2021 will be re-valued, with an estimated positive impact on the capital position of about NOK 145m. Further, the bank's CET1 capital ratio will benefit from the adoption in Norway of the second SME supporting factor contained in CRR2 (expected in June 2022).

Figure 9: Capital ratios and RWA (NOK bn) development



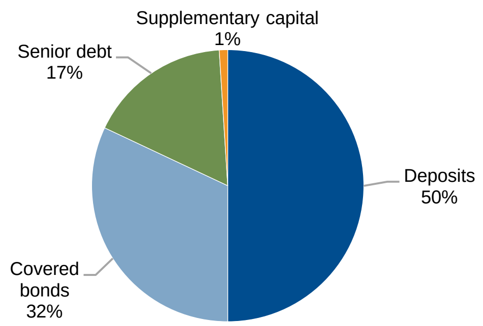
Source: Company data, Scope Ratings.

Figure 10: Capital ratios and RWA intensity (%) – peer comparison



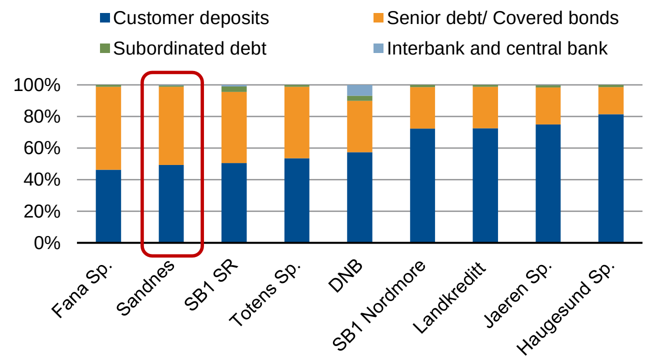
Source: SNL, Scope Ratings.

Figure 11: Funding profile – YE 2021



Source: Company data, Scope Ratings.

Figure 12: Funding profile (YE 2021) – peer comparison



Source: SNL, Scope Ratings.

Reliance on market funding

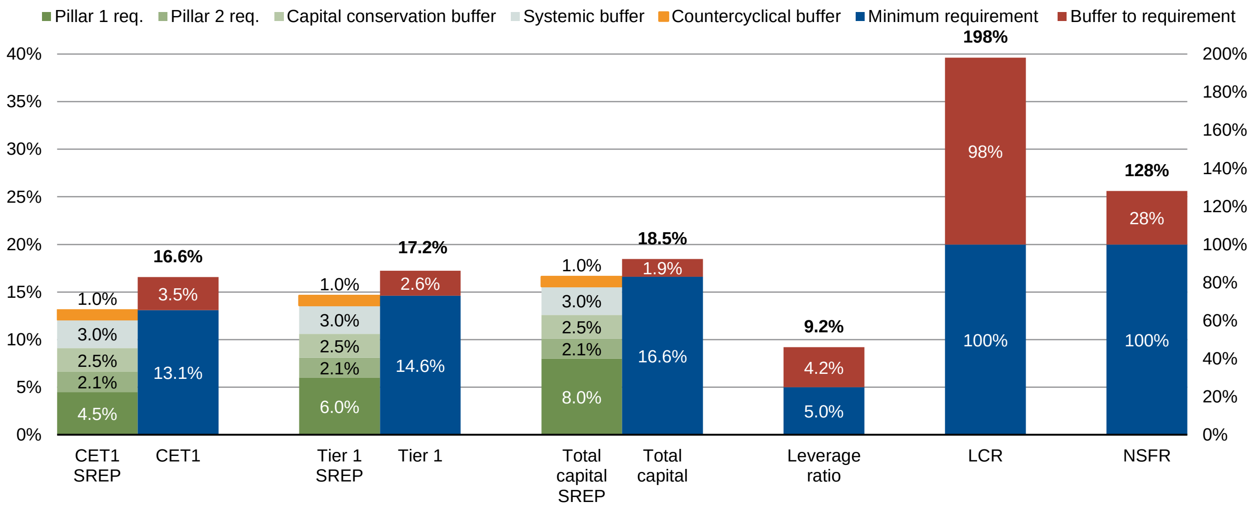
Bank enjoys good access to market funding

In common with other Norwegian banks, Sandnes depends to a substantial degree on market funding, including relatively reliable covered bonds (Figures 11 and 12). The bank has its own covered bond issuing entity, SSB Boligkreditt, and has flexibility to use the covered bond issuing entity of the Eika Alliance.

To mitigate refinancing risks, Sandnes maintains a high-quality liquidity portfolio comprised primarily of covered bonds and government paper. The bank also prefers to issue in smaller size to manage refinancing risks.

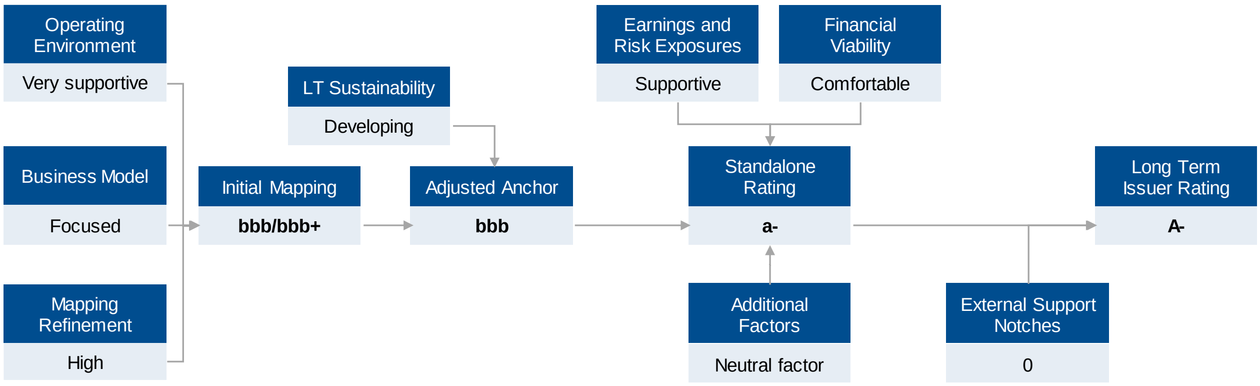
Management considers the natural deposit-to-loan ratio for the group to be 50%. While more deposits could be obtained, this would likely entail attracting less stable, larger deposits or being more aggressive with deposit pricing.

Figure 13: Overview of Sandnes' position against minimum regulatory requirements – YE 2021



Source: Company data, Scope Ratings.

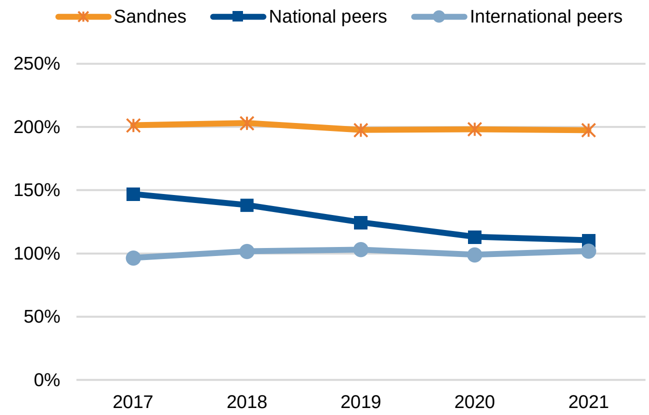
I. Appendix: Overview of the rating process



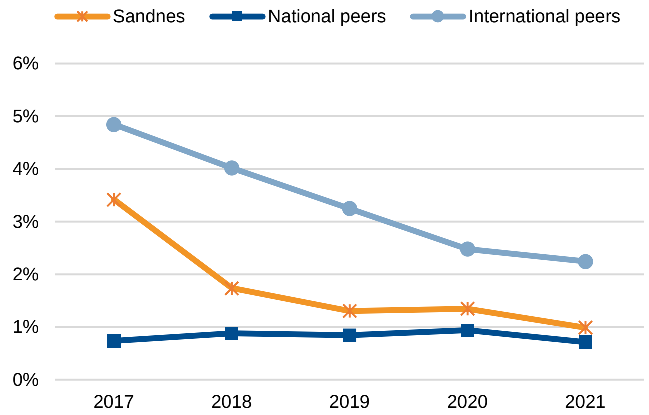
Step		Assessment	Summary rationale
STEP 1	Operating environment	**Very supportive** Supportive Moderately supportive Constraining Very constraining	• Wealthy economy with well-developed capital markets and a solid track record of economic resilience • Supportive competitive environment • Relatively stringent and active financial regulator
	Business model	Very resilient Resilient Consistent **Focused** Narrow	• Savings bank with a focus on retail customers and residential mortgage lending • Membership in an alliance brings significant benefits • Operations concentrated in south-west Norway
	Mapping refinement	**High** Low	• Well-established in local market with resilient operating performance
	Initial mapping	**bbb/bbb+**	
	Long-term sustainability	Best in class Advanced **Developing** Lagging	• In process of upgrading digital infrastructure • Actively embracing developments in ESG-D. Working on capabilities to assess ESG risks in loan portfolio
	Adjusted anchor	**bbb**	
STEP 2	Earnings capacity & risk exposures	Very supportive **Supportive** Neutral Constraining Very constraining	• De-risking and strengthening of business franchise in recent years supports earnings resilience • Sound asset quality and low credit losses
	Financial viability management	Ample **Comfortable** Adequate Limited Stretched At risk	• Sound prudential metrics • Reliance on market funding, including more stable covered bonds
	Additional factors	Significant support factor Material support factor **Neutral** Material downside factor Significant downside factor	• No further considerations
	Standalone	**a-**	
STEP 3	External support	Not applicable	
Issuer rating		**A-**	

II. Appendix: Peer comparison

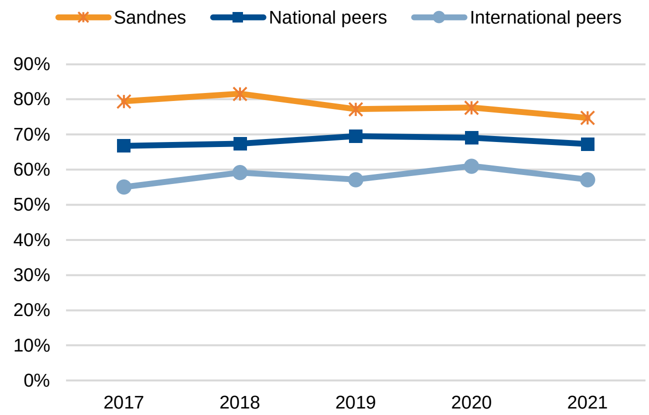
Net customer loans % Deposits



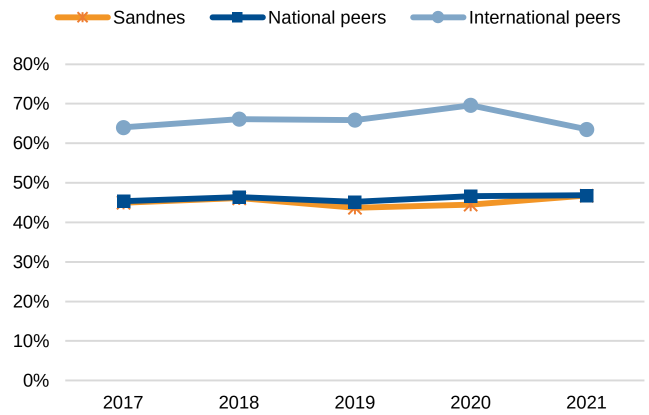
Problem loans % Gross customer loans



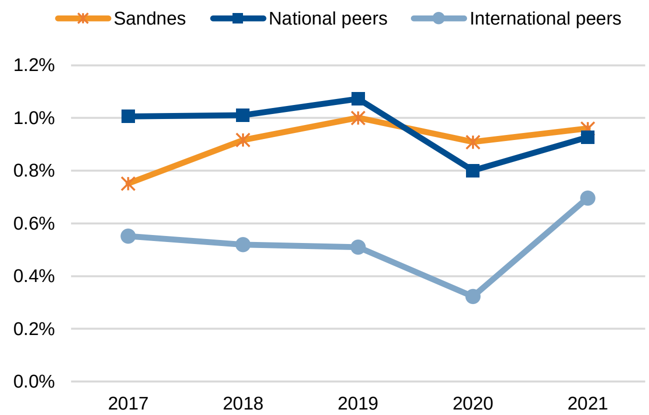
Net interest income % Operating income



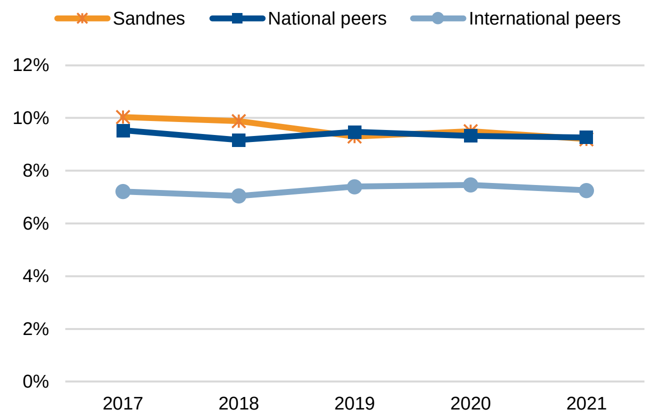
Costs % Income



Return on average assets (%)



Leverage ratio (%)



National peers: BN Bank, DNB Bank, SpareBank 1 SR-Bank, Landkreditt, Fana Sparebank, Haugesund Sparebank, Jaeren Sparebank, Totens Sparebank, SpareBank 1 Nordmore.
International peers: Bausparkasse Wustenrot AG, Oberbank AG, Banca Popolare di Sondrio SpA, Credito Emiliano SpA, Kutxabank SA, Unicaja Banco SA, TSB Bank plc, Sparbanken Sjuharad AB.
Source: SNL.

III. Appendix: Selected financial information – Sandnes Sparebank

	2017	2018	2019	2020	2021
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	645	656	574	489	440
Total securities	3,867	4,270	4,524	4,567	3,374
of which, derivatives	155	150	113	326	142
Net loans to customers	21,473	22,214	22,878	24,000	25,392
Other assets	115	69	182	180	167
Total assets	**26,100**	**27,209**	**28,158**	**29,235**	**29,373**
Liabilities					
Interbank liabilities	37	50	44	1,472	99
Senior debt	11,702	12,318	12,800	12,379	12,911
Derivatives	102	148	111	146	47
Deposits from customers	10,857	11,252	11,833	11,926	12,842
Subordinated debt	525	318	201	201	201
Other liabilities	167	163	150	159	198
Total liabilities	**23,391**	**24,248**	**25,139**	**26,283**	**26,298**
Ordinary equity	2,704	2,857	2,916	2,847	2,970
Equity hybrids	0	100	100	100	100
Minority interests	4	4	3	5	5
Total liabilities and equity	**26,100**	**27,209**	**28,158**	**29,235**	**29,373**
Core tier 1/ common equity tier 1 capital	*2,569*	*2,585*	*2,625*	*2,843*	*2,766*
Income statement summary (NOK m)					
Net interest income	474	462	476	470	456
Net fee & commission income	54	49	77	80	90
Net trading income	15	-4	14	-3	15
Other income	54	59	49	58	50
Operating income	**597**	**566**	**616**	**605**	**610**
Operating expenses	269	261	269	269	285
Pre-provision income	**328**	**305**	**347**	**336**	**325**
Credit and other financial impairments	72	24	13	25	-32
Other impairments	0	0	0	0	0
Non-recurring income	0	18	0	0	0
Non-recurring expense	0	0	0	0	29
Pre-tax profit	**256**	**300**	**333**	**311**	**328**
Income from discontinued operations	0	0	0	0	0
Income tax expense	59	55	56	50	47
Other after-tax Items	0	0	0	0	0
Net profit attributable to minority interests	1	0	0	1	1
Net profit attributable to parent	**197**	**244**	**277**	**260**	**280**

Source: SNL

IV. Appendix: Selected financial information – Sandnes Sparebank

	2017	2018	2019	2020	2021
Funding and liquidity					
Net loans/ deposits (%)	201%	203%	198%	198%	197%
Liquidity coverage ratio (%)	238%	171%	209%	247%	198%
Net stable funding ratio (%)	117%	125%	138%	NA	128%
Asset mix, quality and growth					
Net loans/ assets (%)	82.3%	81.6%	81.2%	82.1%	86.4%
Problem loans/ gross customer loans (%)	3.4%	1.7%	1.3%	1.3%	1.0%
Loan loss reserves/ problem loans (%)	52.4%	60.3%	46.3%	44.7%	35.7%
Net loan growth (%)	0.0%	3.5%	3.0%	4.9%	5.8%
Problem loans/ tangible equity & reserves (%)	24.4%	12.3%	9.6%	10.5%	8.0%
Asset growth (%)	-1.2%	4.3%	3.5%	3.8%	0.5%
Earnings and profitability					
Net interest margin (%)	1.8%	1.7%	1.7%	1.6%	1.5%
Net interest income/ average RWAs (%)	3.1%	3.0%	3.0%	3.0%	2.8%
Net interest income/ operating income (%)	79.4%	81.6%	77.2%	77.7%	74.7%
Net fees & commissions/ operating income (%)	9.0%	8.7%	12.5%	13.2%	14.7%
Cost/ income ratio (%)	45.0%	46.1%	43.7%	44.5%	46.8%
Operating expenses/ average RWAs (%)	1.8%	1.7%	1.7%	1.7%	1.7%
Pre-impairment operating profit/ average RWAs (%)	2.1%	2.0%	2.2%	2.1%	2.0%
Impairment on financial assets / pre-impairment income (%)	22.1%	7.8%	3.9%	7.4%	-10.0%
Loan loss provision/ average gross loans (%)	0.3%	0.1%	0.1%	0.1%	-0.1%
Pre-tax profit/ average RWAs (%)	1.7%	1.9%	2.1%	2.0%	2.0%
Return on average assets (%)	0.8%	0.9%	1.0%	0.9%	1.0%
Return on average RWAs (%)	1.3%	1.6%	1.8%	1.7%	1.7%
Return on average equity (%)	7.4%	8.7%	9.4%	9.1%	9.2%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	16.6%	16.6%	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	16.6%	16.6%	17.4%	17.8%	16.6%
Tier 1 capital ratio (%, transitional)	18.1%	17.3%	18.1%	18.5%	17.2%
Total capital ratio (%, transitional)	20.0%	18.6%	19.4%	19.8%	18.5%
Leverage ratio (%)	10.0%	9.9%	9.3%	9.5%	9.2%
Asset risk intensity (RWAs/ total assets, %)	59.2%	57.1%	53.6%	54.7%	56.8%
Market indicators					
Price/ book (x)	0.7x	0.7x	0.8x	0.8x	1.1x
Price/ tangible book (x)	0.7x	0.7x	0.8x	0.8x	1.1x
Dividend payout ratio (%)	50.0%	75.4%	63.3%	NA	62.9%

Source: SNL

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