Sandnes Sparebank
Issuer Rating Report

STABLE
A-

Scope's credit view (summary)

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

Following successful efforts to de-risk and strengthen the bank's business in recent years, Sandnes' operating performance in 2020 was solid. Despite the cut in interest rates to zero and an increase in credit costs, the group reported a return on equity of 9%. In a challenging operating environment, asset quality remained sound, with the Stage 3 ratio at 1.2%. While operating in a region more exposed to the country's oil and gas industry, the group's direct exposure is immaterial.

The group continues to maintain reassuring solvency metrics. At year-end 2020, the CET1 capital ratio was 17.8% (proportional consolidation basis) and the leverage ratio was 9.5%.

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. Scope rates the covered bonds issued by SSB Boligkreditt at AAA.

Outlook

The **Stable Outlook** reflects our view that Sandnes will continue to perform resiliently. While the full impact of the pandemic remains uncertain, we expect the group's earnings to be more than sufficient to absorb potential credit losses.

Credit strengths

- Management's track record in improving the bank's business and risk profile.
- Solid and resilient earnings.
- Sound prudential metrics.

Credit weaknesses

- As with other Norwegian banks, a reliance on market funding.
- Operations are limited to one region of Norway, the centre of the country's oil and gas industry.

Positive rating-change drivers

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

Negative rating-change drivers

- Larger than expected credit losses stemming from the pandemic.
- A change in strategic direction which increases the group's risk profile.

Ratings & Outlook

Issuer rating	A-
Senior unsecured debt rating	BBB+
Outlook	Stable
SSB Boligkreditt covered bond rating	AAA
Outlook	Stable

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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 40,000 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, 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 2020, the ECC ratio was 63.6%.

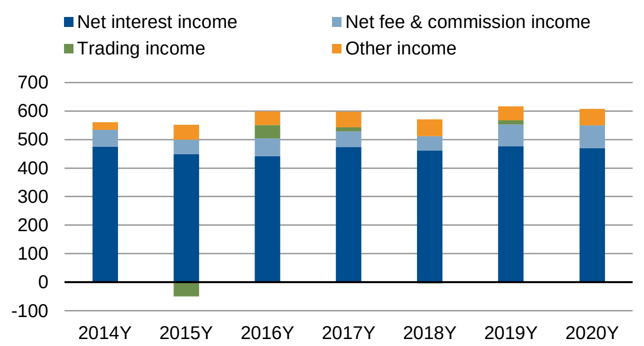
Management focused on further strengthening the bank's franchise

Following the conclusion of the 2017-2020 strategic plan, the bank has returned to its savings bank roots and strengthened its market position. The 2021-2024 strategic plan builds on the achievements of the last four years. The focus remains on enhancing the customer experience to generate profitable growth.

The plan is wide-ranging and incorporates the priorities of the bank's various stakeholders, including employees and the local community. Management believes that integrating sustainability in its business strategy will eventually lead to outperformance. For example, the bank has started evaluating business clients to assess potential ESG risks in its lending activities. This is still at a relatively early stage, with the bank developing its capabilities in conjunction with the Eika Alliance.

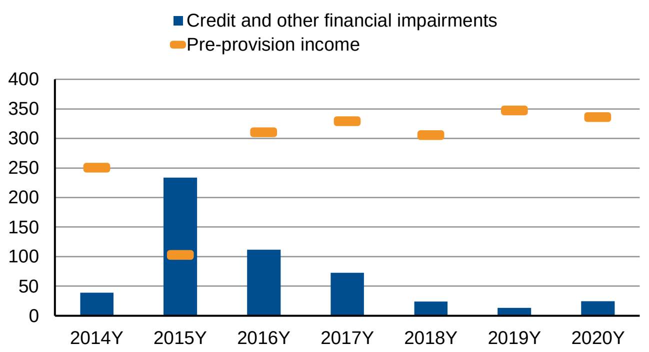
As well, Sandnes will be upgrading its digital infrastructure to meet the evolving demands of customers and to increase the efficiency of internal operations. The conversion to a new technology provider and platform is being done within the Eika Alliance and is expected to generate NOK 15-20m in annual savings for the bank once fully implemented in 2024.

Figure 1: Operating income development (NOK m)



Source: Company data, Scope Ratings.

Figure 2: Pre-provision income vs impairments (NOK m)



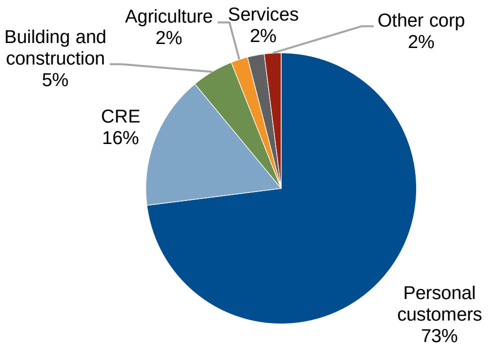
Source: Company data, Scope Ratings.

Reduced risk profile supports earnings resilience

Along with actions taken to strengthen the business 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.

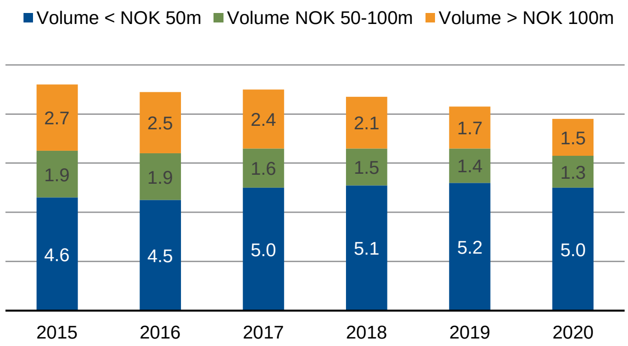
The loan book has become more granular as the share of lending to personal customers (primarily mortgages) has increased to more than 70%. Further, the magnitude and concentration of large business loan exposures have been significantly reduced. Management's policy to avoid direct exposure to the oil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

Figure 3: Loan portfolio breakdown



Note: Gross loans of NOK 24bn as of YE 2020.
Source: Company data, Scope Ratings.

Figure 4: Share of larger business loans has fallen (NOK bn)

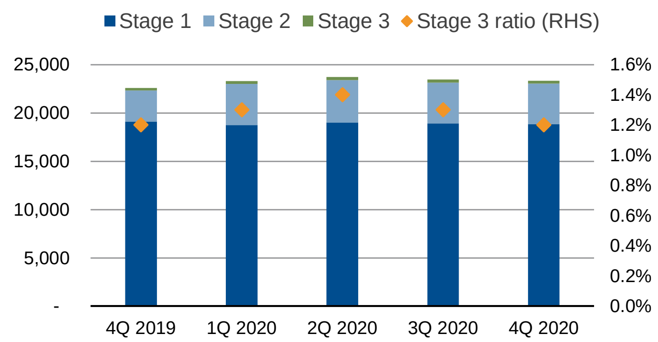


Source: Company data, Scope Ratings.

With the de-risking of the loan book over the last few years, asset quality has remained sound in a challenging operating environment. There was a small increase in Stage 3 exposures in 2Q 2020, but this had returned to pre-pandemic levels by year-end 2020 (Figure 5).

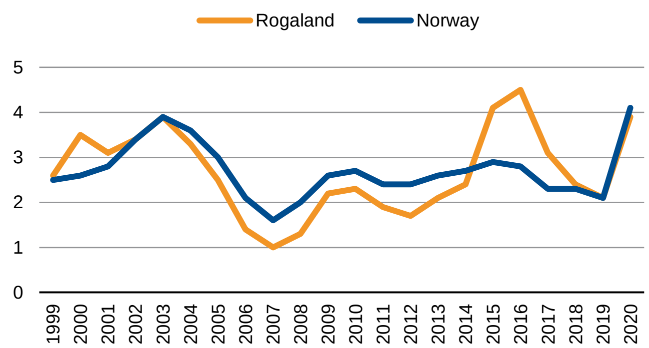
Macroeconomic indicators in Rogaland, the bank's primary market, remain relatively supportive. The local unemployment rate has moved in line with the national average, unlike in the previous economic downturn. As well, house prices continue to be comparatively stable. While the outlook for commercial real estate is more uncertain, the sector has so far not been a driver of credit losses for Norwegian banks.

Figure 5: Loan staging (NOK m)



Source: Company data, Scope Ratings.

Figure 6: Unemployment rates (%)



Source: Statistics Norway.

Sound prudential metrics

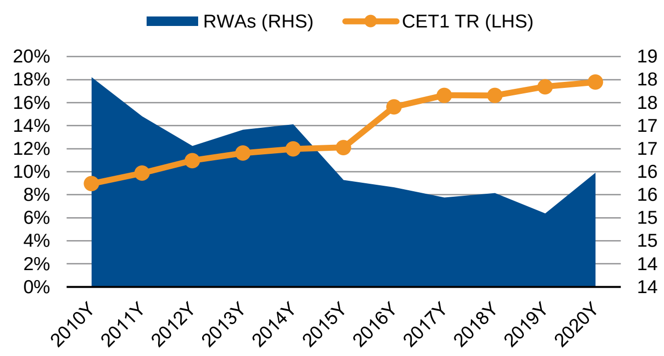
Sandnes is well positioned against current and future expected solvency requirements. As of year-end 2020, the CET1 capital ratio was 17.8% (proportional consolidation basis) while the leverage ratio was 9.5%, compared to requirements of 13.1% and 5%, respectively. Management targets a 1% buffer above requirements.

The minimum CET1 capital requirement for domestic oriented 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. Further, Sandnes is subject to a Pillar 2 requirement of 2.1%.

As the economy recovers, the countercyclical buffer rate is expected to eventually revert to 2.5%, with decisions to increase the requirement normally taking effect 12 months after they have been made. In addition, the systemic risk buffer is slated to increase to 4.5% from 3% at year-end 2022 for banks using the standardised approach like Sandnes.

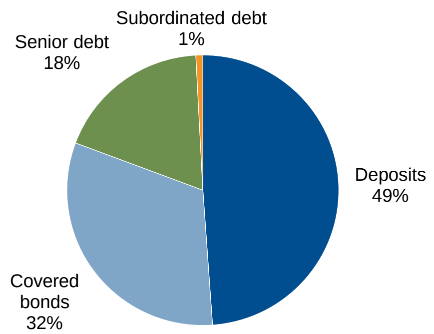
The bank has applied the current Norwegian FSA guidance to use a 150% risk weight for exposures related to real estate development. The impact on the CET1 capital ratio at year-end 2020 was a reduction of 0.15%. There remains another NOK 175m in exposure, those with a certain level of advance sales, where the guidance has not been applied. If this were done, this would negatively impact the CET1 capital ratio by another 0.1%.

Figure 7: CET1 capital (%) and RWA (NOK bn) development



Source: Company data, Scope Ratings.

Figure 8: Funding profile (YE 2020)



Source: Company data, Scope Ratings.

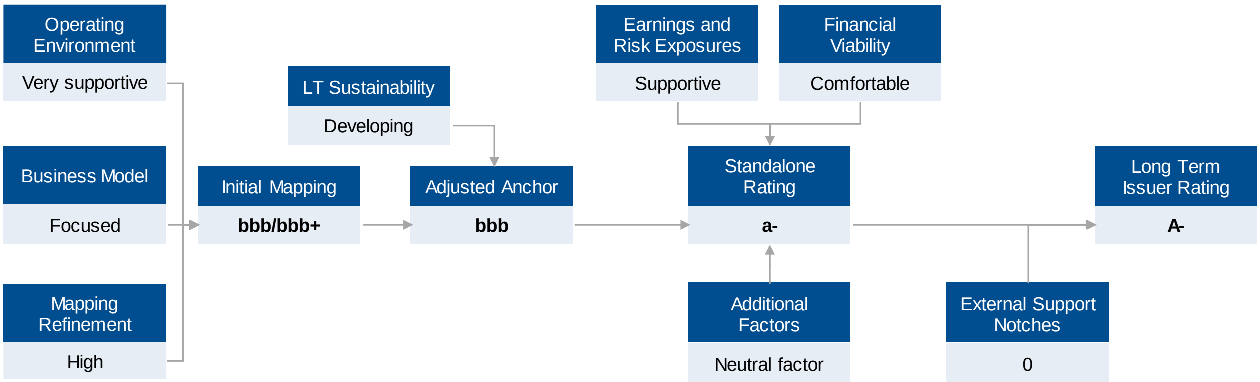
Reliance on market funding

In common with other Norwegian and Nordic banks, Sandnes depends to a substantial degree on market funding, including relatively reliable covered bonds (Figure 8). 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.

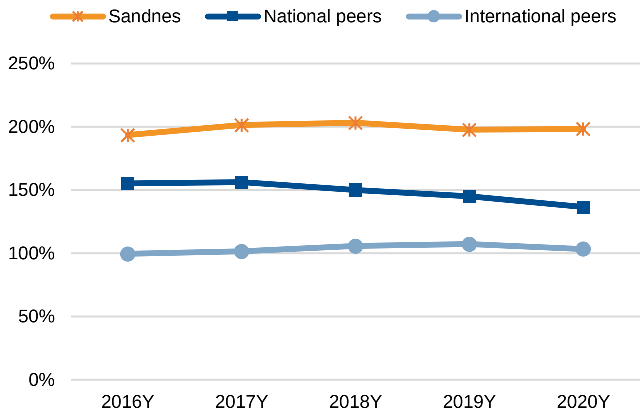
I. Appendix: Overview of the rating process



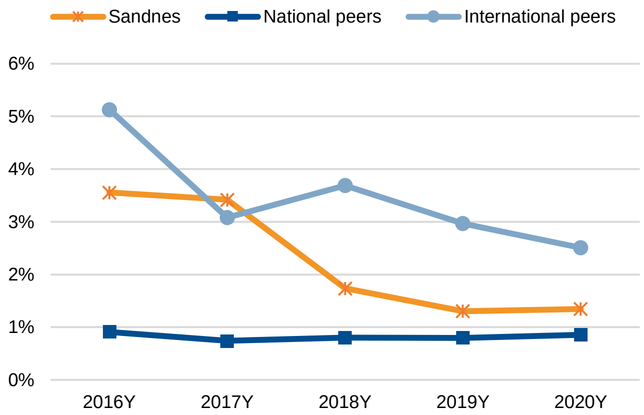
Step		Assessment	Summary rationale
STEP 1	Operating environment	Very supportive (selected)	• Wealthy economy with well-developed capital markets and a solid track record of economic resilience • Supportive competitive environment • Relatively stringent and active financial regulator
		Supportive	
		Moderately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

II. Appendix: Peer comparison

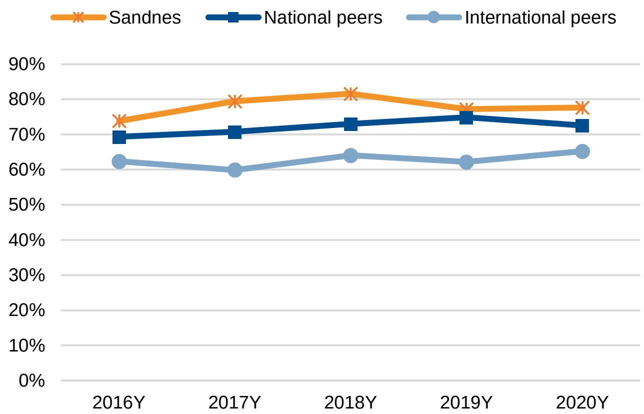
Net customer loans % Deposits



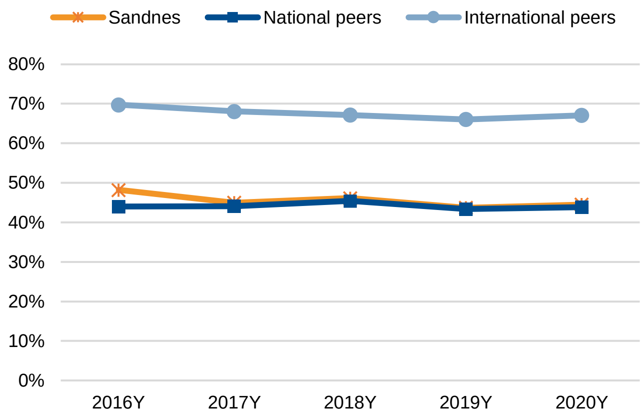
Problem loans % Gross customer loans



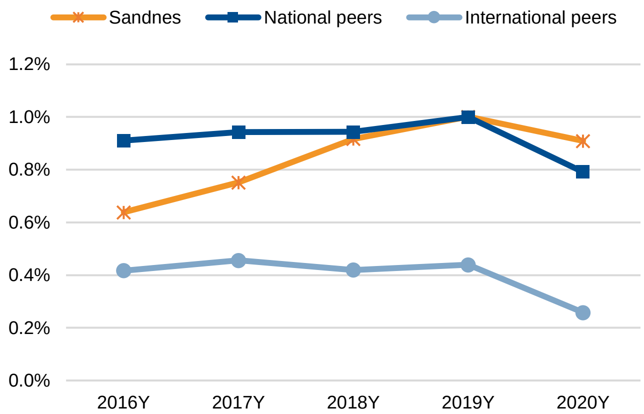
Net interest income % Operating income



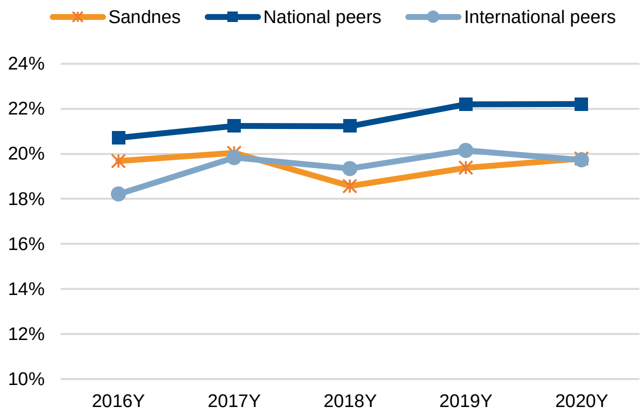
Costs % Income



Return on average assets (%)



Total capital ratio (%, transitional)



National peers: BN Bank, SpareBank 1 SR-Bank, DNB, Landkreditt Bank, Haugesund Sparebank, Totens Sparebank, SpareBank 1 Nordvest, Fana Sparebank, Sparebanken Ost, Jaeren Sparebank.
International peers: Bausparkasse Wustenrot AG, Oberbank AG, Banca Popolare di Sondrio SCpa, Credito Emiliano SpA, Kutxabank SA, Unicaja Banco SA, TSB Banking Group plc, Principality Building Society, Sparbanken Skane AB.
Source: SNL.

III. Appendix: Selected financial information – Sandnes Sparebank

	2016Y	2017Y	2018Y	2019Y	2020Y
Balance sheet summary (NOK m)					
Assets					
Cash and interbank assets	1,149	645	656	574	489
Total securities	3,627	3,867	4,270	4,524	4,567
of which, derivatives	175	155	150	113	326
Net loans to customers	21,483	21,473	22,214	22,878	24,000
Other assets	162	115	69	182	180
Total assets	**26,420**	**26,100**	**27,209**	**28,158**	**29,235**
Liabilities					
Interbank liabilities	29	37	50	44	1,472
Senior debt	11,997	11,702	12,318	12,800	12,379
Derivatives	104	102	148	111	146
Deposits from customers	10,905	10,857	11,252	11,833	11,926
Subordinated debt	649	525	318	201	201
Other liabilities	153	167	163	150	159
Total liabilities	**23,837**	**23,391**	**24,248**	**25,139**	**26,283**
Ordinary equity	2,578	2,704	2,857	2,916	2,847
Equity hybrids	0	0	100	100	100
Minority interests	6	4	4	3	5
Total liabilities and equity	**26,420**	**26,100**	**27,209**	**28,158**	**29,235**
Core tier 1/ common equity tier 1 capital	*2,448*	*2,569*	*2,585*	*2,625*	*2,843*
Income statement summary (NOK m)					
Net interest income	442	474	462	476	470
Net fee & commission income	62	54	49	77	80
Net trading income	47	15	-4	14	-3
Other income	48	54	59	49	58
Operating income	**598**	**597**	**566**	**616**	**605**
Operating expenses	288	269	261	269	269
Pre-provision income	**310**	**328**	**305**	**347**	**336**
Credit and other financial impairments	112	72	24	13	25
Other impairments	-2	0	0	0	0
Non-recurring income	18	0	18	0	0
Non-recurring expense	0	0	0	0	0
Pre-tax profit	**218**	**256**	**300**	**333**	**311**
Income from discontinued operations	0	0	0	0	0
Income tax expense	46	59	55	56	50
Other after-tax Items	0	0	0	0	0
Net profit attributable to minority interests	0	1	0	0	1
Net profit attributable to parent	**172**	**197**	**244**	**277**	**260**

Source: SNL

IV. Appendix: Selected financial information – Sandnes Sparebank

	2016Y	2017Y	2018Y	2019Y	2020Y
Funding and liquidity					
Net loans/ deposits (%)	193%	201%	203%	198%	198%
Liquidity coverage ratio (%)	193%	238%	171%	209%	247%
Net stable funding ratio (%)	137%	117%	125%	138%	130%
Asset mix, quality and growth					
Net loans/ assets (%)	81.3%	82.3%	81.6%	81.2%	82.1%
Problem loans/ gross customer loans (%)	3.6%	3.4%	1.7%	1.3%	1.3%
Loan loss reserves/ problem loans (%)	52.3%	52.4%	60.3%	46.3%	44.7%
Net loan growth (%)	-5.9%	0.0%	3.5%	3.0%	4.9%
Problem loans/ tangible equity & reserves (%)	26.5%	24.4%	12.3%	9.6%	10.5%
Asset growth (%)	-3.2%	-1.2%	4.3%	3.5%	3.8%
Earnings and profitability					
Net interest margin (%)	1.7%	1.8%	1.7%	1.7%	1.6%
Net interest income/ average RWAs (%)	2.8%	3.1%	3.0%	3.0%	3.0%
Net interest income/ operating income (%)	73.8%	79.4%	81.6%	77.2%	77.7%
Net fees & commissions/ operating income (%)	10.3%	9.0%	8.7%	12.5%	13.2%
Cost/ income ratio (%)	48.2%	45.0%	46.1%	43.7%	44.5%
Operating expenses/ average RWAs (%)	1.8%	1.8%	1.7%	1.7%	1.7%
Pre-impairment operating profit/ average RWAs (%)	2.0%	2.1%	2.0%	2.2%	2.1%
Impairment on financial assets / pre-impairment income (%)	36.1%	22.1%	7.8%	3.9%	7.4%
Loan loss provision/ average gross loans (%)	0.5%	0.3%	0.1%	0.1%	0.1%
Pre-tax profit/ average RWAs (%)	1.4%	1.7%	1.9%	2.1%	2.0%
Return on average assets (%)	0.6%	0.8%	0.9%	1.0%	0.9%
Return on average RWAs (%)	1.1%	1.3%	1.6%	1.8%	1.7%
Return on average equity (%)	7.5%	7.4%	8.7%	9.4%	9.1%
Capital and risk protection					
Common equity tier 1 ratio (%, fully loaded)	NA	NA	NA	NA	NA
Common equity tier 1 ratio (%, transitional)	15.6%	16.6%	16.6%	17.4%	17.8%
Tier 1 capital ratio (%, transitional)	17.5%	18.1%	17.3%	18.1%	18.5%
Total capital ratio (%, transitional)	19.7%	20.0%	18.6%	19.4%	19.8%
Leverage ratio (%)	9.7%	10.0%	9.9%	9.3%	9.5%
Asset risk intensity (RWAs/ total assets, %)	59.3%	59.2%	57.1%	53.6%	54.7%
Market indicators					
Price/ book (x)	0.6x	0.7x	0.7x	0.8x	0.8x
Price/ tangible book (x)	0.6x	0.7x	0.7x	0.8x	0.8x
Dividend payout ratio (%)	26.0%	50.0%	75.4%	63.3%	NA

Source: SNL

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