MOODY'S
INVESTORS SERVICE

Credit Opinion: SpareBank 1 Nord-Norge

Global Credit Research - 28 Mar 2014

Tromso, Norway

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	A2/P-1
Bank Financial Strength	C-
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Senior Unsecured	A2
Subordinate MTN	(P)Baa3
Jr Subordinate MTN	(P)Baa3
Pref. Stock Non-cumulative	Ba1 (hyb)

Contacts

Analyst	Phone
Kim Bergoe/London	44.20.7772.5454
Richard (Blake) B. Foster/London	
Simon Harris/London	

Key Indicators

SpareBank 1 Nord-Norge (Consolidated Financials)[1]

	[2]**12-13**	[2]**12-12**	[2]**12-11**	[2]**12-10**	[2]**12-09**	**Avg.**
Total Assets (NOK billion)	**77.6**	**75.4**	**71.0**	**68.8**	**64.2**	[3]**4.9**
Total Assets (EUR million)	**9,288.5**	**10,270.8**	**9,169.6**	**8,820.5**	**7,750.6**	[3]**4.6**
Total Assets (USD million)	**12,799.1**	**13,541.0**	**11,903.4**	**11,833.1**	**11,120.2**	[3]**3.6**
Tangible Common Equity (NOK billion)	**7.5**	**6.0**	**5.4**	**4.7**	**4.3**	[3]**15.3**
Tangible Common Equity (EUR million)	**899.5**	**823.8**	**693.9**	**601.3**	**512.9**	[3]**15.1**
Tangible Common Equity (USD million)	**1,239.5**	**1,086.2**	**900.7**	**806.7**	**735.9**	[3]**13.9**
Net Interest Margin (%)	**1.8**	**1.7**	**1.7**	**1.8**	**1.9**	[4]**1.8**
PPI / Average RWA (%)	**1.9**	**1.4**	**1.2**	**1.8**	**2.1**	[5]**1.7**
Net Income / Average RWA (%)	**1.7**	**1.2**	**1.1**	**1.7**	**1.9**	[5]**1.5**
(Market Funds - Liquid Assets) / Total Assets (%)	**9.6**	**16.2**	**13.5**	**15.8**	**24.6**	[4]**15.9**
Core Deposits / Average Gross Loans (%)	**81.3**	**78.2**	**82.1**	**80.6**	**69.7**	[4]**78.4**
Tier 1 Ratio (%)	**13.4**	**12.1**	**11.6**	**10.9**	**10.7**	[5]**11.8**
Tangible Common Equity / RWA (%)	**13.0**	**11.0**	**10.4**	**9.6**	**9.4**	[5]**10.7**
Cost / Income Ratio (%)	**52.4**	**58.7**	**62.9**	**53.3**	**50.7**	[4]**55.6**
Problem Loans / Gross Loans (%)	**1.5**	**2.0**	**1.9**	**2.0**	**1.7**	[4]**1.8**
Problem Loans / (Equity + Loan Loss Reserves) (%)	**9.2**	**14.3**	**13.8**	**15.7**	**14.3**	[4]**13.4**

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel II; IFRS [3] Compound Annual Growth Rate based on IFRS reporting periods [4] IFRS reporting periods have been used for average calculation [5] Basel II & IFRS reporting periods have been used for average calculation

Opinion

SUMMARY RATING RATIONALE

The C- standalone financial strength rating (BFSR), which is equivalent to a standalone baseline credit assessment (BCA) of baa1, primarily reflects SpareBank 1 Nord-Norge's strong regional market position, its retail-focus and its sizeable deposit base but is mainly constrained by the high borrower concentration and substantial exposure to the real estate sector in its loan book.

SpareBank 1 Nord-Norge's global local currency (GLC) deposit rating of A2 receives a two-notch uplift from its baa1 standalone credit assessment. This is based on our assessment of a high probability of systemic support for the bank if necessary and its importance to the Norwegian market. Furthermore, we continue to factor in a low probability of support from its membership of the SpareBank 1 Alliance; however due to the reduction of the availability of Alliance support in light of the December 2012 lowering of the standalone credit assessments of three of the four rated members of the SpareBank 1 Alliance, such support is no longer reflected in a notch of uplift.

Rating Drivers

- Strong regional market position and brand recognition in northern Norway. Some benefits from membership of the Sparebank 1 Alliance

- Funding profile is underpinned by a sizeable deposit base but exhibits some reliance on market funding

- Sound asset quality reflects retail-focus but limited by sector and borrower concentrations. Capital ratios are improving

- Recent profitability helped by system-wide margin increases

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

Upward rating momentum could develop if SpareBank 1 Nord-Norge demonstrates (1) sustained good asset quality in its retail and corporate loan books, including in the more volatile segments, (2) continued good access to capital markets and improved liquidity position, and/or (3) stronger earnings generation without an increase in its risk profile.

What Could Change the Rating - Down

The bank's ratings could decline further if (1) SpareBank 1 Nord-Norge's asset quality deteriorates more than we anticipate, (2) financing conditions become more difficult and/or (3) its risk profile increases, for example as a result of increased exposures to more volatile sectors. In addition, we believe that downwards pressure could be exerted on the ratings due to external factors, such as less supportive macroeconomic environment and/or substantially adverse developments in the Norwegian real-estate market.

DETAILED RATING CONSIDERATIONS

STRONG REGIONAL MARKET POSITION AND BRAND RECOGNITION IN NORTHERN NORWAY SOME BENEFITS FROM MEMBERSHIP OF THE SPAREBANK 1 ALLIANCE

SpareBank 1 Nord-Norge has a solid, defensible footprint in northern Norway with 74 branches across the region. Moody's estimates that the bank commands market shares of around 35% in deposits in the three most northerly counties of Norway although its national market share is limited, at around 2% (based on total lending in the bank's counties of operation and in the whole country according to Statistics Norway). We note that SpareBank 1 Nord-Norge has expanded in North-West Russia via the acquisition of 75% of Russian North West 1 Alliance Bank to service Nordic and Russian corporates and individuals - although the operations are still relatively small and the bank's board of directors have decided that its exposure to Russia should not increase at the present time.

In addition, SpareBank 1 Nord-Norge's franchise value benefits from its membership in the SpareBank 1 Alliance, which consists of 15 savings banks across Norway, together constituting one of the leading banking groups in Norway. The SpareBank 1 brand enjoys strong name recognition in a wide range of segments including life and non-life insurance and asset management.

We expect the bank to maintain a leading position in the region but we note that the Norwegian banking market is highly competitive and that savings banks generally lack pricing power against the two national market leaders. Additionally, the limited geographic diversification remains a key constraint in our assessment of the franchise value of SpareBank 1 Nord Norge.

FUNDING PROFILE IS UNDERPINNED BY A SIZEABLE DEPOSIT BASE BUT EXHIBITS SOME RELIANCE ON MARKET FUNDING

SpareBank 1 Nord-Norge's on-balance sheet funding consisted of almost 70% deposits at end-2013, which has proven resilient over many years. The bank's 2013 deposits were up 3% on 2012, driven mainly by retail deposit growth and despite a contraction in government deposits.

Sparebank 1 Nord-Norge is somewhat less reliant on market funds than some of its rated Norwegian peers. However, we view its usage of market funding as sufficient in scale to represent a source of risk because, in times of market stress, market funding can become more expensive or/and restricted. Additionally, SpareBank 1 Nord-Norge has increasingly used covered bond funding, which is done off-balance-sheet through specialised companies it jointly owns together with other members of the SpareBank 1 Alliance (SpareBank 1 Boligkreditt for residential mortgages and SpareBank 1 Næringskreditt for commercial mortgages). At end-2013 the bank had transferred retail mortgages worth NOK23 billion to SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt i.e. almost 30% of its gross loan book (including the loans transferred to covered bonds companies). Whilst we view positively the diversification benefit of covered bond funding, we caution that extensive use of covered bond funding increases the amount of pledged assets unavailable for unsecured bondholders including depositors in a liquidation.

SpareBank 1 Nord-Norge's liquid assets accounted for around 18% of total assets at end- 2013. The liquidity reserve primarily consists of Norwegian T-bills, sovereigns, rated covered bonds as well as bonds issued by domestic or international financial institutions and domestic corporate bonds.

SOUND ASSET QUALITY REFLECTS RETAIL-FOCUS BUT LIMITED BY SECTOR AND BORROWER CONCENTRATIONS. CAPITAL RATIOS ARE IMPROVING

SpareBank 1 Nord-Norge's loan book benefits from a substantial proportion of retail loans, mostly in the form of mortgages (almost 60% excluding loans transferred to covered bond companies and almost 70% including them). The bank's asset quality remains strong with problem loans (defined as gross non-performing and impaired commitments) of1.5% of on-balance-sheet loans at end-2013, down from 1.8% at end-2012. This level benefits from the beneficial lending environment in Norway, for example high unemployment benefits which supports borrowers' ability to repay debt and a creditor-friendly legal framework. Additionally, the current low levels of problem loans benefit from the supportive macroeconomic conditions Norway has experienced over recent years.

Looking forwards, we expect such low problem loan levels to be very hard to replicate in the longer-term as the economy fluctuates over time. We also note that house prices fell slightly towards the end of 2013 after several years of almost continuous growth, although it is too early to say whether this may presage a longer fall. Additionally, we think households' high indebtedness and the fact that the mortgage loans remaining on the bank's balance sheet have higher loan-to-values than those transferred to the Alliance's covered bond vehicles, could result in asset quality deterioration in the future.

We also note that SpareBank 1 Nord-Norge's loan book exhibits some concentration towards the real estate and construction sectors, which represented close to 15% of the on-balance-sheet loan portfolio. We also note risks related to individual borrower concentration - which could accelerate the extent and pace of any deterioration in asset quality, and is common to many Nordic banks.

SpareBank 1 Nord-Norge reported Tier 1 and total capital ratios of 13.4% and 13.9%, respectively, at end- 2013 (including the transitional floor). This marked a significant improvement on the 2012 figures of 11.1% and 11.7% respectively, with the increase primarily due to a NOK750 million rights issue in September 2013. The bank has also taken several measures to increase its capital position, for example through selling its stake in Sparebank 1 Oslo Askershus, reducing dividend payouts, reducing lending growth particularly in the corporate market.

RECENT PROFITABILITY HELPED BY SYSTEM-WIDE MARGIN INCREASES

SpareBank 1 Nord-Norge's earnings base benefits from resilient retail banking operations, which contributed to just over half of its 2013 pre-provision profit. Net interest income continued to constitute the largest proportion of income at 50% (compared with net fee and commission income of 36% and income from financial instruments of 14%), and benefitted in 2013 from margin increases across the market related to lower funding costs and banks passing on higher capital requirements. However, net interest income's importance was significantly reduced from 2012 when it constituted 62% of total income, as a result of a material improvement in fee and commission income related to a 90% increase in commission income from loans transferred to the two Alliance covered bond companies.

The bank's cost-income ratio of 53% at end-2013 remains strong and was down from 59% at end-2012 as the banks income outgrew costs. Having said this, costs did increase by 8% as a result of a 57% increase in staff costs mainly related to the acquisition of accountancy firm, and to some extent to the expansion in Russia and the general wage increases seen across Norway. The bank's 2013 loan losses of NOK172 million marked a slight reduction on the 2012 figure of NOK195 million, with NOK146 million coming from the corporate sector which the bank views as unusually high.

We expect the bank's profitability growth to slow over the coming year as we do not expect a continuation of margin increases but we do expect wages to continue to rise. All else being equal, we would not anticipate the bank's corporate loan losses to remain at their current level although we expect Norway to experience a slightly tougher bank operating environment than in recent years.

NOTE ON DATA

Unless noted otherwise, all figures shown in this report are sourced from the bank's latest annual and interim financial reports and our Banking Financial Metrics. These metrics are based on our own chart of account, and are adjusted for analytical purposes. Please refer to the documents entitled "Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies" and "Frequently Asked Questions: Moody's Approach to Global Standard Adjustments in the Analysis of the Financial Statements of Banks, Securities Firms and Finance Companies", both published on 19 July 2012.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a GLC deposit rating of A2 to SpareBank 1 Nord-Norge. The rating is supported by the bank's baa1 standalone credit assessment and the Aaa local currency deposit ceiling of Norway, which is considered the underlying support provider. As a result of SpareBank 1 Nord-Norge's importance to its region and the region's importance to the national economy of Norway, Moody's assesses a very high probability of systemic support for the bank in the event of a stress situation. We are however likely to gradually reduce such unusual support uplift as such support mechanisms are phased out, as banks' standalone profiles improve, and as regulators globally consider implementing bank resolution regimes.

Notching Considerations

SpareBank 1 Nord-Norge's subordinated (dated) and junior subordinated (undated) debt instruments are rated Baa3(hyb) i.e. two notches below SpareBank 1 Nord-Norge`s baa1 adjusted standalone credit assessment (which is in line with its standalone credit assessment as the low probability of support from the SpareBank 1 Alliance no longer results in a notch of uplift). There is no coupon deferral option for subordinated debt while the issuer remains a going concern but junior subordinated debt features a coupon skip mechanism, which requires coupon suspension on a cumulative basis if a minimum regulatory capital trigger is breached. The wider notching compared to similar instruments issued by banks in other Nordic countries primarily reflects the ability of rated Norwegian issuers such as SpareBank 1 Nord-Norge to permanently write-down principal in a going concern scenario if net assets are less than 25% of share capital and after the bank's share capital has been fully written down.

SpareBank 1 Nord-Norge's Tier 1 securities are rated Ba1(hyb), i.e. three notches below its adjusted standalone credit assessment. They are deeply subordinated, as they are senior only to equity. The loss absorption for Tier 1 securities stems from the non-cumulative coupon skip mechanism while the issuer remains a going concern. Coupon skip is mandatory upon the breach of minimum regulatory capital requirements or if the issuer does not have sufficient available distributable funds (balance-sheet trigger). The securities also feature a permanent principal write-down if the share capital has been reduced to zero and a temporary principal write-down if capital falls below the regulatory minimum.

The ratings do not include systemic support uplifts, reflecting Moody's view that systemic support for subordinated debt may no longer be sufficiently predictable or reliable to be a sound basis for incorporating uplift into Moody's ratings.

Foreign Currency Deposit Rating

SpareBank 1 Nord-Norge's foreign currency deposit rating of A2 is unconstrained given that Norway has a country ceiling of Aaa.

Foreign Currency Debt Rating

SpareBank 1 Nord-Norge's senior unsecured foreign currency debt rating of A2 is unconstrained given that Norway has a country ceiling of Aaa.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honour its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Credit Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. An Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

SpareBank 1 Nord-Norge

Rating Factors [1]	**A**	**B**	**C**	**D**	**E**	**Total Score**	**Trend**
Qualitative Factors (50%)						**C-**	
Factor: Franchise Value						**D+**	**Neutral**
Market share and sustainability			**x**				
Geographical diversification					**x**		
Earnings stability			**x**				
Earnings Diversification [2]							
Factor: Risk Positioning						**D+**	**Neutral**
Corporate Governance [2]	**--**	**--**	**--**	**--**	**--**		
- Ownership and Organizational Complexity	**--**	--	--	--	--		
- Key Man Risk	**--**	--	--	--	--		
- Insider and Related-Party Risks	**--**	--	--	--	--		
Controls and Risk Management		**x**					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency		**x**					
- Global Comparability	x						
- Frequency and Timeliness	x						
- Quality of Financial Information			x				
Credit Risk Concentration	**--**	**--**	**--**	**--**	**--**		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management				**x**			
Market Risk Appetite		**x**					
Factor: Operating Environment						**A-**	**Neutral**
Economic Stability		**x**					
Integrity and Corruption	**x**						
Legal System	**x**						
Financial Factors (50%)						**C**	
Factor: Profitability						**C**	**Neutral**
PPI % Average RWA (Basel II)			1.51%				
Net Income % Average RWA (Basel II)			1.31%				
Factor: Liquidity						**D**	**Neutral**
(Market Funds - Liquid Assets) % Total Assets				13.09%			
Liquidity Management				x			

Factor: Capital Adequacy						**A**	**Improving**
Tier 1 Ratio (%) (Basel II)	12.38%						
Tangible Common Equity % RWA (Basel II)	11.45%						
Factor: Efficiency						**C**	**Neutral**
Cost / Income Ratio			58.02%				
Factor: Asset Quality						**B**	**Weakening**
Problem Loans % Gross Loans		1.80%					
Problem Loans % (Equity + LLR)		12.41%					
Lowest Combined Financial Factor Score (15%)						**D**	
Economic Insolvency Override						**Neutral**	
Aggregate BFSR Score						**C**	
Aggregate BCA Score						**a3**	
Assigned BFSR						**C-**	
Assigned BCA						**baa1**	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
[2] - A blank score under Earnings Diversification or Corporate Governance indicates the risk is neutral.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. ("MIS") AND ITS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATION") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL