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CREDIT OPINION
27 February 2024

Update

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RATINGS

Sparebanken Ost

Domicile	Drammen, Norway
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	A1
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Sparebanken Ost

Update to credit analysis

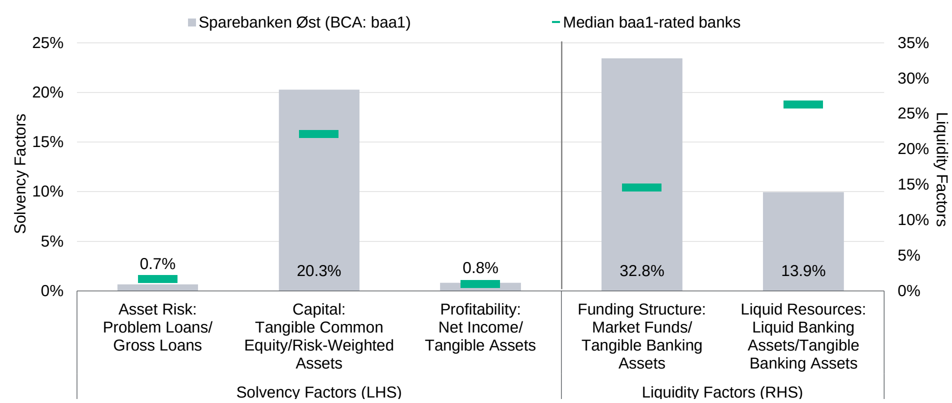
Summary

We assign baa1 Baseline Credit Assessment (BCA) and A1 long-term deposit and issuer ratings to Sparebanken Ost. Sparebanken Ost's BCA of baa1 primarily reflects its good asset quality with low level of problem loans (0.6% of total loans in September 2023), underpinned by its predominantly mortgage loan book (approximately 89% of total loans in September 2023), as well as its solid capitalization with a tangible common equity (TCE) ratio of 20.3% in September 2023. We expect the bank's core profitability to remain satisfactory, supported by high net interest margins.

The bank's BCA is also supported by its adequate liquidity, with a ratio of liquid resources relative to tangible banking assets of 14.9%, a liquidity coverage ratio (LCR) of around 344%, and a net stable funding ratio (NSFR) of 131% in September 2023. The BCA also reflects the bank's relatively high market funding dependence through covered bonds, a common feature for all local banks, and some mortgage margin pressure from strong competition.

The bank's A1 deposit and issuer ratings take into account our Loss Given Failure (LGF) analysis of the bank's large volume of deposits and substantial layers of subordination, resulting in three notches of rating uplift from its BCA. Sparebanken Ost's ratings do not benefit from any government support uplift.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Investors Service

Credit strengths

» Good asset quality mainly driven by predominant exposure to retail mortgages

» Solid capital buffers, which compare well with those of similarly rated banks

» Adequate profitability on the back of higher interest rates and low impairments

Credit challenges

» Sparebanken Ost maintains a high reliance on confidence-sensitive market funding

» Strong competition in retail mortgages exerts some pressure in Sparebanken Ost's market share and franchise

» Relatively high contribution from interest income on mortgages

Outlook

The bank's deposit and issuer ratings carry a stable outlook balancing its robust financial performance with downside risks stemming from its dependence on market funding and real estate and home prices in its home region. The outlook also reflects Moody's expectation that the bank will issue sufficient volumes of junior senior debt to support the senior unsecured rating.

Factors that could lead to an upgrade

The ratings and assessments of Sparebanken Ost could be upgraded if the bank improved its funding profile through a reduction of confidence sensitive market funding or reduced its geographic, sector, and single borrower concentration while maintaining good asset quality and adequate coverage of problem loans.

Factors that could lead to a downgrade

The ratings and assessments of Sparebanken Ost could be downgraded if its credit risk profile worsens through elevated sectoral or borrower concentration, its franchise weakens reducing its earnings capacity, funding conditions become more difficult that would challenge the bank's refinancing capacity, or the bank issues a significantly lower volume than expected of junior senior securities.

Key indicators

Exhibit 2
Sparebanken Ost

	09-23 [2]	12-22 [2]	12-21 [2]	12-20 [2]	12-19 [2]	CAGR/Avg. [3]
Total Assets (NOK Billion)	45.4	44.1	48.1	44.1	42.4	1.8 [4]
Tangible Common Equity (NOK Billion)	4.0	4.0	3.8	3.7	3.5	4.2 [4]
Problem Loans / Gross Loans (%)	0.6	0.6	0.8	0.6	0.6	0.6 [5]
Tangible Common Equity / Risk Weighted Assets (%)	20.3	21.0	18.1	17.9	17.8	19.0 [6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.8	5.2	7.5	5.3	6.0	6.0 [5]
Net Interest Margin (%)	1.8	1.5	1.3	1.4	1.5	1.5 [5]
PPI / Average RWA (%)	2.8	1.9	2.1	2.8	2.2	2.3 [6]
Net Income / Tangible Assets (%)	0.9	0.6	0.8	1.0	0.8	0.8 [5]
Cost / Income Ratio (%)	38.5	45.5	40.8	34.5	38.5	39.5 [5]
Market Funds / Tangible Banking Assets (%)	34.1	32.8	33.4	36.5	37.5	34.9 [5]
Liquid Banking Assets / Tangible Banking Assets (%)	14.9	13.9	15.6	18.2	18.2	16.2 [5]
Gross Loans / Due to Customers (%)	242.4	232.3	223.2	237.2	229.3	232.9 [5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

Sparebanken Ost is a savings bank based in Drammen with a good market positioning in southeastern Norway. Traditional banking services including deposit accounts, mortgage loans and money-transfer services are provided to retail customers and small and medium-size enterprises (SMEs). Through agreements with external suppliers, the bank also distributes pension insurance, life and general insurance, and asset management services. As of September 2023, the bank reported total consolidated assets of NOK45.4 billion (approximately €4.0 billion).

Recent developments

To curb rising inflation Norges Bank has been gradually increasing its reference rate since September 2021, resulting in a reference rate of 4.5% as of December 2023. Norges Bank expects the policy rate to remain around 4.5% in 2024.

The counter cyclical buffer (CCyB) requirement remains unchanged at 2.5%. Russia's invasion of Ukraine (Ca stable) and the economic sanctions that the US (Aaa negative), European governments and other allies have subsequently imposed on Russia have increased risks to the global economic outlook. Heightened geopolitical risks are unambiguously negative for economic activity. The magnitude of the effects will depend on the length and severity of the crisis.

Detailed credit consideration

Norway's 'Very Strong-' Macro Profile remains supportive towards the bank's standalone credit profile

Sparebanken Ost operates only in Norway and thus its operating environment is reflected through the 'Very Strong -' Macro Profile we assign for Norway. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as a very low susceptibility to event risk. Norway has a diversified and growing economy, which demonstrated resilience to the last weakening in the oil sector in 2014-15.

The main risks to the banking system stem from the high level of household debt, elevated real estate prices and domestic banks' extensive use of market funding. However, these risks are mitigated by households' strong ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with the total size of the economy.

Nonetheless, we expect the Norwegian mainland economy (excluding any oil-related activity) to have expanded by 1.2% in 2023, and to grow by 1.5% in 2024, down from 3.8% in 2022. Although unemployment rose to around 4.7% in 2020, it fell back to 3.5% as of January 2024.

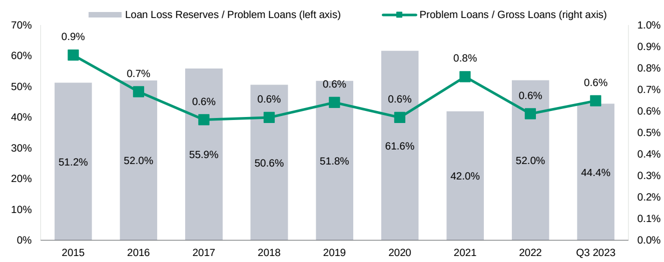
Good asset quality mainly driven by exposure to retail mortgages

We expect Sparebanken Ost's problem loans to remain low, reflecting its focus on mortgage lending and limited lending to business customers. The bank's corporate loans declined to 10.5% in September 2023 from a peak of around 24% of gross loans in 2011, while its top 20 exposures amount to less than 5% of total loans, demonstrating the granularity of its loan book.

As of September 2023, the bank's problem loan ratio (measured as impaired loans as a percentage of total loans) stood at 0.65% (0.59% as of year-end 2022) with the bulk of the nonperforming loans related to car loans to individuals. This low level compares favorably to rated domestic peers, with the increase from 2020 being attributable to updated definitions of default implemented in 2021. Sparebanken Ost's coverage of problem loans reduced to 44% as of September 2023 from 52% in December 2022 (see Exhibits 3-4).

Exhibit 3

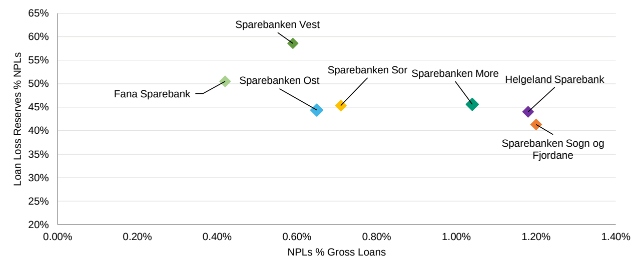
Sparebanken Ost's asset quality has performed well in recent years...



Source: Moody's Banking Financial Metrics

Exhibit 4

... and compares well with its Norwegian peers



Source: Moody's Banking Financial Metrics (September 2023)

Sparebanken Ost's concentration level in the commercial real estate (CRE) sector is significant. Loans to the real estate and construction sector accounted for around 8.2% of its gross loans as of September 2023. The exposure to the CRE sector makes its asset quality vulnerable in case the sector faces difficulties, particularly given that many of the bank's large customers are active in this sector. However, Sparebanken Ost's CRE portfolio has been decreasing since 2011, while both residential and commercial real estate prices have grown, particularly in the Oslo metropolitan area. Growth in real estate prices started falling in 2022, following strong growth in 2021, however, they are expected to slowly pick-up again in 2024.

As of September 2023 gross lending increased by 0.4% year-on-year. Lending to retail customers decreased by 0.9% year-on-year while the bank's gross lending to corporate customers increased by 13.0% over the same period.

The bulk of Sparebanken Ost's lending is in retail loans, mostly in the form of mortgages with very low average LTVs (the average LTV within the security pool was around 45% at the end of third quarter of 2023), accounting for around 89% of total loans as of September 2023. Sparebanken Ost is based in Drammen, which is located on the outskirts of Oslo and where residential property prices have increased significantly over the past several years. Nonetheless, we expect the bank to maintain its high asset quality within its portfolio over the medium term, even if competition challenges its positioning in the market.

Loan losses remain low and decreased to NOK3.9 million in September 2023 from NOK4.3 million a year earlier, indicating an annualised credit loss ratio (loss provisions as a % gross loans) of 0.01%, compared to 0.02% the year before. Sparebanken Ost's low credit loss ratio in September 2023 was one of the lowest among Norwegian banks, supporting its bottom line performance.

Solid capital buffers comparing favourably with similarly rated banks

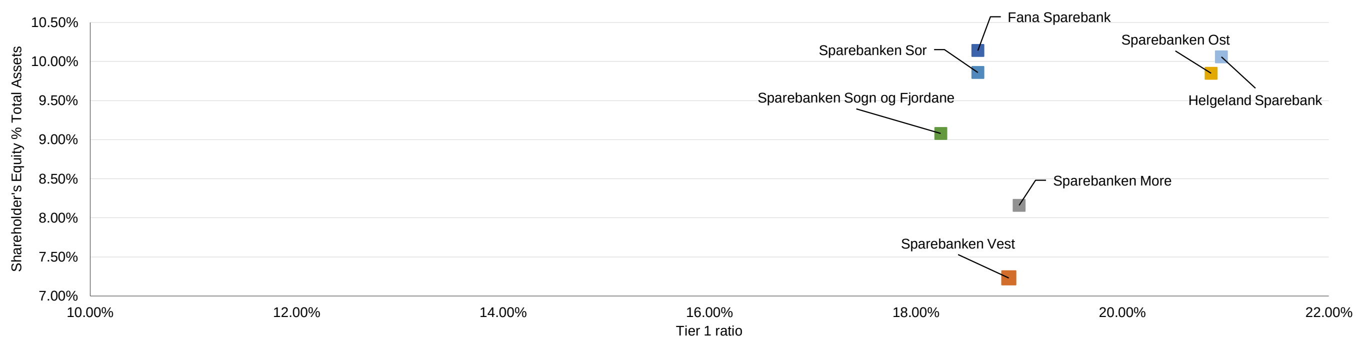
Sparebanken Ost's capital buffers are solid with a Common Equity Tier 1 (CET1) ratio of 19.9% in September 2023, broadly stable from 20.1% as of year-end 2022. Concurrently, the bank had a Tier 1 ratio of 20.9% and a total capital adequacy ratio of 22.9% as of September 2023, combined with a leverage ratio of 8.9% indicating the ample room it has for credit growth and for absorbing losses. We expect the bank's capital ratios to come down once lending growth picks up or when the bank distributes excess capital, but they should still remain strong, as indicated by the bank's CET1 ratio target of 15.6%.

The bank's capital levels compare favorably both with other similarly rated banks and other Norwegian savings banks (see Exhibit 5) and exceed both the current regulatory requirement of 13.1% (including a Pillar 2 requirement of 1.1% for Sparebanken Ost) and the increased requirement of 15.6% which will come into force at the end of 2023, following the increase in systemic risk and countercyclical capital buffers. The bank's internal target will be reduced to 15.6% at that point.

Following the implementation of finalised EU bank capital rules (which have yet to be fully agreed), it is likely that the bank's risk-weighted assets (RWAs) could decrease, with lower requirements being applied both to SME exposures and to retail mortgages. However, the implementation has been delayed from 2023 to 2025. It should be noted that Sparebanken Ost applies the standardised model for the calculation of its RWAs and has no intention to start an internal ratings-based (IRB) process.

Our aa2 capital score for the bank reflects comfortable capital metrics and strong leverage ratio. However, we apply a one-notch negative adjustment to the capital score to reflect our view that raising fresh equity in case of need could prove challenging for the bank given that only 28.6% of capital is in the form of equity certificates.

Exhibit 5
Sparebanken Ost's capital levels compare favorably with that of peers



Source: Banks reports, Moody's Investors Service (September 2023)

Favourable profitability on the back of low impairments although with relatively low contribution from fees and commissions

Sparebanken Ost's annualized return on assets, under our calculations, reached 0.90% in September 2023. Net income increased in the first nine months of 2023 compared with the same period in 2022 due to the positive effect from an increased level of the Norwegian interest rate. Recent rate increases by Norges Bank have translated into increased mortgage and deposit rates. This is expected to support the bank's profitability going forward, although the very competitive market environment will continue to be a challenge for the bank.

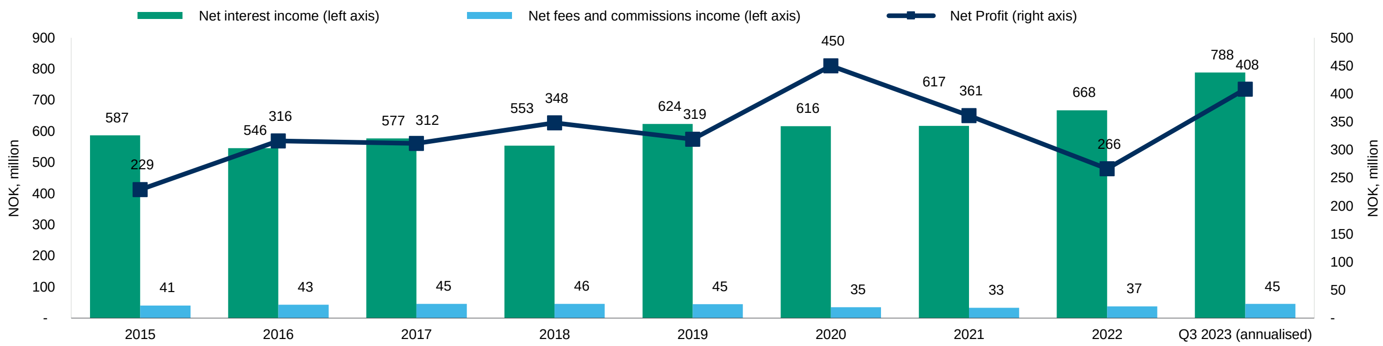
Net interest income from lending operations still constitutes the main income line for Sparebanken Ost with majority of loans being predominantly retail — representing a stable source of income. We note that there is also some margin pressure due to intense competition in the bank's core markets and increased focus on retail mortgages. On average, net interest income represents around 80% of the bank's net revenues, while fees and commissions income remains a relatively low contributor.

The bank managed to keep good control of its costs with operational efficiency remaining sound and continuing to compare well with that of its domestic peers, with a cost-to-income ratio of 38.5% as of September 2023. The wage moderation combined with the digitalisation transformation have also helped contain its cost base and be one of the most efficient Norwegian banks, despite significant IT investments in the last two years.

Over the next 12-18 months, we do not expect any major deviation in the bank's profitability metrics. The bank has good recurring pre-provision income and higher interest rates will continue to support its profitability. However, the strong competition the bank faces in the greater Oslo and Akershus area where it also operates, mainly from bigger commercial and digital banks with strong pricing power, could pressure margin and constrain its long-term profitability trajectory. In addition, higher costs caused by energy prices, inflation and supply chain constraints could lead to higher provisioning needs by the bank, in addition to higher personnel and IT expenses. We expect higher expenses and competitive pressure to offset positive effect from the increased net interest income.

Exhibit 6

Sparebanken Ost's profitability evolution



Source: Banks reports, Moody's Investors Service

Sparebanken Ost maintains a sizable reliance on market funding although mitigated by high liquidity buffers

Sparebanken Ost remains more reliant on market funds than most of its domestic peers, as its Moody's-adjusted market funds ratio comprised around 34% of the bank's tangible banking assets as of September 2023. Accordingly, we believe that the bank remains sensitive to fluctuations in investor sentiment, which we view as a potential credit challenge.

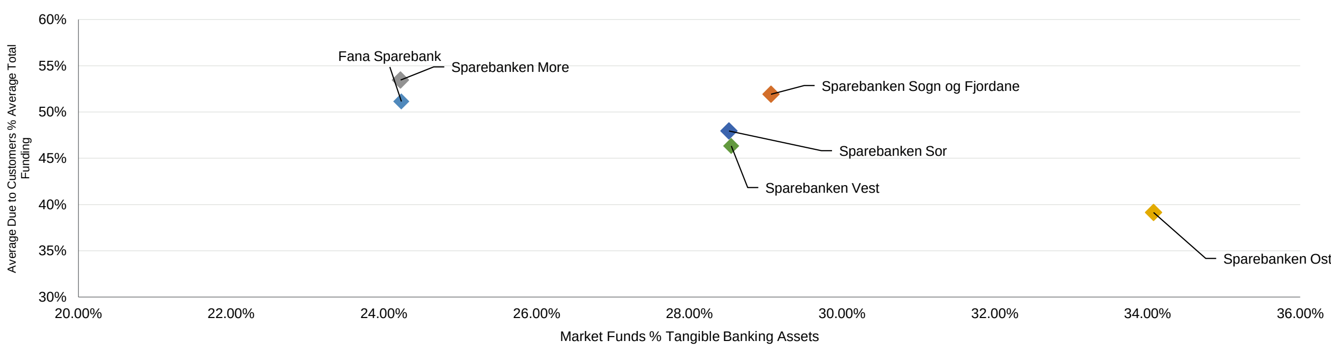
A relatively large part of Sparebanken Ost's market funding consists of covered bonds issued via Sparebanken Ost Boligkreditt, with this source of funding representing around 71% of Sparebanken Ost's unadjusted market funds as of September 2023. We view the benefits from diversification and the typically longer maturity of these funding instruments positively, particularly because recent larger issuances are eligible liquid assets under the liquidity coverage ratio (LCR) rules. The bank also had a comfortable net stable funding ratio (NSFR) at 131% at the end of September 2023.

We expect that the bank will continue to refinance part of its senior preferred debt with senior non-preferred (SNP) debt. This is based on the bank's minimum requirement for own funds and eligible liabilities (MREL).

Deposits accounted for about 38% of Sparebanken Ost's non-equity funding as of September 2023 — at the lower end of the range of similarly rated Norwegian savings banks. The 8.5% decrease in total deposits as of September 2023 from a year earlier was largely driven by the deposits from the corporate sector decreasing by 11.6%.

Exhibit 7

A relatively large part of Sparebanken Ost's market funding consists of covered bonds



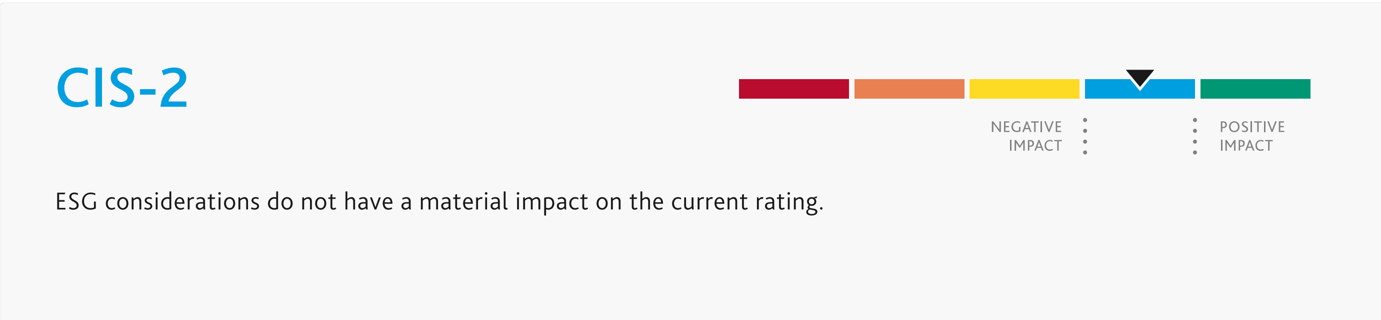
Source: Banks reports, Moody's Investors Service (September 2023)

Mitigating its high reliance on market funds, Sparebanken Ost holds a large liquidity buffer. As of September 2023, liquid assets stood at NOK6.7 billion or 14.9% (13.9% as of December 2022) of total assets and consisted mainly of cash, as well as government-related bonds and covered bonds. Furthermore, according to the bank, liquid assets should be sufficient enough to cover its funding needs for at least the next 12 months without the need for external financing, and its LCR was 344% in September 2023.

ESG considerations

Sparebanken Ost's ESG credit impact score is CIS-2

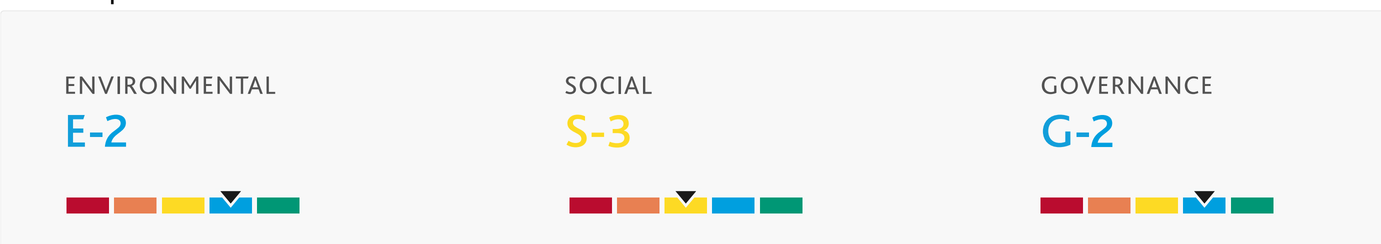
Exhibit 8
ESG credit impact score



Source: Moody's Investors Service

Sparebanken Ost's **CIS-2** indicates that ESG considerations do not have a material impact on the current rating.

Exhibit 9
ESG issuer profile scores



Source: Moody's Investors Service

Environmental

Sparebanken Ost has a low exposure to environmental risks, specifically in relation to carbon transition risks. This is because of its loan composition which consists primarily of mortgages and property management and negligible exposure to corporate lending, which typically carries higher carbon transition risk.

Social

Sparebanken Ost faces moderate social risks related to customer relations and associated regulatory and litigation risks, requiring high compliance standards. The exposure to customer relation risks is lower than its international peers, given the bank's untarnished customer conduct track record supported by the social mandate of the Savings Bank's model. Sparebanken Ost is a digitally advanced bank in Norway, with a robust IT infrastructure and strong capabilities to mitigate cyber and personal data risks.

Governance

Sparebanken Ost faces low governance risks and its risk management, policies and procedures are in line with industry best practices. Despite sectoral and geographical concentrations, due to its limited reach, the bank benefits from strong underwriting standards which mitigate some of these concerns. The bank has a track record of sound capital and liquidity management and earnings stability while losses have been low, even at times of market turbulence. Being a regional savings bank, more than 70% of the bank is owned by the community foundation and around 30% by other private investors, in the form of listed equity certificates. The bank's Supervisory Board, comprises of representatives of EC holders, the foundation and employees. Related governance risks are however mitigated by Norway's developed institutional framework

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Loss Given Failure and additional nothing

The European Union's BRRD2 has been transposed into Norwegian law which underpins our current assumptions regarding the LGF analysis. We assume a residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits, a 5% run-off in preferred deposits, and assign a 25% probability to deposits being preferred over senior unsecured debt. These metrics are in line with our standard assumptions.

For Sparebanken Ost's short-term and long-term deposit ratings, we consider the likely impact of loss-given-failure, reflecting the combination of debt and deposit volumes and the amount of debt subordinated to them. We also take into consideration the expected level of MREL eligible debt issuance until the end of 2023. This has resulted in a Preliminary Rating Assessment of three notches above the BCA for the bank's deposit and senior unsecured ratings, reflecting very low loss-given-failure.

Government Support considerations

Given the implementation of the BRRD law in Norway on 1 January 2019 we reconsidered the probability that government support would benefit certain creditors.

Sparebanken Ost benefits from a well-established market position in the lower Buskerud County of southeastern Norway. While its market share in this county is material (we estimate it at around 6% on terms of loans), it falls to around 1.4% if we include the greater Oslo and Akershus areas, in which Sparebanken Ost also operates. We also note that the proximity of the bank's home region to Oslo means that a number of other Norwegian banks are operational in the area. Therefore, we take into consideration the probability of government support for debt and deposits as low, resulting in no rating uplift. Sparebanken Ost's market share in loans on a national basis is around 0.7%.

Counterparty Risk Assessment

Sparebanken Ost's CR Assessment is A1(cr)/P-1(cr)

Sparebanken Ost's CR Assessment is A1(cr)/P-1(cr), three notches above the bank's Adjusted BCA of baa1, based on the buffer against default provided by junior deposits, senior unsecured, subordinated debts and preference shares. The bank's CR Assessment does not benefit from any government support, in line with deposits and senior unsecured debt ratings.

Counterparty Risk Ratings (CRRs)

Sparebanken Ost's CRR is A1/P-1

The CRR is three notches above the Adjusted BCA of baa1 and at the same level as the CR Assessment, reflecting the buffer against default provided by more junior instruments to the CRR liabilities.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard 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 methodology and scorecard factors

Exhibit 10
Sparebanken Ost

Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.6%	aa1	↔	a3	Geographical concentration	Sector concentration
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	20.3%	aa1	↔	aa2	Access to capital	
Profitability						
Net Income / Tangible Assets	0.8%	baa1	↔	baa3	Earnings quality	
Combined Solvency Score		aa2		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	32.8%	baa3	↔	ba1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	13.9%	baa3	↔	baa3	Stock of liquid assets	
Combined Liquidity Score		baa3		ba1		
Financial Profile				baa1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Aaa		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	**in-scope (NOK Million)**	**% in-scope**	**at-failure (NOK Million)**	**% at-failure**
Other liabilities	21 095	46.5%	22 663	50.0%
Deposits	15 374	33.9%	13 806	30.4%
Preferred deposits	11 377	25.1%	10 808	23.8%
Junior deposits	3 997	8.8%	2 998	6.6%
Senior unsecured bank debt	5 275	11.6%	5 275	11.6%
Junior senior unsecured bank debt	1 492	3.3%	1 492	3.3%
Dated subordinated bank debt	400	0.9%	400	0.9%
Preference shares (bank)	350	0.8%	350	0.8%
Equity	1 360	3.0%	1 360	3.0%
Total Tangible Banking Assets	45 346	100.0%	45 346	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	26.2%	26.2%	26.2%	26.2%	3	3	3	3	0	a1
Counterparty Risk Assessment	26.2%	26.2%	26.2%	26.2%	3	3	3	3	0	a1 (cr)
Deposits	26.2%	7.9%	26.2%	19.6%	2	3	2	3	0	a1
Senior unsecured bank debt	26.2%	7.9%	19.6%	7.9%	2	2	2	3	0	a1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	3	0	a1	0	A1	A1
Senior unsecured bank debt	3	0	a1	0	A1	A1

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 11

Category	Moody's Rating
SPAREBANKEN OST	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Issuer Rating	A1

Source: Moody's Investors Service

REPORT NUMBER 1389160

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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