FitchRatings

Fitch Revises Sandnes' Outlook to Positive; Affirms 'BBB'

Fitch Ratings-London-01 October 2018: Fitch Ratings has revised Sandnes Sparebank's Outlook to Positive from Stable while affirming the bank's Long-Term Issuer Default Rating (IDR) on at 'BBB'.

A full list of rating actions is at the end of this rating action commentary.

The Outlook revision reflects our expectation that the Viability Rating (VR) and the IDRs are likely to be upgraded within one or two years on the back of improving asset quality metrics.

The rating actions were part of Fitch's periodic review of Norwegian savings banks.

KEY RATING DRIVERS
IDRS, VIABILITY RATING AND SENIOR DEBT
The ratings of Sandnes reflect its healthy pre-impairment profitability, improving asset quality, sound capital ratios, and an entrenched regional presence in south-west Norway. Its ratings are constrained by the bank's smaller franchise relative to domestic peers', and by still significant geographical and obligor loan concentration.

Sandnes' impaired loans accounted for 2.2% of gross loans at end-June 2018, materially down from a recent peak of 3.6% at end-2016, and we expect a continued reduction. A significant share of the impaired loans relate to legacy commercial real estate (CRE) loans, which in our assessment includes building and construction and property management lending. We expect management to continue the progress it has made in reducing concentration in this segment from its peak in 2008, although it remains a material risk. The bank's efforts to shorten maturities and reduce high loan-to-value CRE lending are positive for the ratings. Direct lending to the oil and gas sectors is minimal.

Sandnes' lending books are concentrated in south-west Norway, the primary base for the oil industry, making the bank sensitive to more widespread contagion from potential oil price volatility and reduced activity.

A significant property price correction is a key sensitivity for the bank. Fitch does not expect such a scenario to lead to significant deterioration of the quality of the bank's retail lending, although reduced consumption would likely negatively affect the bank's SME portfolio.

Sandnes has healthy pre-impairment profitability and the regional franchise supports stable revenue generation. Net interest income, with healthy margins, is the main source of revenue, but the bank is also looking to strengthen fee income from ancillary products such as insurance, wealth management and real-estate brokerage. Cost-efficiency is

acceptable, with a cost-to-income ratio of 39.8% in 1H18.

Fitch expects that with the material part of Sandnes' problem portfolio restructuring completed, and loan impairment charges (LICs) should be lower in 2018 than in 2017, and remain low in 2019. The loss experienced in 2015 highlights the concentration risks it faces.

Fitch has positively reassessed its view of Sandnes' capitalisation, given improved capital ratios and a continued reduction in unreserved impaired loans. Sandnes demonstrates strong capital ratios, and its end-June 2018 Fitch Core Capital (FCC) ratio was 17.5%, despite the use of the standardised approach in calculating its capital requirements for both retail and corporate credit exposures. Leverage is in line with domestic peers'. Nonetheless, our assessment of capital is constrained by the small absolute size of the bank's equity, making the bank vulnerable to shocks.

Like most Nordic banks, Sandnes relies on wholesale funding to varying degrees. It has maintained access to domestic and international funding markets, particularly for covered bonds. We expect the bank to retain a large liquidity portfolio to mitigate refinancing risk.

The 'F3' Short-Term IDR of Sandnes maps to the lower of the two options for the 'BBB' Long-Term IDR. Fitch believes the bank has sound funding and liquidity, but its liquidity is not notably better than its rating level would suggest.

SUPPORT RATING AND SUPPORT RATING FLOOR
The Support Rating (SR) of '5' and Support Rating Floor (SRF) of 'No Floor' reflect Fitch's view that senior creditors of Sandnes cannot rely on receiving full extraordinary support from the sovereign in the event of it becoming non-viable. The EU's Bank Recovery and Resolution Directive (BRRD) provides a framework for resolving banks that is likely to require senior creditors participating in losses, if necessary, instead of or ahead of a bank receiving sovereign support, and it is Fitch's expectation that this legislation will be transposed into Norwegian law in the short term. The SR and SRF for Sandnes further reflect its small size and lack of systemic importance.

RATING SENSITIVITIES
IDRS, VR AND SENIOR DEBT
The Positive Outlook on Sandnes' ratings reflects the progress the bank is making in materially reducing its legacy CRE exposure and obligor concentration. We expect to upgrade Sandnes' ratings if this trend of improving asset quality metrics continues. Conversely, Sandnes' ratings could come under pressure if reduced activity in the region should lead to a significant house price correction or larger losses in the corporate sector, particularly if this leads to issues in maintaining access to competitively priced funding.

SUPPORT RATING AND SUPPORT RATING FLOOR
An upgrade of the Sandnes' SR or upward revision of the bank's SRF would be contingent on a positive change in Norway's propensity to support its banks. This is highly unlikely, in Fitch's view. An upward revision of Sandnes' SRF would be also contingent on a positive change in Fitch's view of the systemic importance of the bank, which is also unlikely.

The rating actions are as follows:

Sandnes Sparebank

Long-Term IDR affirmed at 'BBB'; Outlook revised to Positive from Stable
Short-Term IDR affirmed at 'F3'
Viability Rating affirmed at 'bbb'
Support Rating affirmed at '5'
Support Rating Floor affirmed at 'No Floor'

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Applicable Criteria

Bank Rating Criteria (pub. 22 Jun 2018) (https://www.fitchratings.com/site/re/10034713)

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