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## Research Update:

# Ratings On Iceland's Ibudalanasjodur (Housing Financing Fund) Affirmed At 'BB-/B'; Outlook Stable

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## Research Update:

# Ratings On Iceland's Ibudalanasjodur (Housing Financing Fund) Affirmed At 'BB-/B'; Outlook Stable

## Overview

- On Jan. 15, 2016, Standard & Poor's raised its long-term sovereign credit ratings on Iceland to 'BBB+'.
- We continue to assess Iceland's Ibudalanasjodur (Housing Financing Fund; HFF) stand-alone credit profile at 'b-' and the likelihood of extraordinary government support as high.
- We are therefore affirming our 'BB-/B' ratings on HFF.
- The outlook is stable, reflecting our view of balanced risks to the ratings.

## Rating Action

On Jan. 22, 2016, Standard & Poor's Ratings Services affirmed its 'BB-/B' issuer credit ratings on Ibudalanasjodur (Housing Financing Fund, HFF). The outlook is stable.

## Rationale

The affirmation reflects our view that HFF's stand-alone credit profile (SACP) remains 'b-' and the likelihood of extraordinary government support remains high.

On Jan. 15, 2016, we raised our long-term ratings on Iceland to 'BBB+'. Even though we expect an improving trend for the operating environment for banks in Iceland, we do not anticipate HFF's SACP to improve to above 'b-' over the next 12 months. This is because we anticipate the institution's capital position will remain very weak, with the government only providing enough capital to run-off the institution in an orderly fashion. In addition, we believe that HFF continues to experience revenue problems, with a high share of prepayments resulting in very low operating profits and limiting any meaningful capital generation. While we see the risks in its loan book decreasing in line with strong economic growth in Iceland, nonperforming assets (based on our definitions) remain relatively high at double those of the system as of June 30, 2015. We expect loan loss provisions to be small for the next 12-24 months and have little impact on HFF's income.

We rate HFF under our criteria for government-related entities. We believe that HFF has an important role for and an integral link with the Icelandic government. Consequently, we believe there is a high likelihood that the government would provide extraordinary support to the institution if needed.

We see HFF as having an important role for the government of Iceland, primarily based on the consequences for the government and the domestic capital market of a

default by HFF. HFF's outstanding bonds amount to about 30% of Iceland's GDP and nearly 80% is held by Icelandic pension funds. A default could therefore entail losses for the pension funds; we do not believe the government would view this as politically acceptable. HFF's default could also undermine confidence in other companies that benefit from similar government guarantees.

We also regard HFF's link with the government as integral and we believe it will remain 100% state-owned. As a state agency, HFF is not subject to bankruptcy proceedings and is exempt from taxation. The government provided support to HFF through capital injections three times during 2010-2014, contributing a total of more than Icelandic krona 50 billion. The government also provides an ultimate, but not timely, guarantee on HFF's outstanding debt.

At present, HFF's future role and operations remain highly uncertain. As we have previously stated, we expect a gradual and orderly disbanding of the institution over several years (see "Ratings On Iceland's Housing Financing Fund Affirmed At 'BB-/B'; Outlook Stable," published July 22, 2015). We anticipate HFF's new lending to remain minimal and the institution's loan portfolio will continue to contract. At present, we do not expect to change our assessment of HFF's role for or link with the government.

## **Outlook**

The stable outlook reflects our expectation that HFF's current SACP will remain unchanged, and that the likelihood of the government of Iceland providing timely and sufficient extraordinary support to HFF in the event of financial distress remains high. We do not expect to take a rating action on HFF if we raise or lower our long-term local currency sovereign credit rating on Iceland by one notch, all else being equal.

We could lower the ratings if we concluded that the effects of a potential HFF default for the government and the capital markets had reduced, which would reduce the incentive for the government to provide timely and extraordinary support to the institution. This could occur, for instance, if the volume of HFF's outstanding bonds declined markedly.

We could raise the ratings if we believed that the risks inherent in unwinding the mortgage portfolio had reduced substantially, for instance based on improved asset quality and resilient pre-provision earnings generation.

## **Related Criteria And Research**

### **Related Criteria**

- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity - April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013

- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework - June 22, 2012
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions - December 06, 2010
- Criteria - Financial Institutions - Banks: Methodology For Mapping Short- And Long-Term Issuer Credit Ratings For Banks - May 04, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks - March 23, 2004

### Related Research

- Ratings On Iceland's Housing Financing Fund Affirmed At 'BB-/B'; Outlook Stable, July 22, 2015

### Ratings List

	Rating	
	To	From
Housing Financing Fund Ibudalanasjodur		
Issuer credit rating		
Foreign and Local Currency	BB-/Stable/B	BB-/Stable/B
Senior Unsecured		
Local Currency	BB-	BB-

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