

Rating Action: Moody's upgrades the Housing Financing Fund's ratings to Baa1; outlook stable

Global Credit Research - 09 Sep 2016

This action concludes the rating review started on 14 June 2016 and is driven by conclusion of the review on Iceland's government ratings

London, 09 September 2016 -- Moody's Investors Service has today upgraded the issuer and the backed senior unsecured debt ratings of the Housing Financing Fund (HFF) to Baa1 from Baa3. This rating action follows the recent rating action on the Icelandic sovereign, which guarantees HFF's debt. Iceland's sovereign issuer rating was upgraded to A3 from Baa2 on 1 September 2016. Please refer to Moody's separate press release "Moody's upgrades Iceland's government ratings to A3; outlook stable (https://www.moodys.com/research/--PR_351195)"; for further details on the recent rating action. The outlook on HFF's ratings is stable and in line with the stable outlook on the sovereign ratings.

This rating action concludes the review on the issuer and backed senior unsecured debt ratings initiated on 14 June 2016.

RATINGS RATIONALE

The upgrade of HFF's long-term issuer and backed debt ratings to Baa1 from Baa3 reflects the Icelandic government's improved credit fundamentals, as indicated by the upgrade of its long-term ratings to A3 from Baa2, and its capacity to support HFF through its guarantee.

The two-notch upgrade of Iceland's government rating reflects the speed and extent of the country's recent progress in recovering from its 2008 banking crisis. Sustained growth and fiscal restraint allowed a very sizeable reduction in government debt over the past year, which Moody's expects to continue and to be sustained with the deployment of the proceeds of the failed banks' estates over the coming years. Cautious but steady progress in addressing the problems in the banking sector and in relaxing capital controls has considerably reduced the risks to economic and financial stability from the final stages of capital account liberalization.

Moody's continues to position HFF's ratings one notch below the Icelandic sovereign's rating to reflect that, although the government is responsible for full payment of HFF's liabilities, there is no explicit guarantee on timely payment. In case of default of HFF, under the guarantee creditors would first have to pursue potentially lengthy legal procedures before the government would be obliged to pay, which creates uncertainty over the timeliness of repayment.

On 12 August 2016, the Icelandic Minister of Social Affairs and Housing introduced a bill on the future arrangement of housing matters. Some of the proposed changes would impact HFF. The most significant proposed changes are: (i) increased focus on HFF's role in formulating policies and plan in housing matters; (ii) limitation of the fund's authorisation to grant loans to individuals; and (iii) introducing a booking separation between the existing loan portfolio and the tasks that HFF will undertake if the bill is approved by the parliament. The bill is subject to approval in parliament, and does not propose any change in the government guarantee for HFF.

Moody's considers HFF's intrinsic financial strength as weak, characterised by low profitability and relatively modest -- although improving - capitalisation, with tangible common equity at 6.45% of risk weighted assets as of the end of June 2016. These vulnerabilities are mitigated by the state guarantee.

RATIONALE FOR THE STABLE OUTLOOK

The outlook is stable and reflects the stable outlook on HFF's support provider, the Icelandic sovereign.

WHAT COULD CHANGE THE RATINGS UP/DOWN

In line with the existing guarantee, an upgrade or downgrade of the Icelandic sovereign could trigger an

upgrade or downgrade of HFF. In addition, strengthening or weakening of the sovereign guarantee could lead to the rating being positioned closer to, or further below the sovereign rating.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Government-Related Issuers published in October 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

LIST OF AFFECTED RATINGS

Upgrades:

... LT Issuer Rating, Upgraded to Baa1 Stable from Baa3 Rating Under Review

... BACKED Senior Unsecured Regular Bond/Debenture, Upgraded to Baa1 Stable from Baa3 Rating Under Review

Outlook Actions:

...Outlook, Changed To Stable From Rating Under Review

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