MOODY'S
INVESTORS SERVICE

CREDIT OPINION
12 July 2016

Update

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RATINGS

SpareBank 1 Nord-Norge

Domicile	Norway
Long Term Rating	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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SpareBank 1 Nord-Norge

Semi - Annual Update

Summary Rating Rationale

Moody's assigns a baseline credit assessment (BCA) of baa1 to SpareBank 1 Nord-Norge, a long-term deposit rating of A1, a senior unsecured debt rating of A1, and a short-term rating of Prime-1. We also assign a Counterparty Risk Assessment (CR Assessment) of Aa3(cr) long term and Prime-1(cr) short term.

SpareBank 1 Nord-Norge's BCA of baa1 reflects the bank's strong regional position, retail focus combined with a solid deposit franchise, as well as its robust capital base and favourable asset quality with low level of non-performing loans (NPLs). The bank's BCA also takes into account its comfortable liquidity position and satisfactory profitability. These positive rating drivers are to some degree counterbalanced by our view that the currently softening operating environment in Norway combined with the bank's real estate exposures in its loan book are likely to lead to a modest rise in problem loans, exerting some pressure on its credit profile and profitability. However, we expect such pressure to be limited, and unlikely to place the bank's BCA at risk over the next 12-18 months.

The bank's deposit and senior unsecured debt ratings incorporate our Loss Given Failure (LGF) analysis, taking into account the bank's volume of deposits and senior unsecured debt, and the stock of securities subordinated to them. SpareBank 1 Nord-Norge benefits from a large volume of deposits and substantial layers of subordination, resulting in very low loss given failure and two notches of rating uplift from the bank's BCA. In addition, both the deposit and senior debt ratings of A1 also benefit from one notch of rating uplift due to government support, in view of the bank's systemic importance.

Credit Strengths and Challenges

- SpareBank 1 Nord-Norges's BCA is supported by its Very Strong- Macro Profile
- Solid capital ratios that we expect to improve further by year-end
- Low problem loans, but asset risk profile partly impacted by some sector and borrower concentrations
- Satisfactory profitability on the back of cost reduction, although margins are likely to be pressured
- Funding profile underpinned by a sizeable deposit base although with some reliance on market funding

» Large volume of deposits and junior debt resulting in deposit ratings benefiting from a very low loss-given-failure rate.

» Moderate probability of government support resulting in one-notch rating uplift for debt and deposits

Rating Outlook

The stable outlooks on the bank's long-term senior debt and deposit ratings reflect our view that the bank's financial standing will remain broadly resilient to a modest slowdown in Norway's economic performance.

Factors that Could Lead to an Upgrade

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; and/or (3) stronger earnings generation without compromising its risk profile.

Factors that Could Lead to a Downgrade

Future downward rating pressure would emerge if (1) SpareBank 1 Nord-Norge's problem loan ratio increases above our system wide expectation of approximately 2%; (2) financing conditions were to become more difficult; (3) its risk profile were to increase, for example as a result of increased exposure to more volatile sectors; and/or (4) macroeconomic environment were to deteriorate more than estimated, leading to adverse developments in the Norwegian real-estate market.

Key Indicators

Exhibit 1

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

	3-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (NOK billion)	88.7	85.4	83.2	77.5	75.3	4.2[4]
Total Assets (EUR million)	9409.4	8882.1	9169.3	9273.0	10266.8	-2.2[4]
Total Assets (USD million)	10722.4	9648.6	11095.4	12777.6	13535.6	-5.7[4]
Tangible Common Equity (NOK billion)	9.9	9.8	9.3	8.4	6.8	9.9[4]
Tangible Common Equity (EUR million)	1055.3	1022.3	1024.8	1004.8	928.0	3.3[4]
Tangible Common Equity (USD million)	1202.6	1110.6	1240.0	1384.6	1223.5	-0.4[4]
Problem Loans / Gross Loans (%)	0.7	1.0	1.1	1.7	2.0	1.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	16.2	16.3	15.0	14.5	12.4	15.8[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	4.3	6.3	6.9	10.9	15.2	8.7[5]
Net Interest Margin (%)	1.9	1.9	1.9	1.8	1.7	1.8[5]
PPI / Average RWA (%)	1.8	1.4	1.7	1.8	1.4	1.7[6]
Net Income / Tangible Assets (%)	1.2	1.0	1.2	1.2	0.8	1.1[5]
Cost / Income Ratio (%)	52.5	63.5	55.4	53.7	60.0	57.0[5]
Market Funds / Tangible Banking Assets (%)	28.5	29.1	30.8	27.6	28.6	28.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	17.9	16.4	17.4	14.9	16.1	16.6[5]
Gross loans / Due to customers (%)	129.4	133.2	134.1	127.5	125.2	129.9[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

Detailed Rating Considerations

SpareBank Nord-Norge's BCA is Supported by its Very Strong - Macro Profile

As a domestically focused bank, SpareBank 1 Nord-Norge's operating environment is heavily influenced by Norway and its Macro Profile is thus aligned with that of Norway at Very Strong-. Norwegian banks benefit from operating in a wealthy and developed country with very high economic, institutional and government financial strength, as well as low susceptibility to event risk. The main risks to the system stem from a high level of household indebtedness and domestic banks' reliance on market funding. However, these risks are offset by the strength of households' ability to service debt, banks' adequate capitalisation and the relatively small size of the banking system compared with GDP.

Solid Capital Ratios That we Expect to Improve Further by Year-End

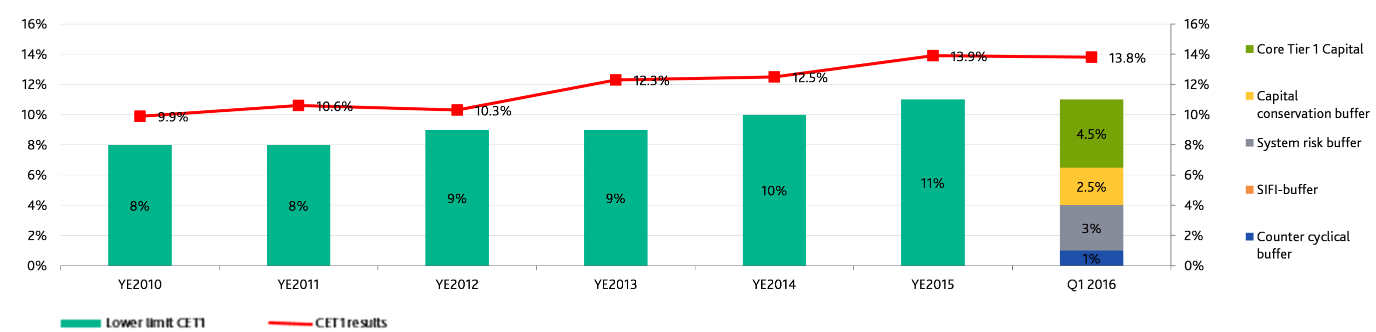
SpareBank 1 Nord-Norge reported a consolidated Tangible Common Equity (TCE) ratio of 16.2% at end-March 2016 (including transitional floors), a significant improvement when compared with 12.4% in 2012, while the group's Common Equity Tier 1 (CET1) was 13.8% (see Exhibit 2), in excess of the 11.5% minimum regulatory requirement that came into force on 1 July 2016. During the first quarter of 2015, the bank received permission to apply the Advanced IRB approach to calculate regulatory charges against credit risk on corporate clients, compensating for the increase in the risk weight of home mortgages as a result of Norwegian's FSA tightening.

SpareBank 1 Nord-Norge aims to have an internal capital buffer of at least 0.5% above the statutory minimum requirement and its long-term CET1 capital ratio target is currently 14.5%, which was also recommended by the FSA. In connection to achieving the new capital requirements, the board had previously communicated its intention to reduce its dividend payout ratio. The overall payout ratio for 2015 was around 30% of profits, with 48.7% for the bank's equity certificate holders and 13.1% for the community-owned capital. Furthermore, in an effort to rationalise capital use, the bank's board has agreed to the run-off of the corporate portfolio of BN Bank (not rated), an entity which is co-owned by the rest of the SpareBank 1 Alliance banks.

Our assigned Capital Score of aa2 reflects the bank's capital strength, as illustrated by its TCE/tangible banking assets ratio of 11.2% at end-March 2016 (without taking into account the mortgages used for covered bonds), which compares well with banks globally with a BCA of baa1. We also note the bank's increase in the capital metrics with the consolidated Tier 1 and total capital adequacy ratios rising to 14.9% and 16.9% respectively as of March 2016, from 14% and 16.1% in March 2015. Concurrently, the bank's leverage ratio was at 6% in March 2016, which was in line with the ratio as of March 2015 and the FSA's proposal as a minimum requirement for banking groups.

Exhibit 2

SpareBank 1 Nord-Norge's capitalisation



Source: Company presentations and reports

Low Problem Loans, but Asset Risk Profile Partly Impacted by Some Sector and Borrower Concentrations

SpareBank 1 Nord-Norge's loan book benefits from a substantial proportion of retail loans (around 72% of gross loans in March 2016 including loans transferred to covered bond companies), mostly in the form of mortgages. The bank's asset quality is strong with a problem loan ratio (impaired loans as a percentage of total loans) of 0.67% of on-balance-sheet loans at March 2016, down from 0.9% in March 2015. The bank's strong asset performance benefits from a favourable lending environment, including high unemployment benefits that support borrowers' ability to repay debt, a creditor-friendly legal framework, and the less affected macroeconomic conditions in the Northern part of Norway where the bank is based.

Although Sparebank 1 Nord-Norge has some exposure to the oil sector accounting for around NOK 2.1 billion, or 2.3% of total loans as of March 2016, the majority of these are supported by long-term contracts. Such contracts provide some level of stability to the bank's asset quality considering the significant deterioration in the sector over the past year, a trend we expect to continue during 2016. Our assigned Asset Risk score indicates that overall, asset risk remains a relative strength for SpareBank 1 Nord-Norge. The bank operates mainly in northern Norway that has limited dependence on the petroleum sector and has benefited from the Norwegian currency depreciation in recent years through exporting industries such as farming, fishing and tourism.

The negative adjustments that we incorporate on SpareBank 1 Nord-Norge's asset risk score are mainly driven by some concentrations in its loan book towards the real estate and construction sectors, which represent 29.8% of the on-balance-sheet corporate loan portfolio as of March 2016. We also note risks related to individual borrower concentration, which could accelerate the extent and pace of any deterioration in asset quality, a characteristic common to many Nordic banks, although we view favourably the bank's significant reduction in its exposure to certain Russian entities.

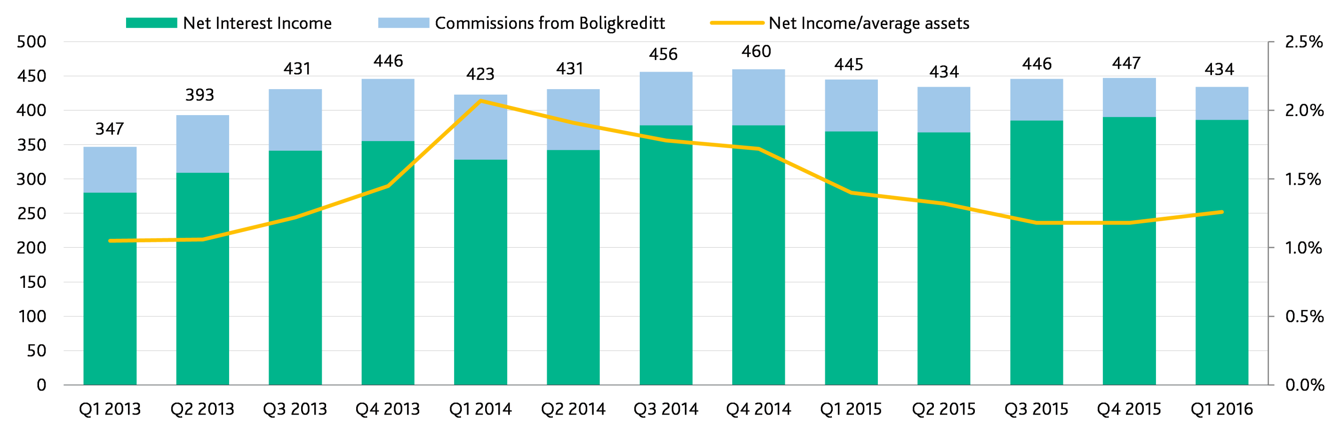
Looking ahead for the rest of the year, we expect the bank's problem loan ratio to increase marginally due to the general softening of economic conditions in the country. Nonetheless, we do not expect any major asset quality deterioration over the next 12-18 months, which could trigger downward rating pressure for the bank, while the bank's more favourable exposure to non-oil exporting sectors such as fisheries is likely to alleviate any asset quality deterioration. We also note the bank's relatively high provisioning coverage for problem loans of approximately 87% in March 2016, which minimises the risks for any additional significant credit losses from the existing stock of non-performing loans.

Satisfactory Profitability on the Back of Cost Reduction, Although Margins are Likely to be Pressured

SpareBank 1 Nord-Norge's earnings base also benefits from its resilient retail banking operations, which contributed to just over 46% of its 2015 pre-provision profit and 51% of its first quarter 2016 pre-provision profit. Net interest income continued to constitute the largest proportion of income at almost 57% (compared with net fee and commission income of 31% and income from financial instruments of 12%). The importance of net interest income was significantly reduced from 2012 when it constituted 62% of total income, as a result of a 90% increase in commission income reflecting loan transfers to the two covered bond companies owned by the Sparebank 1 Alliance. Income from the covered bond companies booked as commission income mainly originates from interest income from the bank's mortgage loans transferred to Sparebanken 1 Boligkreditt (the residential mortgages vehicle), although the bank's lower net interest income since 2014 is also due to the lower interest rates in Norway (see Exhibit 3).

Exhibit 3

SpareBank 1 Nord-Norge's net interest income (NOK million)



Source: Company reports, Moody's Financial Metrics

The bank's cost-income ratio as calculated by Moody's improved to 52.5% at end-March 2016 from a relatively high 63.5%% at end-December 2015. The bank's cost base decreased by 5% (excluding restructuring costs) year-on-year as a result of 8% lower total personnel and general administration costs, which were mainly driven by its voluntary severance package offered to 150 employees completed in Q4 2015. In addition, the increased digitalization and changes in customer behaviour have triggered a reorganization at the bank to improve efficiency.SpareBank 1 Nord-Norge has taken several initiatives in 2015 to optimise its operations. The bank announced plans to dispose of less profitable businesses, starting with the write-down of the majority of its Russian exposure earlier in the year. This was followed by plans to reorganise the business in response to increased digitalisation and changes in customer behavior. The bank's reorganisation plan envisaged a net reduction of the full-time employees of the parent bank by up to 15% during 2015-2016, which will provide additional support to the bank's profitability in a challenging operating environment.

Loan loss provisions reduced to 0.13% of gross loans at end March 2016, from 0.32% at end 2015 and 0.28% at end 2014. In 2014 the bank had booked specific provisions of NOK300 million to cover its exposure in Russia following the economic crisis in the country that caused deposit outflows and resulted in liquidity pressures. The bank's commitment associated with its banking activities in Russia has been wound up, while its residual exposure amounts to around NOK 50 million.

SpareBank 1 Nord-Norge reported net income at NOK275 million for the three months ending in March 2016 compared to NOK292 million for the same period a year earlier at group level. Net income as a proportion of average assets was a satisfactory 1.26% in March 2016, marginally down from 1.41% in March 2015, in line with most Norwegian savings banks. As we expected, the bank's profitability growth has slowed in 2015-16 owing to renewed margin pressure as a result of lower interest rates and losses arising from the mark-to-market of the liquidity portfolio. All else being equal, we would not anticipate the bank's corporate loan losses to remain at their currently low levels, as we expect that Norway will experience a slightly tougher bank operating environment than in recent years.

Funding Profile Underpinned by a Sizable Deposit Base But Some Reliance on Market Funding

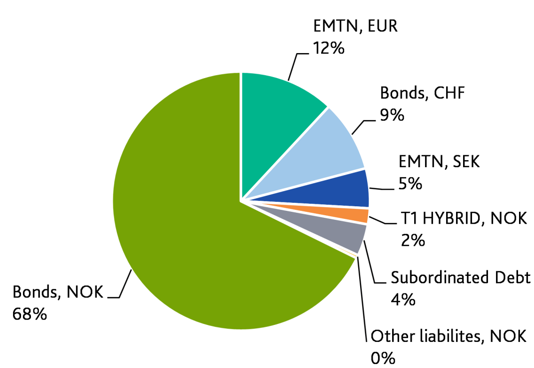
SpareBank 1 Nord-Norge's on-balance sheet funding consisted by almost 65% of deposits at end-March 2016, which has proven resilient over many years. As of end-March 2016 , the bank's deposits were up by almost 9% year-on-year, driven mainly by retail deposits that constituted around 60% of total deposits, although the bank's gross loans-to-deposits ratio (excluding securitized loans) was around 130%.

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-March 2016 the bank had transferred retail mortgages worth NOK24.5 billion to these vehicles (i.e., around 27.3% of its gross loan book). While we view positively the diversification benefit of covered bond funding, its extensive use increases the amount of pledged assets unavailable for unsecured bondholders, including depositors in liquidation.

We globally reflect the relative stability of covered bonds compared with unsecured market funding through a standard adjustment in our scorecard accounting around half of such covered bonds as deposit-like funding. Our Funding Structure score reflects our view that SpareBank 1 Nord-Norge's usage of market funding (see Exhibit 4) is of sufficient scale (market funds comprised around 29% of tangible banking assets in March 2016) to represent a source of vulnerability because, in times of market stress, market funding can become more expensive or/and restricted.

Exhibit 4

Funding Distribution as of End-March 2016



Source: Company presentations and reports

SpareBank 1 Nord-Norge's liquid assets accounted for approximately 18% of total assets at end-March 2016. This liquidity reserve primarily consists of Norwegian T-bills, sovereign bonds, rated covered bonds as well as bonds issued by domestic or international financial institutions and domestic corporate bonds. The bank's LCR ratio under Basel III stood at a comfortable 120% as of March 2016, compared to the 70% requirement for 2016, while the NSFR was 132% although this ratio has yet to come into effect. We generally believe that the bank will continue to have a relatively conservative liquidity profile, maintaining excess liquidity and minimizing any refinancing risk.

Notching Considerations

Loss Given Failure and Additional Notching

We expect that Norway will look to introduce legislation to implement the EU's Bank Resolution and Recovery Directive (BRRD). In our LGF analysis we assume residual tangible common equity of 3% and losses post-failure 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 to senior unsecured debt. These are in line with our standard assumptions.

For SpareBank 1 Nord-Norge's long term deposit rating and senior unsecured debt rating, we take into consideration the likely impact of loss given failure (LGF) of the combination of their own volume and the amount of debt subordinated to them. According to our LGF model, this results in a Preliminary Rating Assessment (PRA) of two notches above the bank's BCA of baa1 for both deposits and senior debt, reflecting very low loss given failure.

For junior securities issued by SpareBank 1 Nord-Norge, our LGF analysis confirms a high level loss given failure, given the small volume of debt and limited protection from more subordinated instruments and residual equity, positioning them below the bank's BCA. We also incorporate additional notching for junior subordinated and preference share instruments reflecting the coupon features.

Government Support

The expected implementation of resolution legislation has caused us to reconsider the probability that government support would benefit certain creditors.

SpareBank 1 Nord-Norge has a solid, defensible footprint in northern Norway with 62 branches across the region as of December 2015. Moody's estimates that the bank commands market shares of around 32% in deposits and 16% in terms of loans in the three most northerly counties of Norway, although its national market share is limited, at around 2.3% in terms of deposits and 3.4% in terms of loans (based on total lending in the bank's counties of operation and in the whole country according to Statistics Norway as of year-end 2015). Therefore, we conclude a moderate probability of government support for debt and deposits, resulting in one notch of rating uplift above their PRA, positioning them at A1.

For other junior securities, we continue to believe that potential government support is low and these ratings do not include any related uplift. Junior securities also include additional downward notching from the BCA, reflecting coupon suspension risk ahead of a potential failure.

Counterparty Risk Assessment

We assign a Aa3(cr) long-term and P-1(cr) short-term CR Assessment to SpareBank 1 Nord-Norge.

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

Rating Methodology and Scorecard Factors

Exhibit 5

SpareBank 1 Nord-Norge

Macro Factors						
Weighted Macro Profile	**Very Strong -**	**100%**				
Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.1%	aa2	↓↓	a3	Single name concentration	Geographical concentration
Capital						
TCE / RWA	16.2%	aa2	←→	aa2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	1.2%	a2	←→	a2	Expected trend	
Combined Solvency Score		aa3		a1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	29.1%	baa2	←→	ba1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	16.4%	baa2	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		baa2		baa3		
Financial Profile				a3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				a2-baa1		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Instrument Class	**Loss Given Failure notching**	**Additional notching**	**Preliminary Rating Assessment**	**Government Support notching**	**Local Currency rating**	**Foreign Currency rating**
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3 (cr)	--
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1	--	A1
Dated subordinated bank debt	-1	0	baa2	0	--	Baa2
Junior subordinated bank debt	-1	-1	baa3	0	--	Baa3
Non-cumulative bank preference shares	-1	-2	ba1 (hyb)	0	--	Ba1 (hyb)

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
SPAREBANK 1 NORD-NORGE	
Outlook	Stable
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Subordinate MTN	(P)Baa2
Jr Subordinate MTN	(P)Baa3
Pref. Stock Non-cumulative	Ba1 (hyb)

Source: Moody's Investors Service

Foreign Currency Deposit Rating

SpareBank 1 Nord-Norge's foreign currency deposit rating of A1 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 A1 is unconstrained given that Norway has a country ceiling of Aaa.

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.

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