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Research Update:

The Mortgage Society of Finland 'BBB/A-2' Ratings Affirmed On Unchanged Asset Quality And Capitalization; Outlook Stable

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Overview

- The Mortgage Society of Finland (Hypo) continues to expand in its small niche focusing on well-collateralized mortgage loans to households and housing companies in the Helsinki metropolitan area.
- We project that Hypo will maintain high capital ratios offsetting its loan portfolio concentrations, but it remains more dependent on wholesale funding and therefore on preserving appropriate levels of liquidity for stress events than peers.
- We are affirming our 'BBB/A-2' long- and short-term issuer credit ratings on Hypo.
- The stable outlook reflects our projection of continued sound economic conditions in Finland and our view that changes to the bank's conservative lending policies and capital management are unlikely over our 12-24 months outlook horizon.

Rating Action

On July 25, 2018, S&P Global Ratings affirmed its 'BBB/A-2' long- and short-term issuer credit ratings on Finland-based The Mortgage Society of Finland (Hypo). The outlook is stable.

Rationale

The affirmation reflects our view that Hypo maintains its prudent underwriting standards and very strong capitalization while potentially growing its loan book at a relatively high pace of about 15% annually over the next two to three years. Despite its growth, Hypo remains a small niche player in Finland. It also continues to rely more strongly on senior unsecured wholesale funding despite growing issuance of covered bonds recently.

Hypo operates with a concentrated business model focused on residential mortgage lending to housing companies and households in Helsinki, southern Finland, and in specified growth centers in the rest of the country. Despite strong loan growth in recent years, nearly doubling its customer loans since 2014, it holds only a small market share in Finland, with total assets of €2.7 billion as of March 31, 2018. Moreover, the growth did not result in stronger profitability as its cost-to-income ratio deteriorated and surpassed 60% in 2017--for the first time since 2012. The ratio was 67.6% in first-quarter 2018, weaker than most banks in the Nordic countries, but we note Hypo's sizable one-time contribution to Finland's Financial Stability Fund. We project that profitability will improve, however, mainly reflecting a higher net interest margin from lower funding costs.

Hypo offsets this rating weakness with very strong capitalization. We expect its risk-adjusted capital ratio to reach 16.0%-16.5% over the next 24 months, compared with 17.1% as of Dec. 31, 2017. The projected decline results from the continued high loan growth outpacing earnings retention.

Its regionally focused mortgage business makes the bank vulnerable to real estate price development in some regions of Finland. That said, its loan loss track record is strong, with a negligible nonperforming loan ratio of 0.13% on March 31, 2018. Also, the bank has very conservative lending policies, in our view. This is demonstrated, for example, by its reported average loan-to-value (LTV) ratio on mortgage loans of 36.5% as of March 31, 2018.

We continue to view Hypo's funding and liquidity as weaker than Finnish peer banks. Funding comes predominantly from wholesale markets, with 43% of total funds representing wholesale instruments as of March 31, 2018. In our view, these are generally more confidence-sensitive and prone to volatility during adverse market and economic conditions. The elevated loan-to-deposit ratio of 156% at the end of first-quarter 2018 is weaker than most banks in Finland and underpins our conservative assessment. We view as positive the increasing share of covered bonds, which leads to an improving funding profile given the long-term lending business on the asset side. Moreover, Hypo's broad liquidity asset to short-term wholesale funding multiple was at 1.4x, an average metric in comparison to rated banks on a global scale. However, Hypo's monoline business model, small size, and relatively high share of wholesale funding may require stronger liquidity buffers in a stress event than at larger more diversified peers.

Outlook

The stable outlook reflects our view that sound construction activity in Finland on the back of an improving economic environment will support Hypo to reach its growth ambitions without diluting its asset quality. It also reflects our view that material changes to the bank's capital management are unlikely over our outlook horizon.

Downside scenario

We could lower the ratings on Hypo in the next 18-24 months if:

- Hypo unexpectedly changes its current conservative lending policies;
- Hypo fails to maintain its very strong capital (for example, by more aggressive business growth without corresponding earnings improvements);

or

- Hypo manages its liquidity buffers more aggressively than currently, leading to a substantial weakening of its liquidity ratios. We view this scenario as unlikely, however.

Upside scenario

A positive rating action is, in our view, remote at this stage. It could be triggered by an improved funding profile demonstrated by a more diversified funding mix and funding metrics in line with domestic peers'.

Ratings Score Snapshot

Issuer Credit Rating	BBB/Stable/A-2
SACP	bbb
Anchor	a-
Business Position	Weak (-2)
Capital and Earnings	Very Strong (+2)
Risk Position	Moderate (-1)
Funding and Liquidity	Below Average and Adequate (-1)
Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria

- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings , April 7, 2017
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Banking Industry Country Risk Assessment: Finland, Feb. 2, 2018
- Nordic Banks' Capitalization Should Remain Stable Despite Revised Basel III Standards, Jan. 24, 2018
- The Mortgage Society of Finland, Sept. 14, 2017

Ratings List

Ratings Affirmed

The Mortgage Society of Finland	
Issuer Credit Rating	BBB/Stable/A-2
Senior Unsecured	BBB

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.