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CREDIT OPINION
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Update

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Municipality Finance Plc

Update to credit analysis

Summary

The Aa1 senior debt and issuer ratings assigned to Municipality Finance Plc (MuniFin), as assessed by our Government-Related Issuers (GRIs) methodology, reflects the institution's close links to Finnish regional and local governments (RLGs) and ultimately the sovereign, because of (1) its role as the main provider of funding to the municipal sector and to the central government subsidised housing sector; (2) its public policy mandate to act as the de-facto debt management office for the RLGs; and (3) the joint guarantee by RLGs in Finland (Aa1, Stable) with income tax levying power, provided through the Municipal Guarantee Board (MGB, Aa1, stable). They also reflect the institution's predictable financial performance, as well as its low risk appetite which is consistent with its peers. We also assign an Aa1(cr)/ P-1(cr) Counterparty Risk Assessment.

Credit strengths

» Ownership and market share reflect MuniFin's importance to the Finnish regional and local government sector

» MuniFin's funding is guaranteed by the Aa1 rated Municipal Guarantee Board

» Strong sovereign and healthy RLG sector result in good asset quality

» Predictable financial performance due to public policy mandate

» Diverse funding and good liquidity

» Capitalisation and low risk appetite consistent with peers

Credit challenges

» Borrower concentration

» Mismatches between assets and liabilities mitigated by ample liquidity portfolio, diverse funding and the liquidity facility from the Finnish central bank (thanks to its status as a central bank counterparty)

Outlook

The stable outlook on MuniFin's rating is in line with the stable outlook on the government of Finland's rating.

Factors that could lead to an upgrade

MuniFin's senior unsecured and issuer ratings could be upgraded as a result of an upgrade of the government of Finland.

Factors that could lead to a downgrade

MuniFin's senior unsecured and issuer ratings could be downgraded if the government of Finland is downgraded. Downward pressure on the ratings could also arise over time as a result of: (1) asset quality deterioration; (2) a diluted public policy mandate; (3) a weaker standing in debt capital markets; and (4) a weakening in the MGB guarantee.

Key indicators

Exhibit 1

Municipality Finance Plc (Consolidated Financials) [1]

	12-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (EUR Million)	43,736.1	41,302.8	36,897.5	33,497.3	32,663.0	7.6[4]
Total Assets (USD Million)	49,557.6	50,536.2	41,417.4	38,292.2	39,221.6	6.0[4]
Tangible Common Equity (EUR Million)	1,475.2	1,311.5	1,177.7	1,104.1	952.8	11.5[4]
Tangible Common Equity (USD Million)	1,671.6	1,604.7	1,322.0	1,262.1	1,144.2	9.9[4]
Problem Loans / Gross Loans (%)	0.4	0.5	0.2	0.0	0.0	0.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	99.5	107.2	84.1	68.7	53.4	82.6[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	8.6	10.3	5.2	0.0	0.1	4.9[5]
Net Interest Margin (%)	0.6	0.6	0.7	0.7	0.7	0.7[5]
PPI / Average RWA (%)	17.9	14.8	8.6	10.8	11.6	12.7[6]
Net Income / Tangible Assets (%)	0.5	0.4	0.3	0.5	0.5	0.4[5]
Cost / Income Ratio (%)	18.3	21.5	29.9	19.2	16.4	21.1[5]
Market Funds / Tangible Banking Assets (%)	88.7	87.0	83.8	82.9	83.4	85.2[5]
Liquid Banking Assets / Tangible Banking Assets (%)	25.1	21.9	17.8	16.5	27.8	21.8[5]
Gross Loans / Due to Customers (%)	876.5	720.4	640.8	591.9	577.9	681.5[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

MuniFin is the only financial institution in Finland which specialises in providing financing to the Finnish municipal and social housing sector. The institution provides loans to local and regional governments for a wide range of investments, including environmental projects, local infrastructure, education, healthcare and central government subsidized housing. The total assets of MuniFin were €43.7 billion at the end of December 2021 (Moody's adjusted).

MuniFin has been growing its personnel in the last few years and increased the number of employees to 164 in December 2021 from 151 in 2018 due to business development and greater regulatory requirements.

MuniFin is jointly owned by the Finnish RLGs (53%), the Finnish public sector pension fund (Keva, 31%) and the government of Finland (16%).

Recent developments

On 23 June 2021, the Finnish parliament approved the social and healthcare (SOTE) reform legislation. The reform aims to create 21 service counties with responsibilities for healthcare, hospitals, and fire and rescue services. The legislation included changes to the Act on the MGB, allowing for MuniFin to keep financing the existing loans that are transferred to the new service counties. Further changes to the Act were approved in April 2022 and came into effect as of 1 May 2022, enabling MuniFin to finance new loans and commitments to the service counties.

The outlook for Finland's (Aa1, Stable) banking system remains stable, unchanged from last year. This reflects expectation that while Finland's economic growth will slow in 2022, it will remain sufficiently strong to drive an increase in the banking sector's commission income. This will help offset continued pressure on Finnish banks' net interest income from still low interest rates and intense competition. We expect Finland's real GDP to grow by 1.8% in 2022, down from 3.5% in 2021, however, there is significant risk to GDP forecast from Russia's invasion of Ukraine, which has exacerbated inflationary pressure and added to supply chain constraints.

MuniFin's senior ratings are assessed by our GRI methodology and reflects the institution's close links to Finnish RLGs and ultimately the sovereign, and therefore that the bank is not expected to face the same challenges as commercial banks.

Detailed credit considerations

Ownership and market share reflect MuniFin's importance to the Finnish regional and local government sector and to the central government subsidised housing sector

MuniFin is closely associated with the Finnish regional and local government sector and effectively acts as the debt management office for Finnish RLGs, and lends exclusively to Finnish public sector customers or entities guaranteed by the Finnish public sector. The institution is owned by the Finnish municipal sector (53%), a Finnish local government pension institution (Keva) (31%), and the Republic of Finland (16%). MuniFin is under the oversight of the Prime Minister's Office, in line with other government owned companies.

MuniFin's importance to the Finnish RLG sector is also reflected by its leading market share. The institution's dominant position is likely to persist since its public policy mandate is to lend at cost-effective rates to RLGs rather than maximising profits. We note that MuniFin's regional peers in other Nordic countries also report high market shares, assisted by their not-for-profit mandate.

MuniFin's funding is guaranteed by the Aa1 rated Municipality Guarantee Board

Munifin's funding is guaranteed by the Municipal Guarantee Board (MGB), a public body established by law for the sole purpose of safeguarding the funding of Finnish municipalities. The MGB's strong credit strength (Aa1 stable) reflects that all municipalities in Finland (except for the Åland Islands) are permanent MGB members, and these municipalities are closely linked to the Finnish sovereign. If one municipality fails to meet its obligations towards the MGB, then all remaining municipalities are obliged to cover the shortfall in proportion to their population size.

Strong sovereign and healthy RLG sector result in good asset quality despite the challenging economic environment

MuniFin's strong creditworthiness reflects the supportive framework that underpins the RLG sector: (1) Finnish RLGs have full authority to levy income taxes on their inhabitants (2) RLGs' other revenue sources include grants from the central government, (3) Finnish RLGs benefit from an equalisation principle to ensure provision of public services across the country, (4) RLGs are required by law to balance their finances over a four-year horizon, (5) lending for the purpose of public housing construction (around 48% of lending at the end of December 2021) is guaranteed by the Aa1 rated Finnish government, and (6) the Ministry of Finance is responsible for the oversight of local governments. Moreover, Finnish law does not allow for a municipality to be declared bankrupt and this is consistent with other Nordic countries.

These characteristics ensure that RLGs remain creditworthy in the long-term, and are able to deliver key public services, such as education and health-care, as mandated by the central government.

Although MuniFin's asset quality is very strong, we believe that the coronavirus has increased the solvency risks, given the implications for public health and safety across Finland, as well as the adverse impact the virus will have on the collection of locally generated tax due to weaker economic growth. Nevertheless, we do not expect any significant changes in MuniFin’s asset risk given the support mechanisms that underpin the RLG sector.

The growth of the lending portfolio was 3.5% in 2021, down from 2020 when the lending portfolio grew by 13.1% driven by the municipal sector due to uncertainties caused by the Covid-19 pandemic. In 2021, lending grew at a slower pace following significant support from the Central Government in the form of Covid-19 state grants to the municipalities. The total amount of the total green financing stood at €2,328 million as of end-December 2021, which is a 30.3% increase compared to year-end 2020. Similar to peers, MuniFin's lending book is somewhat concentrated due to its customer base which is small in number. MuniFin does comply with all banking regulatory requirements, including those on large exposures.

Relaxation in capital requirements will mitigate negative effects of the coronavirus

MuniFin is currently well capitalised relative to its risks. As of December 2021, the institution reported a common equity Tier 1 (CET1) ratio of 95.0%. We recognise that the very high CET1 ratio is a result of the zero risk weights applicable on MuniFin's lending. This ratio nonetheless represents 12.4 times the minimum CET1 ratio of 7.65% required by the ECB. As of December 2021, the minimum capital requirements were inclusive of a capital conservation buffer of 2.5%, an other systemically important credit institutions (O-SII) requirement of 0.5% and an institution-specific countercyclical buffer based on geographical distribution of exposures of 0.15%. MuniFin's minimum Tier 1 Capital and Total own funds requirements as of December 2021 were 9.15% and 11.15% respectively.

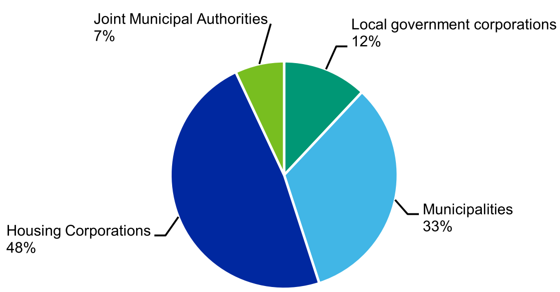
The adoption of CRR II and CRD V in June 2021 requires MuniFin to maintain a minimum Tier 1 leverage ratio of 3%. MuniFin's ratio was situated at 12.8% as of December 2021 (3.9% as at year-end 2020). As a public development credit institution under CRR II, Munifin was able to exclude all credit receivables from municipalities and social housing loans, i.e. the bulk of its portfolio, from the leverage ratio. This allowed the institution to increase its ratio by 8.9 percentage points.

Predictable financial performance due to public policy mandate

Like its peers, MuniFin has a not-for-profit mandate consisting of providing cost effective lending to Finnish RLGs. The institution has a good track record of fulfilling its mandate even during times when debt capital markets were under severe pressure. Net income over tangible assets increased to 0.46% in 2021, up from 0.38% during the same period a year earlier. This development follows a 10% year-over-year improvement of the net interest income, which offset the total operating expense increase of 5% year-over-year.

MuniFin's profitability is predictable because (1) it lends exclusively to the Finnish municipal sector and the central government subsidised housing sector (see Exhibit 2), (2) we consider the Finnish RLG sector financially stable for the reasons outlined above, and (3) its dominant market position.

Exhibit 2
MuniFin's Lending Broken Down By Type in 2021
MuniFin's lending is diversified within the RLG sector



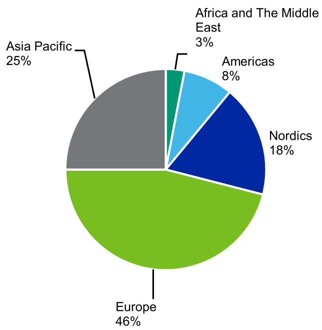
Source: Company reports

Diverse funding and good liquidity, but mismatches between assets and liabilities

Like its peers, MuniFin issues various types of debt in several geographies, in multiple currencies to a diverse investor base (see Exhibit 3-5) and in many different product segments in the international capital markets. We view this diversification as positive because it means that MuniFin is not dependant on a single source for funding.

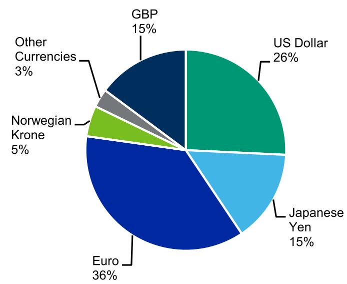
MuniFin was the first credit institution to launch green finance onto the Finnish market and the first Finnish green bond issuer. As of December 2021, the total amount of green bond was €2.3 billion (€1.98 billion as of year-end 2020). In February 2020, MuniFin published a social bonds framework, introducing a social finance product targeted at investments that provide benefits for the society, and in September 2020 issued the Finland's first social bond which was oversubscribed by nearly four times. As of year-end 2021, the total amount of social bond was €1.1 billion.

Exhibit 3
Funding By Region as of YE2021



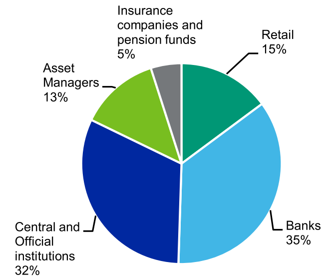
Source: Company reports

Exhibit 4
Funding by Currency as of YE2021



Source: Company reports

Exhibit 5
Funding by Investor Type in YE2021



Source: Company reports

MuniFin is not match-funded, as the average maturity of its liabilities are shorter than the maturity of its assets. Also, over 10% of MuniFin's funding comes with callable features (although proportions have come down significantly compared to a few years ago) which, if triggered, could further shorten the maturity of MuniFin's liability profile. MuniFin manages this risk by maintaining a large liquidity reserve as well as having good access to funding in various markets and maintaining a liquidity facility at the Bank of Finland.

MuniFin reported total liquid assets of €12.2 bn as of December 2021 compared to €10.1 bn as of year-end 2020. Furthermore, as of year-end 2021 82% of the liquid assets were HQLA Level 1 (85% in YE2020) and 7% were HQLA Level 2 (9% in YE2020) assets. The debt securities in the portfolio are very highly rated, which is also the case for MuniFin's Nordic peers. MuniFin also has access to Central Bank liquidity facility whereby it can pledge eligible loans as collateral, giving it access to additional liquidity in case of need.

ESG considerations

We consider MuniFin to have a low exposure to Environmental risks in line with how we view the banking sector. See our Environmental risks Environmental heatmap for further information.

Due to MuniFin's role as one of Finland's largest credit institution specialising in the financing of Finnish municipalities, it is susceptible to politically and socially motivated decisions that could affect its financial profile. Its borrowers are exposed to the challenges of providing services to an aging population leading to increasing dependency ratios. Over time, these challenges can add pressure on municipalities' finances, even though the sector's institutional framework overlying MuniFin's clients help manage these risks.

The framework includes municipalities constitutional right to set local level tax rates independently, an equalisation mechanism supporting financially weaker municipalities, and the joint guarantee where member organisations are responsible for each others commitments in proportion to their population figures. Social considerations are material to Munifin's credit profile due to the credit institution's exposure to the social service and health care provision that must be delivered by its clients, Finnish local governments.

We view the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety across Finland, as well as the adverse impact the virus will have on the collection of locally generated tax and service fee revenues due to weaker economic growth. Overall, we consider the issuer to have a moderate exposure to Social risk.

See our Social risks Social heatmap for further information.

Governance is highly relevant to MuniFin's creditworthiness. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. We do not have any particular concern around MuniFin's corporate governance, which is regulated by law and influenced by its public ownership structure.

Support and structural considerations

Counterparty Risk Assessment

MuniFin's CR Assessment is Aa1(cr)/ P-1(cr).

The CR Assessment, also reflects the application of the banks methodology, and is positioned three notches above the implied BCA of a1. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

We assume a very high support assumption from the government for the CR Assessment but due to the proximity between the sovereign rating and the CR Assessment prior to government support, this support does not result in any rating uplift. The very high support assumption reflects our view that any support provided by governmental authorities to a bank which benefits senior unsecured debt or deposits is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with our belief that governments are likely to maintain such operations as a going-concern in order to reduce contagion and preserve a bank's critical functions.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on http://www.moodys.com for the most updated credit rating action information and rating history.

Ratings

Exhibit 6

Category	Moody's Rating
MUNICIPALITY FINANCE PLC	
Outlook	Stable
Counterparty Risk Assessment	Aa1(cr)/P-1(cr)
Issuer Rating	Aa1
Bkd Senior Unsecured	Aa1
Bkd Commercial Paper -Dom Curr	P-1
Bkd Other Short Term -Dom Curr	(P)P-1
PARENT: MUNICIPAL GUARANTEE BOARD	
Outlook	Stable
Issuer Rating -Dom Curr	Aa1

Source: Moody's Investors Service

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