

ANNUAL REPORT 2016

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**SR-Boligkreditt**

Subsidiary of SpareBank 1 SR-Bank

## Annual accounts

<b>Contents</b>		<b>Page</b>
Report of the Board of Directors		3
Income statement		8
Balance sheet		9
Statement in changes of equity		10
Statement of cash flow		10
<b>Notes to the Accounts</b>		<b>11-34</b>
Note 1	General information	11
Note 2	Accounting policies	11
Note 3	Critical estimates and judgements concerning use of the accounting policies	15
Note 4	Capital adequacy	17
Note 5	Risk management	18
	<b>Credit risk</b>	
Note 6	Lending to customers	21
Note 7	Non-performing and impaired loans	22
Note 8	Credit risk exposure for each internal risk class	22
Note 9	Maximum credit risk exposure	23
Note 10	Credit quality per class of financial asset	24
	<b>Market risk</b>	
Note 11	Market risk related to interest rate risk	24
Note 12	Market risk related to currency risk	25
	<b>Liquidity risk</b>	
Note 13	Liquidity risk	25
	<b>Income statement</b>	
Note 14	Net interest income	26
Note 15	Net income from financial instruments	26
Note 16	Other operating costs	26
Note 17	Tax	27
	<b>Balance sheet</b>	
Note 18	Classification of financial instruments	28
Note 19	Financial derivatives	29
Note 20	Other assets	29
Note 21	Debt securities issued	30
Note 22	Asset coverage	31
Note 23	Other liabilities	31
	<b>Other information</b>	
Note 24	Material transactions with related parties	31
Note 25	Share Capital	32
Note 26	IFRS 9 Financial instruments	32
Note 27	Events after the balance sheet date	34
Independent auditor's report		35
Statement by the board of directors and chief executive officer		39

## Annual report for 2016

SR-Boligkreditt AS (the Company) has an office in Stavanger and is a fully-owned subsidiary of SpareBank 1 SR-Bank ASA. The enterprise is a finance company that issues covered bonds. The assets consist primarily of securitised residential mortgages.

At the end of 2016, the Company's total loans to customers amounted to NOK 29.4 billion, compared to NOK 9.9 billion at the end of 2015. Debt in the form of covered bonds amounted to NOK 27.3 billion (NOK 9.4 billion).

### The market

Funding opportunities by means of issuing covered bonds have been good in 2016. Covered bonds is an important asset class in the Norwegian market, and foreign investors have also shown great interest in buying covered bonds issued by Norwegian enterprises. SR-Boligkreditt AS bonds have been assigned an Aaa rating by Moody's Investor Service, and the high rating ensures access to financing on good terms.

### Corporate governance

SR-Boligkreditt AS's principles and policy for corporate governance are built on the Norwegian code of practice for corporate governance issued by the Norwegian Corporate Governance Board (NCGB). The Company has adapted the code mentioned above, and SR-Boligkreditt AS's principles and policy are intended to ensure that corporate governance is in line with generally accepted perceptions and standards, and is in compliance with applicable laws and regulations. Furthermore, corporate governance shall ensure good cooperation among the various interests such as shareholders, lenders, customers, employees, governing bodies, management and society at large. It is the opinion of the Board of Directors that SR-Boligkreditt AS's corporate governance is satisfactory and in accordance with applicable principles and policy.

During 2016, 9 board meetings were held. The Board's focal areas have been following up operations, strategy, risk and capital governance and surveillance of markets and framework terms and conditions. The Board has prepared an annual schedule for its work, and emphasis is placed on ensuring sufficient knowledge and expertise among board members.

As a fully-owned subsidiary of SpareBank 1 SR-Bank ASA, SR-Boligkreditt AS is exempt from having a separate audit committee. The Company has an independent and effective external and internal audit.

Risk management and internal control is done continuously and any operational incidents that could cause disruptions and/or loss are recorded. SR-Boligkreditt AS conducts an annual review of these routines. The enterprise's risk strategy is adopted by the Board. Identified areas of risk and any significant control deviations concerning the company's financial reporting are followed up by means of the company's risk management and internal control system, and reported to the Board at each board meeting.

The Company's ethical guidelines include a duty to report in cases of blameworthy conditions, including breaches of internal guidelines, laws and regulations, as well as the method to be used to submit this information.

Major enterprises shall submit information on their handling of social responsibility, cf. Section 3-3c of the Norwegian Accounting Act. The parent bank, SpareBank1 SR-Bank ASA submits such reports for the group, which also covers subsidiaries. Reference is made to the parent bank's annual report for further information.

SR-Boligkreditt AS's activities are supervised by the Financial Supervisory Authority of Norway. The Board and administration endeavour to maintain an open and constructive dialogue with the Financial Supervisory Authority of Norway.

## Review of the annual accounts

### Profit and loss account

SR-Boligkreditt AS reports in accordance with the IFRS. The Company's operating result before depreciation and tax amounted to NOK 115.4 million for the 2016 accounting year, compared to NOK 39.8 million for the period 17.03.15-31.12.2015. The result after depreciation and tax was NOK 84.9 million (NOK 28.7 million). The Company's interest income and similar income in 2016 amounted to NOK 508.3 million (NOK 124.7 million). Net interest income amounted to NOK 169.3 (NOK 50.3 million) in 2016. Net losses from financial investments in 2016 amounted to NOK 33.4 million (NOK 1.7 million), which for the most part is due to value regulation of swaps related to deferral hedge accounting of financial liabilities.

The Company's operating costs and fee expenses in 2016 amounted to NOK 20.5 million (NOK 8.9 million). The Company purchases a number of services from SpareBank1 SR-Bank ASA. Purchase of services is formalised by means of various agreements and the Company is thereby ensured competencies in central professional areas, while also maintaining cost-efficient operations. The Company purchases loans from SpareBank1 SR-Bank ASA. Commissions for purchase of loans and services are based on ordinary business principles and amounted to NOK 15.0 million (NOK 4.4 million) in 2016.

For the financial year 2016, group loan write-downs amounted to NOK 2.3 million (NOK 0.5 million). There are no individual write-downs on loans in 2016. The Company had no realised losses in 2016.

Tax expense for 2016 is estimated at NOK 28.3 million (NOK 10.6 million), which represents 25.0 per cent (26.9 per cent) of the profit before tax. Net profit after tax for the year 2016 was NOK 84.9 million (NOK 28.7 million), which corresponds to a weighted return on equity of 4.7 per cent after tax.

The Board considers the result as satisfactory. Pursuant to Section 3-3a of the Norwegian Accounting Act, the Board confirms that the accounts have been prepared on a going concern basis.

### Balance sheet and capital adequacy

The total assets of SR-Boligkreditt AS at the end of the financial year amounted to NOK 30.1 billion (NOK 10.8 billion). Net lending to customers was NOK 29.4 billion (NOK 9.9 billion). Liabilities in the form of covered bonds amounted to NOK 27.3 billion (NOK 9.4 billion). The Company's outstanding debt securities amounted to NOK 27.3 billion (NOK 9.4 billion).

SR-Boligkreditt AS has authorisation from the Financial Supervisory Authority of Norway to make use of the IRB approach to calculate the Company's capital. This authorisation does not currently have an effect on SR-Boligkreditt AS's capital coverage since the authorities have also decided to continue the so-called Basel 1 floor. The risk weight on residential mortgages will therefore continue at 40 per cent, and IRB approval thus continues to be given a higher weighting than if the Company did not make use of the IRB approach, since weighting according to the standard approach is 35 per cent. Use of the IRB approach provides, in the Board's opinion, better risk and capital management in the Company.

The capital adequacy ratio of SR Boligkreditt AS based on the transitional arrangements for enterprises with IRB approval, was at year end 16.3 per cent (31.2 per cent). Capital adequacy consists of common equity. All capital is provided by the parent bank.

The cash flow from operating activities was NOK 464.5 million (NOK 105.3 million), while the operating result before tax was NOK 113.1 million (NOK 39.3 million). The difference of NOK 351.4 million is primarily related to interest expenses on financing activities. Net cash flow in 2016 was negative at NOK 0.2 million.

There have been no significant subsequent events that affect the financial statements for 2016.

## **Risk factors**

Laws and regulations for companies with a licence to issue covered bonds suggest that the level of risk is low. The Board emphasises that different types of risk are identified and measured. The Company has established guidelines and frameworks for the management and control of various risk areas. It is the Board's opinion that the overall risk exposure in the Company is low.

## **Credit risk**

Credit risk is defined as the risk of a loan customer or counterparty failing to fulfil its obligations to SR-Boligkreditt AS. In the professional credit framework for the Company, requirements are established for loans that may be incorporated in the Company's loan portfolio. There have been no significant changes in the Company's credit risk profile throughout the fiscal year.

The mortgages in the cover pool of SR-Boligkreditt AS cannot have a loan to value above 75 per cent, average loan to value at 31.12.2016 stood at 57.3 of current value. The Board considers the quality of the loan portfolio to be good, an assessment which is reinforced by the Company's low losses. The Board expects that losses on loans and guarantees will be kept at a low level in future.

A fall in house prices will reduce the net value of the Company's cover pool. Stress tests are carried out regularly to calculate the effect of a fall in house prices. The Board is comfortable with the outcome of the stress tests.

## **Market risk**

Market risk is defined as the risk of financial loss due to changes in observable market variables such as interest rates, exchange rates and prices of financial instruments.

SR-Boligkreditt AS has low market risk, and limits are established for maximum exposure to fluctuations in the interest and currency market.

To the extent that the Company borrows at fixed rates, and/or that the bonds are issued in foreign currency, interest rate and currency risks are eliminated by entering into swap agreements when the bonds are issued for the entire term of the loans. Swaps are entered into with counterparties of good quality. These agreements have been approved by the rating agency used by the Company and contribute to the good rating of the Company's covered bonds.

The Board considers both interest and currency risks, and the overall market risk of the Company to be low.

## **Liquidity risk**

Liquidity risk is the risk that the Company is unable to refinance at maturity, or unable to fund increases in assets.

All bonds are issued by SR-Boligkreditt AS based on agreements in which the Company has a unilateral right to extend the maturity of bonds by up to twelve months. This right may be used if the Company encounters difficulties refinancing by ordinary due date.

The Company has an agreement with the parent bank in which the bank is obliged to provide emergency liquidity support if necessary to ensure that outstanding bonds and associated derivatives shall receive timely settlement by the ordinary due date.

The Board considers the Company's liquidity risk as low.

## **Operational risk**

Operational risk is the risk of loss due to errors and irregularities in the handling of transactions, lack of internal control or irregularities in the it-systems that the Company uses.

Identification of operational risk is done through assessments and management confirmations that are part of the internal control in the Company. A management agreement has been signed with SpareBank1 SR-Bank ASA that comprises administration, bank production, IT operations, finance and risk management. According to the agreement, the bank must compensate the Company's expenses arising from any errors in the deliveries and services that the bank should provide. The operational risk is assessed continually. The Company uses E&Y as internal auditor, and any discrepancies are reported to the Board. The Board considers the Company's operational risk to be low.

## **Employees and the working environment**

The CEO is formally employed by the parent bank and leased to SR-Boligkreditt AS as general manager. Other resources for operation of the company are supplied by various departments in SpareBank1 SR-Bank ASA based on agreements between the Company and the parent bank. No serious workplace accidents have occurred or been reported over the year. The working environment in the Company is considered good, and the Company activities do not pollute the environment.

The Board of Directors consists of four people, of which one is a woman. Three of the Board members are employed in leading positions in SpareBank1 SR-Bank ASA. The other Board member is independent of the SpareBank1 SR-Bank ASA group. There have been no changes in Board membership during 2016.

## **Regulatory framework**

The Ministry of Finance has decided to increase the buffer requirement from 1,5 to 2.0 percentage points from 31 December 2017. The minimum requirement for common equity will thus increase to 12.0 per cent at year-end 2017 and capital adequacy ratio increase to at least 15.5 per cent. SR-Boligkreditt's common equity stood at 16.3 per cent at year end.

The Ministry of Finance introduced March 2017 a requirement for over-collateralization of 2 per cent. The LCR requirements raises from 80 per cent to 100 per cent by December 2017. SR-Boligkreditt reported 127 per cent per 31 December 2016.

## **Economic development and future prospects**

Moderate growth is expected in the global economy. Norwegian economic growth is expected to be low and still affected by the downturn in oil-related activities. Oil investments decreased by 16% in 2016 compared with the year before. The Norwegian Petroleum Directorate expects a further reduction in investments in the petroleum sector of around 10% in 2017 compared with 2016. This will probably affect the overall level of activity in the region in 2017 as well.

Both oil companies and the supply industry have rationalised operations and reduced costs to adapt to the new level of turnover. This is affecting the overall level of activity, although some export-oriented industries are experiencing growth due to the weak Norwegian krone. Low to moderate activity is expected within the construction industry, as well as in some commodity segments. At the same time as the expectations indicate low growth, at the start of 2017 there is significantly greater optimism around than there was at the start of 2016. The main index of the bank's business survey of economic activity is now at 54% compared with 47% at the same time last year, which shows that a majority of the 600 selected companies in our market area that provide the basis for the survey are more optimistic about the future. Continued, stable activity is expected within most sectors in Hordaland and the Agder counties.

The (seasonal adjusted) unemployment rate in Rogaland was 4.3% in March 2017, compared to 4.5% in March 2016. This is somewhat higher than the national average at 2.7%. In Agder, unemployment was at 3.3 per cent (3.8 per cent) in March 2017, while in Hordaland, unemployment in March 2017 was at 3.3 per cent (3.4 per cent).

It is anticipated that the strong competition for mortgage customers will continue. In the Stavanger region housing prices have been stable the last year, whereas most other regions in Norway have had a growth. In Rogaland, the average house price was unchanged from February 2016 to February 2017. In Norway, house price growth was 13% on average, supported by growth of more than 20% in Oslo and its surroundings. The trading volume in Rogaland is increasing. So far in 2017 volume

has increased by 28%. In the Kristiansand area, there has been a rise in prices over the previous 12 months of 3.9 per cent, while in the Bergen region, prices have risen 4.6 per cent.

Defaults are expected to continue to be low and at the same rate as in 2016. SR-Boligkreditt AS's activities are expected to generate satisfactory profitability in 2016 and will contribute to the parent bank's competitiveness in the mortgage market.

The board would like to emphasise that there is considerable uncertainty associated with all assessments of future conditions.

## Allocations

Profit after depreciation and tax for the year 2016 amounted to NOK 84.9 million (28.7 million), and the Board of Directors proposes to issue a NOK 84 million dividend to SpareBank1 SR-Bank ASA, the residual is added to the Company's equity. The dividend is considered justifiable as the Board finds that the parent bank will increase the Company's capital should this be needed.

Stavanger, 19 April 2017



Inge Reinertsen  
Chairman



Stian Helgøy



Merete Eik



Børge Henriksen



Dag Hjelte  
CEO

## Income statement

NOK 1 000	Note	2016	17.03.15- 31.12.15
Interest income	14	508.310	124.749
Interest expense	14	339.006	74.416
<b>Net interest income</b>		<b>169.312</b>	<b>50.333</b>
Commission and fee expenses		14.952	-
<b>Net commission income</b>		<b>-14.952</b>	
Net gains/losses on financial instruments	15	-33.402	-1.664
<b>Net income on financial investments</b>		<b>-33.402</b>	<b>-1.664</b>
<b>Total net income</b>		<b>120.958</b>	<b>48.669</b>
Administrative expenses	16	1.485	4.762
Other operating costs	16	4.058	4.132
<b>Total operating costs before impairment losses on loans</b>		<b>5.543</b>	<b>8.894</b>
<b>Operating profit before impairment losses on loans</b>		<b>115.415</b>	<b>39.775</b>
Impairment losses on loans and guarantees	5	2.281	493
<b>Pre-tax profit</b>		<b>113.134</b>	<b>39.282</b>
Tax expense	17	28.254	10.572
<b>Profit after tax</b>		<b>84.881</b>	<b>28.710</b>
<b>Other comprehensive income</b>			
Items in comprehensive income		-	-
<b>Total comprehensive income</b>		<b>84.881</b>	<b>28.710</b>



## Balance sheet

NOK 1 000	Note	2016	2015
<b>Assets</b>			
Balances with credit institutions		552.748	706.494
Loans to customers	6,7,8,9	29.357.902	9.949.686
Bonds	18	49.967	-
Financial derivatives	18,19	171.271	96.103
Deferred tax assets	17	11.935	-
Other assets	20	489	821
<b>Total assets</b>		<b>30.144.313</b>	<b>10.753.104</b>
<b>Liabilities and equity</b>			
<b>Liabilities</b>			
Listed debt securities	21, 22	27.272.136	9.438.553
Financial derivatives	18,19	717.386	-
Taxes payable	17	40.648	10.143
Other liabilities	23	3.432	548
<b>Total liabilities</b>		<b>28.033.602</b>	<b>9.449.244</b>
<b>Equity</b>			
Paid-in equity capital	25	2.025.150	1.275.150
Retained earnings		85.561	28.710
<b>Total equity</b>		<b>2.110.711</b>	<b>1.303.860</b>
<b>Total liabilities and equity</b>		<b>30.144.313</b>	<b>10.753.104</b>

Stavanger, 19 April 2017



Inge Reinertsen  
Chairman



Stian Helgøy



Merete Eik



Børge Henriksen



Dag Hjelte  
CEO

## Statement of changes in equity

NOK 1 000	Share-capital	Premium reserve	Other equity	Total equity
Incorporation 17 March 2015	150.000	150	0	150.150
Capital increase 24 April 2015	150.000	0	0	150.000
Capital increase 4 September 2015	225.000	0	0	225.000
Capital increase 27 October 2015	750.000	0	0	750.000
Profit for the period	0	0	28.710	28.710
<b>Equity as of 31 December 2015</b>	<b>1.275.000</b>	<b>150</b>	<b>28.710</b>	<b>1.303.860</b>
Dividend 2015, resolved in 2016	0	0	-28.000	-28.000
Capital increase 18 May 2016	750.000	0	0	750.000
Profit for the period	0	0	84.851	84.851
<b>Equity as of 31 December 2016</b>	<b>2.025.000</b>	<b>150</b>	<b>85.561</b>	<b>2.110.711</b>

## Statement of cash flow

NOK 1 000		31.12.16	17.03.15- 31.12.15
Interest receipts from lending to customers	14	493.710	113.976
Provisions to SR-Bank	24	-14.952	0
Payments for operations	16	-4.093	-8.716
Taxes paid	17	-10.143	0
<b>Net cash flow relating to operations</b>		<b>464.522</b>	<b>105.260</b>
Net purchase of loan portfolio	6	-19.393.732	-9.939.407
Net payments on the acquisition of bonds		-49.892	0
Net investments in intangible assets		0	-880
<b>Net cash flow relating to investments</b>		<b>-19.443.624</b>	<b>-9.940.287</b>
Debt raised by issuance of securities	21	18.407.673	9.333.893
Receipts from borrowing from financial institutions		0	0
Paid in capital equity	25	750.000	1.275.150
Net interest payments on funding activities	14	-304.318	-67.522
Dividend paid		-28.000	0
<b>Net cash flow relating to funding activities</b>		<b>18.825.355</b>	<b>10.541.521</b>
<b>Net cash flow during the period</b>		<b>-153.747</b>	<b>706.494</b>
Balance of cash and cash equivalents start of period		706.494	0
Balance of cash and cash equivalents end of period		552.747	706.494

## Notes to the Financial Statements

### Note 1 General information

SR-Boligkreditt AS is a wholly owned subsidiary of SpareBank 1 SR-Bank ASA and was established in accordance with the special banking principle in Norwegian legislation concerning the issuing of covered bonds.

The purpose of the company is to acquire home mortgages from SpareBank 1 SR-Bank ASA and fund lending activities, primarily through issuing covered bonds.

### Note 2 – Accounting principles

#### **Basis for the preparation of the annual financial statements for SR-Boligkreditt AS**

The annual financial statements cover the period 1 January - 31 December 2016.

The annual financial statements of SR-Boligkreditt AS ("the company") have been prepared in accordance with International Finance Reporting Standards (IFRS) as adopted by the EU. This includes interpretations from the IFRS Interpretations Committee and its predecessor the Standing Interpretations Committee (SIC).

SR-Boligkreditt is a limited company registered as based in Norway with its head office in Stavanger.

The basis for measurement used in the company's financial statements is acquisition cost, with the following modifications: financial derivatives and some financial liabilities are recognized at fair value with value changes through profit or loss.

Preparing financial statements in accordance with IFRS requires the use of estimates. Furthermore, applying international reporting standards requires management to use its judgement. Areas that involve a great deal of discretionary estimates, a high degree of complexity, or areas where assumptions and estimates are significant for the company's financial statements are described in note 3.

#### **New standards and interpretations that have not been adopted yet**

A number of new standards, amendments to standards and interpretations will be compulsory in future annual financial statements. The most important of these that the company has chosen not to implement early are described below:

IFRS 9 replaces the classification and measurement models in IAS 39 Financial Instrument: Recognition and measurement with one simple model, which basically only has two categories: amortized cost and fair value. The classification of loans depends on the unit's business model for managing its financial assets and the attributes of the individual asset's cash flows.

Note 26 provides a more exhaustive account of the assessments regarding IFRS 9.

IFRS 15 Revenue from Contracts with Customers deals with recognizing revenue. This will replace IAS 18 which applies to contracts for goods and services and IAS 11 which applies to construction contracts. The new standard is based on the principle that income recognition takes place when control over a good or service is transferred to a customer – so the principle of control will replace the existing principle of risk and return.

The group is currently assessing the effects of IFRS 15.

There are no other standards or interpretations which are not currently in effect and would be expected to have a material effect on the company's financial statements.

### **Presentation currency**

The presentation currency is Norwegian kroner (NOK), which is also the company's functional currency. All figures are in NOK 1 000 unless otherwise stated.

### **Lending and losses on loans**

Loans with variable rates are measured at amortized cost in accordance with IAS 39. The amortized cost is the acquisition cost minus repayments on the principal, taking into account transaction costs, plus or minus cumulative amortization using the effective interest method, and less any amount for impairment in value or exposure to loss. The effective interest rate is the interest that exactly discounts estimated future cash receipts and payments over the expected life of the financial instrument.

### **Purchase of loans**

The company has concluded an agreement concerning the purchase of loans with good security and collateral in real estate from SpareBank 1 SR-Bank ASA. In accordance with the management agreement between the company and SpareBank 1 SR-Bank ASA, SpareBank 1 SR-Bank ASA will be responsible for the management of loans and maintaining customer contact. The company pays a fee for the services included in the management of the loans. This remuneration is in the form of a fixed commission per loan where interest and instalments are paid in accordance with the loan agreement.

SpareBank 1 SR-Bank ASA guarantees the legal status of the purchased loans at the time they are purchased. The company has assumed the risk and returns associated with the purchased loans and records these as loans to customers in the company's balance sheet.

### **Assessment of impairment of financial assets**

On each balance sheet date, the company assesses whether there is any objective evidence that the cash flow expected when the item was initially recorded will not be realized and that the value of the financial asset or group of financial assets has been reduced. An impairment in value of a financial asset assessed at amortized cost or group of financial assets assessed at amortized cost has been incurred if, and only if, there is objective evidence of impairment that could result in a reduction in future cash flows to service the commitment. The impairment must be the result of one or more events that have occurred after the initial recognition (a loss event) and it must be possible to measure the result of the loss event (or events) in a reliable manner. Objective evidence that the value of a financial asset or group of financial assets has been reduced includes observable data that is known to the company relating to the following loss events:

- The issuer or borrower is experiencing significant financial difficulties
- Breach of contract, such as a default or delinquency in payment of instalments and interest
- The company granting the borrower special terms for financial or legal reasons relating to borrower's financial situation
- Likelihood of the debtor entering into debt negotiations or other financial reorganization
- Disappearance of an active market for the financial asset because of financial difficulties
- Observable data indicating that there is a measurable decline in future cash flows from a group of financial assets since the initial recognition of those assets, even though the decline cannot yet be fully identified with the individual financial assets in the group including:
  - adverse changes in the payment status of the borrowers in the group
  - national or local economic conditions that correlate with defaults of the assets in the group

The company first considers whether there is individual objective evidence of impairment of financial assets that are significant individually. For financial assets that are not individually significant, the objective evidence of impairment is considered individually or collectively. If the company decides that there is no objective evidence of impairment of an individually assessed financial asset, significant or not, the asset is included in a portfolio of financial assets with the same credit risk characteristics.

The group is tested for any impairment on a portfolio basis. Assets that are assessed individually with respect to impairment, and where an impairment is identified or continues to be identified, are not included in a general assessment of impairment. See note 5.

If there is objective evidence that impairment has occurred, the amount of the loss is calculated as the difference between the asset's book (carrying) value and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's latest effective interest rate. The book value of the asset is reduced using an allowance account and the loss is recorded in the income statement.

Future cash flows from a group of financial assets that are tested for impairment on a portfolio basis are estimated on the basis of the contractual cash flows for the group and historical losses on assets with a similar credit risk. Historical losses are adjusted for existing observable data in order to take into account the effects of existing circumstances that were not present at the time of the historical losses and to adjust for the effect of earlier circumstances that do not exist today.

### **Non-performing and loss exposed commitments**

The total commitment to a customer is considered to be in default (non-performing) and included in the company's summaries of defaulted loans when an instalment or interest is not paid 90 days after due date, a line of credit is overdrawn for 90 days or more, or the customer is bankrupt. Loans and other commitments that are not in default, but where the customer's financial situation makes it likely that the company will incur a loss, are classified as loss exposed commitments.

### **Realized losses**

When it is highly probable that the losses are final, the losses are classified as realized losses. Realized losses that are covered by earlier specific loss provisions are recorded against the provisions. Realized losses without cover by way of impairment losses on loans and over or under coverage in relation to previous impairment losses on loans are recognized through profit or loss.

### **Reposessed assets**

As part of the handling of non-performing loans and guarantees, the company acquires, in some cases, assets that have been lodged as security for such commitments. At the time of takeover, the assets are valued at their assumed realization value and the value of the loan commitment is adjusted accordingly. Repossessed assets that are to be realized are classified as operations that will be sold, holdings or fixed assets held for sale and recorded in accordance with the relevant IFRS standards (normally IAS 16, IAS 38, IAS 39 or IFRS 5). This has not happened during 2016.

### **Securities**

Securities consists of certificates and bonds. These are either carried at fair value or held to maturity. All financial instruments that are classified at fair value with value change through profit or loss, are measured at fair value, and changes in the value from the opening balance are recorded as income from financial investments.

Certificates and bonds that are classified as held to maturity are measured at amortized cost using an effective interest rate method. See description of this method in the section on lending.

### **Derivatives and hedging**

Derivatives consist of currency and interest rate instruments. Derivatives are recognized at fair value through profit or loss.

The company uses derivatives for operational and accounting (funding) hedging purposes to minimize the interest rate risk in fixed rate instruments (fixed rate funding and fixed rate loans), bonds (assets and liabilities), and certificates (assets and liabilities). The efficiency of the hedging is assessed and documented both when the initial classification is made and on an ongoing basis. When fair value hedging is used the hedging instrument is recognized at fair value, but as far as the hedging object is concerned changes in fair value linked to the hedged risk are recognized in profit and loss.

## **Funding**

Funding is initially recorded at the cost at which it is raised, which is fair value of the proceeds received after deducting transaction costs. Loans raised with variable rates are thereafter measured at amortized cost, and any discount/premium is accrued over the term of the loan. Borrowing at fixed rates is subject to hedge accounting for the NIBOR/LIBOR component of the fixed rate.

## **Contingent liabilities**

Provisions are made for other uncertain liabilities if it is more probable than not that the liability will materialize and the financial consequences can be reliably calculated. Information is disclosed about contingent liabilities that do not satisfy the criteria for balance sheet recording if they are significant.

Provisions are made for restructuring costs when the company has a contractual or legal obligation, payment is probable and the amount can be estimated, and the size of the obligation can be estimated with sufficient reliability.

## **Subordinated loans**

Subordinated loans have a lower priority than all other debt. 50 % of the dated subordinated loans can be regarded as tier 1 capital in the capital ratio, whilst 100 % of perpetual subordinated loans can be included in tier 1 capital. Subordinated loans are classified as subordinated loan capital in the balance sheet and are measured at fair value with value change through profit or loss or amortized cost in the same way as other long-term borrowing. The company uses fair value hedging for measuring fixed-rate loans.

## **Dividends**

Dividends are recognized as equity in the period prior to being approved by the company's annual general meeting.

## **Interest income and interest costs**

Interest income and interest costs related to assets and liabilities that are measured at amortized cost are recorded continuously in the income statement in accordance with the effective interest rate method. The effective interest rate is the interest rate that results in the present value of the expected cash flow over the expected life of a financial asset or liability being equal to the book value (carrying value) of the respective financial asset or liability. When calculating an effective interest rate, the cash flow effect inherent in the agreement is estimated, without taking into account future impairment. The calculations take therefore into account inter alia fees, transaction costs, premiums and discounts.

If a financial asset is written down due to impairment, a new effective interest rate is calculated based on adjusted estimated cash flows.

## **Commissions and commission costs**

Commissions and commission costs are generally accrued in line with the delivery/receipt of a service. Fees in conjunction with interest-bearing instruments are not recorded as commissions, but are included in calculating the effective interest rate and recognized through profit or loss accordingly. Advisory/consultancy fees are accrued in accordance with the signed agreement, typically at the time the service is delivered.

The same applies to day-to-day management services. Fees and charges related to the sale or brokerage of financial instruments, properties or other investment objects that do not generate balance sheet items in the company's financial statements, are recognized when the transaction is completed.

## **Transactions and balance sheet items in foreign currency**

Transactions involving foreign currencies are converted into Norwegian kroner using the exchange rates at the time of the transactions. Gains and losses linked to executed transactions, or to the conversion of holdings of balance sheet items, in foreign currency are recognized on the balance sheet date. Gains and losses on non-monetary items are included in the income statement in the same way as the corresponding balance sheet item. The exchange rate on the balance sheet date is used when converting balance sheet items.

## **Taxes**

Taxes consist of payable tax and deferred tax. Payable tax is the estimated tax on the year's taxable profit.

Payable tax for the period is calculated according to the tax laws and regulations enacted or substantively enacted on the balance sheet date.

Deferred taxes are accounted for using the liability method in accordance with IAS 12. Deferred tax assets or liabilities are calculated based on all the temporary differences, which are the differences between the book values of assets and liabilities for accounting purposes and for taxation purposes. Nonetheless, no deferred tax liability or benefit is calculated on goodwill that does not provide tax-related deductions, or on initially recognized items that affect either the accounting or taxable result.

Deferred tax assets are calculated for tax loss carry forwards. Assets with deferred tax are included only to the extent that future taxable profits are expected to make it possible to exploit the related tax benefit.

## **The statement of cash flow**

The statement of cash flow shows cash flows grouped by source and application area. Cash is defined as cash, deposits in central banks, and deposits in financial institutions with no period of notice. The statement of cash flow is prepared using the direct method.

## **Segment reporting**

The company only has one segment, the retail segment. The segment consists of loans to retail customers and all loans are purchased from SpareBank 1 SR-Bank. The company's total comprehensive income thus represents the entire retail segment.

## **Events after the balance sheet date**

The financial statements are published after the board of directors has approved them. The supervisory board, the annual general meeting and the regulatory authorities may refuse to approve the published financial statements subsequent to this but they cannot change them.

Events that take place before the date on which the financial statements are approved for publication, and which affect conditions that were already known on the balance sheet date, will be incorporated into the pool of information that is used when making accounting estimates and are thereby fully reflected in the financial statements. Events that were not known on the balance sheet date will be reported if they are significant.

## ***Note 3 – Critical estimates and judgements concerning use of the accounting policies***

The preparation of financial information pursuant to IFRS entails the executive management using estimates, judgements and assumptions that affect the effect of the application of the accounting policies and thus the amounts recognised for assets, liabilities, income and costs.

### **Losses on loans and guarantees**

The company makes write-downs if there is objective evidence that can be identified for an individual commitment, and the objective evidence entails a reduction in future cash flows for servicing the commitment. Objective evidence may be default, bankruptcy, insolvency or other significant financial difficulties. Individual write-downs are calculated as the difference between the loan's book (carrying) value and the present value of future cash flows based on the effective interest rate at the time of the calculation of the initial individual write-down. Subsequent changes in interest rates are taken into account for loan agreements with variable rates if these changes affect the expected cash flow.

Collective write-downs are calculated on groups of loans where there is objective evidence indicating that a loss event has occurred after the initial recording of the loans. Objective evidence includes observable data that leads to a measurable

reduction in estimated future cash flows from the group of loans. The development of probability for default is one such objective evidence that is used to identify a possible need to make a write-down. Where a need to make collective write-downs has been identified, loan losses shall be calculated as the difference between the carrying value (book value) and the present value of the estimated future cash flows, discounted at the effective interest rate. The basis for calculating this difference (which corresponds to the level of the collective write-downs) is based on the loans' expected losses.

The assessment of individual and collective write-downs will always call for a considerable degree of discretionary judgement. Predictions based on historical data may prove to be incorrect because of the uncertainty of the relevance of historical data as a decision-making basis. When the value of assets pledged as collateral is linked to special objects or industrial sectors in a crisis, it may be necessary to realize the collateral in markets that are rather illiquid and, therefore, the assessment of collateral securities' values may be subject to considerable uncertainty.

### **Fair value of financial instruments**

The fair value of financial instruments that are not traded in an active market is determined using various evaluation techniques. The company uses methods and assumptions that, insofar as it is possible, are based on observable market data and reflect the market conditions on the balance sheet date. When evaluating financial instruments for which observable market data is not available, the company makes assumptions with regard to what it expects the market to use as a basis for evaluating equivalent financial instruments.



## Note 4 Capital adequacy

On 22 August 2014, the Ministry of Finance issued amendments to the capital requirements regulations that came into effect on 30 September 2014. The amendments were adjustments implemented to comply with the EU's new capital adequacy regulations for banks and securities undertakings (CRD IV/CRR) and entail the minimum requirement for common equity tier 1 capital ratio gradually increasing in the run up to 31 December 2017.

SR-Boligkreditt AS has permission from the Financial Supervisory Authority of Norway to use internal measurement methods (Internal Rating Based Approach) for quantifying credit risk. The use of IRB requires the company to comply with extensive requirements relating to organisation, expertise, risk models and risk management systems.

<b>NOK 1 000</b>	<b>31.12.16</b>	<b>31.12.15</b>
Share capital	2.025.000	1.275.000
Premium reserve	150	150
Other equity	85.561	28.710
<b>Total Common equity Tier 1 capital</b>	<b>2.110.711</b>	<b>1.303.860</b>
Intangible assets	-	-781
Deduction for proposed dividend	-84.000	-28.000
Deduction for expected losses on IRB, net of write-downs	-52.014	-16.784
Value of derivative liabilities at fair value	-883	-96
<b>Total Tier 1 capital</b>	<b>1.973.814</b>	<b>1.258.199</b>
<b>Net primary capital</b>	<b>1.973.814</b>	<b>1.258.199</b>
Credit risk	6.355.116	2.311.343
Operational risk	94.376	33.872
Transitional scheme	5.639.503	1.682.429
<b>Risk weighted balance</b>	<b>12.088.995</b>	<b>4.027.644</b>
Minimum requirement for common equity Tier 1 capital ratio 4,5 %	544.005	181.244
Buffer requirements:		
Capital conservation buffer 2,5 %	302.225	100.691
Systemic risk buffer 3 %	362.670	120.829
Countercyclical capital buffer 1,5 % <sup>1)</sup>	181.335	40.276
Total buffer requirement to common equity Tier 1 capital ratio	846.230	261.797
Available common equity Tier 1 capital ratio after buffer requirement	583.579	815.158
Capital ratio	16,33 %	31,24 %
Tier 1 capital ratio	16,33 %	31,24 %
Common equity Tier 1 capital ratio	16,33 %	31,24 %
Leverage Ratio	6,08 %	11,20 %

<sup>1)</sup> The countercyclical capital buffer 31.12.16 is 1,5 %. Comparable figure is 1 %.

## Note 5 – Risk management

SR-Boligkreditt AS is part of the SpareBank 1 SR-Bank Group (the "Group") and purchases home mortgages from SpareBank 1 SR-Bank ASA. This activity is primarily financed by issuing covered bonds. This means that the company is subject to the Norwegian legislation on covered bonds and the requirements this stipulates with regard to risk exposure. The company wishes to maintain an AAA/Aaa rating for covered bonds, which requires a heavy focus on risk management and low risk exposure.

The purpose of the risk and capital management in SR-Boligkreditt AS is to ensure satisfactory capital adequacy and prudent asset management in relation to the adopted business strategies and risk profile. These are ensured through an appropriate process for risk management and planning and monitoring the company's raising of capital and capital adequacy. The company's risk and capital management must comply with best practice. This is achieved by:

- A strong risk culture characterized by a high awareness of risk management
- A qualified control environment
- A good understanding of the material risks faced by the company

### Organisation and organisational structure

SR-Boligkreditt purchases corporate services from SpareBank 1 SR-Bank as further regulated in service level agreements entered into between the parties.

SR-Boligkreditt AS aims to maintain a strong, healthy organisational culture characterized by a high level of risk management awareness.

SR-Boligkreditt AS focuses on independence in management and control, and this responsibility is divided between the different roles in the organisation:

The board approves the general principles for risk management, including specifying risk profiles, limits and guidelines. The board is also responsible for ensuring that the company has adequate primary capital given the adopted risk profile and regulatory requirements.

The chief executive is responsible for the day-to-day management of the company's activities in accordance with the law, by-laws, powers of attorney and instructions. Matters that are unusual in nature or of material importance to the company must be submitted to the board. The chief executive may, however, decide a matter with the authorization of the board. The chief executive shall implement the company's strategy and develop the strategy further in partnership with the board.

The Group risk manager reports directly to both the chief executive and the board. The risk manager is responsible for the ongoing development of the framework for risk management, including risk models and risk management systems. The post is also responsible for independently monitoring and reporting risk exposure and for ensuring the company complies with current laws and regulations. The chief executive has been delegated the necessary authority by the board to make decisions concerning lines of credit for counterparties and for individual commercial papers.

### Financial risk management

The core purpose of the banking industry is to create value by assuming deliberate and acceptable risk. The Group therefore invests significant resources in the further development of risk management systems and processes in line with leading international practice. SR-Boligkreditt AS is exposed to various types of risk:

- Credit risk: the risk of loss resulting from the customer's inability or unwillingness to fulfil his obligations
- Liquidity risk: is the risk that the Company is unable to refinance at maturity, or unable to fund increases in assets.
- Market risk: the risk of loss due to changes in observable market variables such as interest rates, foreign exchange rates and securities markets
- Operational risk: the risk of losses due to weak or inadequate internal processes or systems, human error or external incidents

- Compliance risk: the risk of incurring public sanctions/penalties or financial loss as a result of a failure to comply with legislation and regulations
- Business risk: the risk of unexpected income and cost variations due to changes in external factors such as market conditions or government regulations
- Reputation risk: the risk of a failure in earnings and access to capital because of lack of trust and reputation in the market, i.e. customers, counterparties, stock market and authorities
- Strategic risk: the risk of losses resulting from the wrong strategic decisions
- Concentration risk: the risk of an accumulation of exposure to an individual customer, sector or geographical area arising. Sectoral concentration risk is exposure that can arise across different types of risk or business areas in the company's, e.g. due to common underlying risk drivers such as the price of oil.

## Risk exposure

SR-Boligkreditt AS is exposed to various types of risk and the most important risk groups are described below:

SR-Boligkreditt AS is exposed to credit risk. The company only provides credit to the private market and the credit policy stipulates criteria such as first priority loans only and a maximum LTV of 75%. The credit risk is considered to be low.

Liquidity risk is managed via the company's general liquidity strategy, which is reviewed and adopted by the board at least once a year. Liquidity management is based on conservative limits and reflects the company's moderate risk profile. The Group's treasury department is responsible for liquidity management, while the Group's risk management and compliance department monitors and reports on the utilization of limits in accordance with the liquidity strategy. The company's lending is mainly funded by long-term security debt. Liquidity risk is minimized by diversifying the securities issued in terms of markets, funding sources, instruments and maturity periods.

Market risk is managed through the market risk strategy, which defines the company's willingness to assume risk. The strategy and the associated specification of the necessary risk ceilings, reporting procedures and authorities are reviewed and adopted by the board at least once a year. The market risk in SR-Boligkreditt AS primarily relates to the company's long-term investments in securities. The company's market risk is measured and monitored on the basis of conservative limits that are renewed and approved by the board at least once a year. The size of the limits is determined on the basis of stress tests and analyses of negative market movements. The company's exposure to market risk is low.

Interest rate risk is the risk of losses incurred due to changes in interest rates. The company's interest rate risk is regulated by limits for maximum value change following a change in the interest rate level of 1%. The interest rate commitments for the company's instruments are mostly short-term and the company's interest rate risk is low.

Currency rate risk is the risk of losses due to fluctuations in foreign exchange rates. The company measures currency risk on the basis of net positions in the different currencies in which the company has exposure. Currency risk is regulated by nominal limits for maximum aggregate currency positions and maximum positions within individual currencies. The scope of the company's trading in foreign currency is modest and the currency rate risk is considered to be low.

Price risk is the risk of losses that arise following changes in the value of the company's commercial paper, bonds and equity instruments. Spread risk is defined as the risk of changes in the market value of bonds as a result of general changes in the credit spreads. In other words, credit spread risk expresses the potential loss in the bond portfolios beyond the bankruptcy risk. Quantification of the risk-adjusted capital for spread risk in the bond portfolios is calculated based on the Financial Supervisory Authority of Norway's model for risk-based supervision of market risk in insurance companies. The company's risk exposure to this type of risk is regulated through limits for maximum investments in the different portfolios.

Operational risk is managed via the risk strategy, which is set annually. According to this strategy, the company will maintain a low risk profile. This will be achieved through a very good corporate risk culture, continuously learning from adverse events, and developing leading methods for identifying, quantifying and balancing risk based on a cost/benefit assessment. This requires the company to strive for a good balance between trust and control that ensures efficiency is safeguarded, at the same time as ensuring it is not exposed to unnecessary risk.

Compliance risk is managed via the framework regulations for compliance that are primarily based on EBA Internal Governance GL44, Basel Committee on Banking Supervision, 'Compliance and the compliance function in banks', ESMA 'Guidelines on certain aspects of the MiFID compliance function requirements ESMA/2012/388', and the Financial Supervisory Authority of Norway's 'Module for evaluating overriding management and control'. The Group's compliance policy is intended to ensure that the company does not incur any public sanctions/penalties, or any financial loss, due to a failure to implement or comply with legislation and regulations. The Group's compliance policy is adopted by the board and describes the main principles for responsibility and organisation. SR-Boligkreditt AS stresses the importance of good processes to ensure compliance with the current laws and regulations. Focus areas are continuous monitoring of compliance with the current regulations and ensuring that the company has adapted to future regulatory changes as best as it can. SR-Boligkreditt AS's compliance function is performed by the Group's risk management and compliance department, which is organized independently of the business units. The department bears overall responsibility for the framework, monitoring and reporting within the area.

## Note 6 Lending to Customers

Lending to customers are residential mortgages only. The mortgages generally have a low loan-to-value and losses have been very low. The total amount of lending to customers at the end of the period were NOK 29.361 million. All mortgages carry a variable interest rate.

NOK 1 000	31.12.16	31.12.15
Flexible loans - retail market	6.751.694	896.941
Amortising loans - retail market	22.583.602	9.042.466
Accrued interest	25.381	10.773
<b>Total loans before specified and unspecified loss provisions</b>	<b>29.360.677</b>	<b>9.950.180</b>
Individual impairments	0	0
Impairments on groups of loans	-2.774	-493
<b>Total net loans and claims with customers</b>	<b>29.357.902</b>	<b>9.949.687</b>
<b>Liability</b>		
Unused balances under customer revolving credit lines (flexible loans)	2.094.205	220.634
<b>Total</b>	<b>2.094.205</b>	<b>220.634</b>
<b>Defaulted loans</b>		
Defaults*	0 %	0 %
Specified loan loss provisions	0 %	0 %
<b>Net defaulted loans</b>	<b>0 %</b>	<b>0 %</b>
<b>Loans at risk for loss</b>		
Loan not defaulted but at risk of loss	0 %	0 %
- Write downs on loans at risk of loss	0 %	0 %
<b>Net other loans at risk of loss</b>	<b>0 %</b>	<b>0 %</b>
*The entire customer loan balance is considered to be in default and will be included in overviews of defaulted loans when overdue instalments and interest payments are not received within 90 days or if credit limits on revolving loans are exceeded for 90 days or more		
<b>Changes to loan loss provisions</b>	<b>31.12.16</b>	<b>31.12.15</b>
Loan loss provisions starting balance	493	-
Change in group loan loss provisions	2.281	493
<b>Loan loss provisions ending balance</b>	<b>2.774</b>	<b>493</b>
<b>Gross loans by geographic area</b>	<b>31.12.16</b>	<b>31.12.15</b>
Rogaland	22.519.920	7.702.475
Agder counties	2.738.269	911.390
Hordaland	3.245.020	1.062.315
International	2.159	724
Other	829.927	262.504
<b>Total</b>	<b>29.335.295</b>	<b>9.939.408</b>

## Note 7 Non-performing and impaired loans

NOK 1 000	31.12.16	31.12.15
<b>Non-performing loans and advances</b>		
Gross non-performing loans above 90 days	4.894	0
Provisions for Individual impairment losses	0	0
<b>Net non-performing loans and advances</b>	<b>4.894</b>	<b>0</b>
<b>Loan loss provision ratio</b>	<b>0 %</b>	<b>0 %</b>
<b>Other problem commitments</b>		
Problem commitments	0	0
Provisions for Individual impairment losses	0	0
<b>Collective impairment loss provisions</b>	<b>2.774</b>	<b>493</b>
<b>Net other problem commitments</b>	<b>0</b>	<b>0</b>
<b>Loan loss provision ratio</b>	<b>0 %</b>	<b>0 %</b>

## Note 8 Credit risk exposure for each internal risk class

NOK 1 000	Average unsecured exposure <sup>2)</sup>	Total commitment	Average unsecured exposure <sup>2)</sup>	Total commitment
	2016		2015	
<b>PD in %<sup>1)</sup></b>				
0,00 - 0,50	5,2 %	26.329.920	3,4 %	8.419.184
0,50 - 2,50	8,2 %	4.601.113	4,8 %	1.591.302
2,50 - 10,00	8,2 %	367.636	6,5 %	114.893
10,00 - 99,9	6,9 %	148.310	3,0 %	45.435
Non-performance and written down	2,2 %	7.903	0,0 %	-
<b>Total</b>	<b>5,7 %</b>	<b>31.454.882</b>	<b>3,7 %</b>	<b>10.170.814</b>

<sup>1)</sup> PD = Probability of Default

<sup>2)</sup> Average unsecured exposure is the difference between the exposure at default (EAD) and the risk adjusted value of the property.

	LTV in Percentage of total commitment <sup>3)</sup>	LTV in Percentage of total commitment <sup>3)</sup>
	2016	2015
LTV 0-70	71,9 %	82,9 %
LTV 70-85	25,7 %	14,6 %
LTV 85-100	2,0 %	1,7 %
LTV >100	0,4 %	0,8 %
	100,0 %	100,0 %

<sup>3)</sup> LTV= Loan-to-value, the ratio of the loan as a percentage of the appraised value of the property.

## Note 9 Maximum credit risk exposure

Maximum exposure to credit risk for balance sheet components, including derivatives  
Exposure is shown gross before assets pledged as security and permitted offsetting.

NOK 1000	2016	2015
<b>Assets</b>		
Receivables from the central bank	-	-
Loans to and receivables from financial institutions	552.748	706.494
Loans to and receivables from customers	29.360.677	9.950.180
Certificates and bonds	49.967	-
Derivatives	171.271	96.103
<b>Total credit risk exposure balance sheet items</b>	<b>30.134.663</b>	<b>10.752.777</b>
<b>Financial guarantees and loan commitments</b>		
Unused credit lines	2.094.205	220.634
Loan commitments	-	-
<b>Total financial guarantees and loan commitments</b>	<b>2.094.205</b>	<b>220.634</b>
<b>Total credit risk exposure</b>	<b>32.228.868</b>	<b>10.973.411</b>
<b>Banking operations</b>	<b>2016</b>	<b>2015</b>
Rogaland	24.699.818	8.588.295
Agder counties	2.936.119	932.609
Hordaland	3.479.485	1.087.047
International	2.315	741
Other	889.892	268.616
<b>Total banking operations</b>	<b>32.007.630</b>	<b>10.877.308</b>
Certificates and bonds	49.967	-
Derivatives	171.271	96.103
<b>Total by geographic area</b>	<b>32.228.868</b>	<b>10.973.411</b>

## Note 10 Credit quality per class of financial asset

The company manages the credit quality of financial assets in accordance with its internal credit rating guidelines. The table shows the credit quality per class of asset for loan-related assets in the balance sheet, based on the customer's probability of default (PD).

2016 NOK 1 000	0,00 - 0,50 %	0,50 - 2,50 %	2,50 - 10,0 %	10,0 - 99,9%	Commitments in default	Total
<b>Loans</b>						
Loans to and receivables from financial institutions	552.748	-	-	-	-	552.748
Loans to and receivables from customers						
- Retail market	24.343.560	4.593.427	367.611	151.185	4.894	29.360.677
- Corporate market	-	-	-	-	-	-
- Unallocated	-	-	-	-	-	-
<b>Total loans</b>	<b>24.896.308</b>	<b>4.593.427</b>	<b>367.611</b>	<b>151.185</b>	<b>4.894</b>	<b>29.913.425</b>

2015 NOK 1 000	0,00 - 0,50 %	0,50 - 2,50 %	2,50 - 10,0 %	10,0 - 99,9%	Commitments in default	Total
<b>Loans</b>						
Loans to and receivables from financial institutions	706.494	-	-	-	-	706.494
Loans to and receivables from customers						
- Retail market	8.199.797	1.590.330	111.776	48.283	-	9.950.186
- Corporate market	-	-	-	-	-	-
- Unallocated	-	-	-	-	-	-
<b>Total loans</b>	<b>8.906.291</b>	<b>1.590.330</b>	<b>111.776</b>	<b>48.283</b>	<b>-</b>	<b>10.656.680</b>

## Note 11 Market risk related to interest rate risk

The table shows the effect on earnings of a positive parallel shift in the yield curve of one percentage point at the end last year, before tax, if all financial instruments were measured at fair value.

NOK 1 000	2016	2015
Other loans and deposits	-28.105	-9.936
Securities issued	40.141	19.681
Other	-86	-
<b>Total interest rate risk</b>	<b>11.950</b>	<b>9.745</b>
Maturity bonds		
0 - 3 months	11.950	9.745
<b>Total interest rate risk</b>	<b>11.950</b>	<b>9.745</b>
Currency		
NOK	11.950	9.745
EUR	-	-
<b>Total interest rate risks</b>	<b>11.950</b>	<b>9.745</b>

Interest rate risk arises because the company's assets and liabilities may be subject to different fixed rate periods. Interest rate instrument trading must at all times comply with the adopted limits and authorities. The company's limits define quantitative targets for the maximum potential loss.

The company shall not have a net interest rate exposure (exposure assets - exposure debt) in excess of 3 % of total capital. The potential for gain / loss is calculated from a parallel shift of the yield curve by 1 percentage point



## Note 12 Market risk related to currency risk

The table shows the net foreign currency exposure including financial derivatives as at 31 December as defined by the Capital Requirements Regulations.

NOK 1000	2016	2015
<b>Currency</b>		
EUR	-	-
Other	-	-
<b>Total</b>	-	-

Currency risk arises when differences exist between the company's assets and liabilities in the individual currency. Currency trading must at all times comply with the adopted limits and authorities.

The company's limits define quantitative targets for the maximum net exposure in currency, measured in NOK.

Maximum aggregate currency position shall not exceed 3% of total capital.

## Note 13 Liquidity risk

The tables shows cash flows including contractual interest maturity. Also see note 5 Risk Management for information about liquidity risk management.

2016 NOK 1 000	On demand	Less than 3 months	3-12 months	1 - 5 years	More than 5 years	Total
Debt to financial institutions						-
Securities issued	-	-71.553	-226.987	-22.043.323	-5.862.320	-28.204.183
<b>Total liabilities</b>	-	<b>-71.553</b>	<b>-226.987</b>	<b>-22.043.323</b>	<b>-5.862.320</b>	<b>-28.204.183</b>

Derivatives						
Contractual cash outflow	-	-55.795	-251.098	-12.899.625	-5.229.318	-18.435.836
Contractual cash inflow	-	671	54.252	11.660.390	4.882.324	16.597.637

2015 NOK 1 000	On demand	Less than 3 months	3-12 months	1 - 5 years	More than 5 years	Total
Debt to financial institutions						-
Securities issued	-	-15.447	-70.695	-9.643.476	-	-9.729.618
<b>Total liabilities</b>	-	<b>-15.447</b>	<b>-70.695</b>	<b>-9.643.476</b>	-	<b>-9.729.618</b>

Derivatives						
Contractual cash outflow	-	-23.783	-70.831	-9.894.357	-	-9.988.971
Contractual cash inflow	-	1.718	29.132	9.727.244	-	9.758.094

## Note 14 Net interest income

NOK 1000	2016			2015		
	Total	Measured at amortised cost	Measured at fair value	Total	Measured at amortised cost	Measured at fair value
<b>Interest income</b>						
Interest on receivables from financial institutions	5.909	5.909	-	3.736	3.736	-
Interest on lending to customers	502.410	502.410	-	121.013	121.013	-
Interest on certificates and bonds	-	-	-	-	-	-
Interest on written down loans	-	-	-	-	-	-
<b>Total interest income</b>	<b>508.319</b>	<b>508.319</b>	<b>-</b>	<b>124.749</b>	<b>124.749</b>	<b>-</b>
<b>Interest costs</b>						
Interest on debts to financial institutions	21.474	21.474	-	11.465	11.465	-
Interest on securities issued	317.532	137.458	180.074	62.950	48.567	14.383
<b>Total interest costs</b>	<b>339.006</b>	<b>158.932</b>	<b>180.074</b>	<b>74.415</b>	<b>60.032</b>	<b>14.383</b>
<b>Net interest income</b>	<b>169.313</b>	<b>349.387</b>	<b>-180.074</b>	<b>50.334</b>	<b>64.717</b>	<b>-14.383</b>

## Note 15 Net income from financial instruments

NOK 1 000	2016	2015
Net gains for bonds and certificates	23	0
Net change in value, basis swap spread	-27.386	2.998
Net change in value, other financial investments	-6.042	-4.602
Net gain currency	3	-59
<b>Net income from financial instruments</b>	<b>-33.402</b>	<b>-1.664</b>

## Note 16 Other operating costs

NOK 1 000	2016	2015
IT costs	216	329
Other administrative costs	1.269	4.434
Depreciation (note 20)	293	99
External fees	3.765	4.032
Other operative costs	-	-
<b>Total operating costs</b>	<b>5.543</b>	<b>8.894</b>
<b>Fees for external auditor - specification of audit fees</b>		
Statutory audit	310	125
Tax advice <sup>1)</sup>	-	-
Other certification services	515	216
Other non-auditing services <sup>1)</sup>	40	51
<b>Total</b>	<b>865</b>	<b>392</b>

<sup>1)</sup> Fees to the law firm PricewaterhouseCoopers included in tax advice and other non-auditing services

All figures include VAT

## Note 17 Tax

NOK 1 000	2016	2015
Pre-tax profit	113.134	39.282
Permanent differences	-	-
Group contribution	-	-
Change in temporary differences	49.458	-1.716
<b>Tax base/ taxable income for the year</b>	<b>162.592</b>	<b>37.566</b>
Of which payable tax 25 % (27 %)	40.648	10.143
Tax effect of group contribution	-	-
Change in deferred tax	-12.364	429
<b>Total tax cost</b>	<b>28.284</b>	<b>10.572</b>
Deferred tax asset		
- deferred tax asset that reverses in more than 12 months	-11.935	-
- deferred tax asset that reverses within 12 months	-	-
<b>Total deferred tax asset</b>	<b>-11.935</b>	<b>-</b>
Deferred tax		
- deferred tax that reverses in more than 12 months	-	429
- deferred tax that reverses within 12 months	-	-
<b>Total deferred tax</b>	<b>-</b>	<b>429</b>
<b>Net deferred tax/ deferred tax asset</b>	<b>-11.935</b>	<b>429</b>
<b>Specification of temporary differences</b>		
Differences related to financial items	-47.742	1.716
Group contribution paid	-	-
Losses carried forward	-	-
<b>Total temporary differences</b>	<b>-47.742</b>	<b>1.716</b>
Tax rate applied	25 %	27 %
Tax rate applied for temporary differences	25 %	25 %

## Note 18 Classification of financial instruments

2016	NOK 1 000	Financial instruments at fair value through profit or loss	Financial assets and liabilities assessed at amortised cost and accrued interest	Total
		Financial derivatives as hedging instruments		
<b>Assets</b>				
Loans to and receivables from financial institutions		-	552.748	552.748
Loans to customers <sup>1)</sup>		-	29.357.902	29.357.902
Certificates and bonds at fair value		49.967	-	49.967
Financial derivatives		171.271	-	171.271
Other assets		-	-	-
<b>Total assets</b>		<b>221.238</b>	<b>29.910.650</b>	<b>30.131.888</b>
<b>Liabilities</b>				
Debt to financial institutions		-	-	-
Securities issued <sup>2)</sup>		-	27.272.136	27.272.136
Financial derivatives		717.386	-	717.386
Other liabilities		-	-	-
<b>Total liabilities</b>		<b>717.386</b>	<b>27.272.136</b>	<b>27.989.522</b>
<b>2015</b>				
<b>Assets</b>				
Loans to and receivables from financial institutions		-	706.494	706.494
Loans to customers <sup>1)</sup>		-	9.949.687	9.949.687
Certificates and bonds at fair value		-	-	-
Financial derivatives		96.103	-	96.103
Other assets		-	-	-
<b>Total assets</b>		<b>96.103</b>	<b>10.656.181</b>	<b>10.752.284</b>
<b>Liabilities</b>				
Debt to financial institutions		-	-	-
Securities issued <sup>2)</sup>		-	9.438.553	9.438.553
Financial derivatives		-	-	-
Other liabilities		-	-	-
<b>Total liabilities</b>		<b>-</b>	<b>9.438.553</b>	<b>9.438.553</b>

1) Fair value of loans to customers approximates book value due to the floating interest rate

2) Securities issued and subordinated loan capital contain secured debt.

### Information about fair value

The table below shows financial instruments at fair value according to their valuation method. The different levels are defined as follows:

Listed price in an active market for an identical asset or liability (level 1).

Valuation based on observable factors other than listed price (used in level 1) either direct (price) or indirect (deduced from prices) for the asset or liability 2 (level 2).

Valuation based on factors not obtained from observable markets (non-observable assumptions) (level 3).

2016	Valuation according to prices in an active market	Valuation according to observable market data	Valuation according to factors other than observable market data	Total
<b>Assets</b>				
Certificates and bonds at fair value	-	49.967	-	49.967
Financial derivatives	-	171.271	-	171.271
<b>Liabilities</b>				
Financial derivatives	-	717.386	-	717.386
<b>2015</b>				
<b>Assets</b>				
Certificates and bonds at fair value	-	-	-	-
Financial derivatives	-	96.103	-	96.103
<b>Liabilities</b>				
Financial derivatives	-	-	-	-

## Note 19 Financial derivatives

At fair value through profit and loss NOK 1 000	Contract amount 31.12.16	Fair value at 31.12.16		Contract amount 31.12.15	Fair value at 31.12.15	
		Assets	Liabilities		Assets	Liabilities
<b>Hedging / Interest and exchange rate instruments</b>						
Interest rate swaps (including cross currency)	33.872.051	133.705	699.086	9.624.000	90.817	-
<b>Total hedging / Interest and exchange rate instruments</b>	<b>33.872.051</b>	<b>133.705</b>	<b>699.086</b>	<b>9.624.000</b>	<b>90.817</b>	<b>-</b>
<b>Total currency and interest rate instruments</b>						
Total interest and exchange rate instruments	33.872.051	133.705	699.086	9.624.000	90.817	-
Total accrued interests	0	37.566	18.300	-	5.286	-
<b>Total financial derivatives</b>	<b>33.872.051</b>	<b>171.271</b>	<b>717.386</b>	<b>9.624.000</b>	<b>96.103</b>	<b>-</b>

SR-Boligkreditt AS has an ISDA agreement with a CSA supplement with the counterparty for derivatives. The agreement is one-way, which means only the counterparty has to pledge security when the market value of derivatives fluctuates.

## Note 20 Other assets

NOK 1 000	2016	2015
Tangible fixed assets*	489	781
Other assets	-	40
<b>Total other assets</b>	<b>489</b>	<b>821</b>
* Tangible fixed assets:		
Acquisition cost 1. Jan	880	-
Additions	-	880
Disposals	-	-
<b>Acquisition cost 31. Dec</b>	<b>880</b>	<b>880</b>
Accumulated depreciation and write-downs 1. Jan	99	-
Year's disposals	292	-
Year's depreciation and write downs	-	99
<b>Accumulated depreciation and write-downs 31. Dec</b>	<b>391</b>	<b>99</b>
<b>Carrying amount 31. Dec</b>	<b>489</b>	<b>781</b>
Financial lifespan	3 years	3 years
Depreciation schedule	linear	linear

## Note 21 Debt securities issued

NOK 1 000	Carrying amount	
	31.12.16	31.12.15
Covered bonds	27.209.665	9.429.274
Accrued interests	62.471	9.279
<b>Total debt securities issued</b>	<b>27.272.136</b>	<b>9.438.553</b>

Change in debt raised through issuance of securities	Nominal amount	
	31.12.16	31.12.15
Covered bonds	18.419.791	9.337.400
<b>Total debt raised through issuance of securities</b>	<b>18.419.791</b>	<b>9.337.400</b>

\* The nominal amount is the principal at the exchange rate when the new loan is raised (EUR/NOK)

Debt securities issued by maturity date (principal)

Public covered bonds	Nominal amount	
	31.12.16	31.12.15
2017	60.000	2.500.000
2018	-	-
2019	5.000.000	-
2020	9.737.400	6.837.400
2021	6.968.775	-
2022	-	-
2023	4.819.050	-
2031	90.918	-
2032	900.000	-
2041	181.048	-
<b>Sum</b>	<b>27.757.191</b>	<b>9.337.400</b>

Liabilities by currency (book value at end of quarter)

NOK	10.906.062	4.600.521
EUR	16.366.075	4.838.032
<b>Sum</b>	<b>27.272.136</b>	<b>9.438.553</b>

## Note 22 Asset coverage

The asset coverage is calculated according to the Financial Services Act, section 2-31. There is a discrepancy between the balance sheet amounts, partly because lending will be reduced due to non-performing loans and loans subject to a change in the loan-to-collateral value ratio in excess of 75%. Market values for all elements in asset coverage are also used.

NOK 1 000	31.12.16	31.12.15
Covered bonds	27.989.523	9.438.553
<b>Total covered bonds</b>	<b>27.989.523</b>	<b>9.438.553</b>
Loans to customers	29.134.271	9.873.033
Substitute collateral	773.986	802.597
<b>Total cover pool</b>	<b>29.908.257</b>	<b>10.675.630</b>
<b>Asset coverage</b>	<b>106,9 %</b>	<b>113,1 %</b>

## Note 23 Other liabilities

NOK 1 000	31.12.16	31.12.15
Taxes payable	40.648	10.143
Deferred taxes	-	429
Accounts payable	2	40
Accrued expenses and prepaid revenue	3.430	79
<b>Total other liabilities</b>	<b>44.080</b>	<b>10.691</b>

## Note 24 Material transactions with related parties

SR-Boligkreditt AS uses SpareBank 1 SR-Bank ASA, the parent, as counterparty for a large number of banking transactions including loans, deposits and financial derivatives. All transactions are carried out at market terms and are regulated in the "Transfer and Servicing agreement" and service level agreements. The Transfer and Servicing agreement regulates the transfer of loan portfolios qualifying as collateral for the issue of covered bonds, while the servicing level agreements regulates purchase of services, including bank production, distribution, customer contact, IT-operations and financial and liquidity management.

The most important transactions with SpareBank1 SR-Bank ASA

2016 NOK 1 000	Deposits in SR-Bank	Financial derivatives	Covered bonds	Interest income	Interest costs	Operating costs	Management fee
SpareBank1 SR-Bank ASA	552.748	-521.727	1.057.388	5.909	43.484	1.229	14.952
<b>Total</b>	<b>552.748</b>	<b>-521.727</b>	<b>1.057.388</b>	<b>5.909</b>	<b>43.484</b>	<b>1.229</b>	<b>14.952</b>

  

2015 NOK 1 000	Deposits in SR-Bank	Financial derivatives	Covered bonds	Interest income	Interest costs	Operating costs	Management fee
SpareBank1 SR-Bank ASA	706.494	96.103	797.172	3.736	17.445	1.492	2.941
<b>Total</b>	<b>706.494</b>	<b>96.103</b>	<b>797.172</b>	<b>3.736</b>	<b>17.445</b>	<b>1.492</b>	<b>2.941</b>

## Note 25 Share Capital

The share capital consists of 2 025 000 shares each with a nominal value of NOK 1 000. All shares and voting rights of the company are owned by SpareBank1 SR-Bank ASA. SR-Boligkreditt AS is included in the consolidated financial statements of SpareBank1 SR-Bank ASA, the consolidated financial statement is available on [www.sr-bank.no](http://www.sr-bank.no).

NOK 1 000	2016	2015
Total number of shares 1 January ( 17 March 2015)	1.275.000	150.000
Issue of new shares	750.000	1.125.000
<b>Total number of shares 31 December</b>	<b>2.025.000</b>	<b>1.275.000</b>

## Note 26 IFRS 9 Financial Instruments

IFRS 9 Financial Instruments will replace the current IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 deals with the recognition, classification, measurement, and derecognition of financial assets and obligations, as well as hedge accounting. IFRS 9 will apply from 1 January 2018 and has been approved by the EU. The standard may be applied early. SR-Boligkreditt AS will not avail itself of this option. Nor will SR-Boligkreditt AS show comparable figures for earlier periods upon implementation of the standard on 1 January 2018.

In 2015, the SpareBank 1 Alliance put together a multidisciplinary implementation team with participants from all of the banks that use IFRS. This will prepare for the implementation of IFRS 9 ("the Project"). The Project is a steering group with the following sub-groups:

1. Models and methods  
Development of calculation solutions and models for establishing unbiased forward-looking estimates of expected losses
2. Strategy, organisation and processes  
Defining how the organisation of the ongoing work of accounting in accordance with IFRS 9 will be organised between the cooperating banks
3. Accounts and reporting  
Concretising the actual accounting and notes, including policy notes and note templates
4. Classification and measurement  
Analysing the group's financial instruments and classifying instruments in various categories

A description of the new requirements in IFRS 9 and changes from the earlier standard is provided below, as is a description of the choices SR-Boligkreditt AS has made and the status of the implementation project.

### Classification and measurement

#### Financial assets

According to IFRS 9, financial assets must be classified into three measurement categories: fair value with value changes through profit or loss, fair value with value changes through other comprehensive income (OCI) and amortised cost. The measurement category must be determined upon initial recognition of the asset. In relation to financial assets, a distinction is made between debt instruments and equity instruments. Financial assets are classified on the basis of the contractual terms and conditions for the financial assets and the business model used to manage the portfolio of which the assets are a part.

#### Financial assets that are debt instruments

Debt instruments with contractual cash flows that are only payments of interest and the principal on given dates and that are held in a business model for the purpose of receiving contractual cash flows should initially be measured at amortised cost.



Instruments with contractual cash flows that are only payments of interest and the principal on given dates and that are held in a business model for the purpose of receiving contractual cash flows and sales, should initially be measured at fair value with value changes through OCI, with interest income, currency translation effects, and any impairments presented in the ordinary income statement. Value changes recognised through OCI must be reclassified to the income statement upon the sale or other disposal of the assets.

Other debt instruments must be measured at fair value with value changes through profit or loss. This applies to instruments with cash flows that are not only payments of normal interest (time value of money, credit spread and other normal margins linked to loans and receivables) and the principal, and instruments that are held in a business model in which the main purpose is not the reception of contractual cash flows.

The provisional assessment is that the designation of financial instruments at fair value will be of about the same scope as today.

### **Derivatives and investments in equity instruments**

All derivatives must be measured at fair value with value changes through profit or loss, however derivatives that are designated hedge instruments must be recognised in line with hedge accounting principles. Investments in equity instruments must be measured on the balance sheet at fair value. Value changes shall as a rule be recognised in the ordinary income statement, but an equity instrument that is not held for trading purposes and that is not a conditional consideration following a business transfer may be designated as measured at fair value with value changes through OCI. When equity instruments are designated at fair value with value changes through OCI, ordinary dividends must be recognised as income, while value changes should not be posted to the income statement on either an ongoing basis or in the event of disposal.

### **Financial liabilities**

The rules on financial liabilities are generally the same as those in today's IAS 39. As a general rule, financial liabilities should still be measured at amortised cost with the exception of financial derivatives measured at fair value, financial instruments included in a trading portfolio, and financial liabilities it has been decided to recognise at fair value with value changes through profit or loss.

### **Hedge accounting**

IFRS 9 simplifies the requirement for hedge accounting in that the hedging effect is tied more closely to the management's risk management and provides greater room for judgement. The requirement for hedge effectiveness of 80-125% has been eliminated and replaced with a more qualitative requirement, including the fact that there should be a financial connection between the hedging instrument and hedged item, and that the credit risk should not dominate the value changes of the hedging instrument. According to IFRS 9, a prospective (forward-looking) effectiveness test is sufficient, while hedge effectiveness pursuant to IAS 39 must be assessed both prospectively and retrospectively (backwards-looking). Hedging documentation is still required. SR-Boligkreditt AS is still assessing the scope of the use of hedge accounting, but the provisional assessment is that hedge accounting of about the scope as today will be continued.

### **Impairment losses on loans**

According to the current rules under IAS 39, impairment losses must only be made when objective evidence exists that a loss event has happened after initial recognition. According to IFRS 9 though, impairment losses must be recognised based on expected credit losses (ECL). The measurement of the provisions for expected losses depends on whether or not the credit risk has increased significantly since initial capitalisation. Upon initial capitalisation and when the credit risk has not increased significantly after initial capitalisation, provisions must be made for 12 months' expected losses. If the credit risk has risen significantly, provisions must be made for expected losses over the entire lifetime. The method in the IFRS 9 standard entails somewhat greater volatility in impairments and it is expected that impairments will be made earlier than is the case with the current practice. This will be especially noticeable at the start of an economic downturn.

## **More detailed description of the future impairment model of SR-Boligkreditt AS**

An estimate of losses will be made each quarter based on data in the data warehouse, which contains a history of account and customer data for the entire credit portfolio. The loss estimates will be calculated on the basis of the 12-month and lifelong probability of default (PD), loss given default (LGD) and exposure at default (EAD). The data warehouse contains a history of observed PD and observed LGD. This will provide the basis for producing good estimates of future values for PD and LGD. In line with IFRS 9, the company groups its loans into three stages.

### **Stage 1:**

This is the starting point for all financial assets covered by the general loss model. All assets that do not have a significantly higher credit risk than they did upon initial recognition will have a loss provision equal to 12 months' expected losses. This category will contain all assets that have not been transferred to stages 2 or 3.

### **Stage 2:**

In stage 2 the loss model is assets that have seen a significant rise in credit risk since initial recognition, but that do not have objective evidence of a loss event. For these assets the loss provision must cover expected losses over the lifetime. This group contains accounts with a significant degree of credit deterioration, but which on the balance sheet data belong to customers that are classified as healthy. As far as the demarcation with stage 1 is concerned, the company bases its definition of a significant degree of credit deterioration on the extent to which the commitment's calculated probability of default (PD) has increased significantly.

### **Stage 3:**

In stage 3 the loss model is assets that have seen a significant rise in credit risk since being granted and where there is objective evidence of a loss event on the balance sheet date. For these assets the loss provision must cover expected losses over the lifetime. These are assets that are defined under the current regulations as non-performing and impaired.

## **Further development of the model**

The impairment model is still under development. The company is assessing forward-looking information like macroeconomic factors such as unemployment, GDP growth, interest rates and house prices, and economic forecasts in order to provide forward-looking information that is as correct as possible. The model will calculate impairments based on data at the end of the month.

## **Effect on financial reporting**

Any implementation effects will be recognised against equity upon the switch to IFRS 9 on 1 January 2018. The provisional review of the future disclosure requirements indicates there will be some changes in disclosure requirements relating to impairment losses, but little effect in relation to notes for financial instruments.

## **Quantitative effects of implementing IFRS 9**

Based on a preliminary review, the transition to IFRS 9 is not expected to have significant effects. This applies to any effects associated with a change in classification and measurement, as well as a change in methods linked to impairment losses. The effect on the capital adequacy ratio will, according to our preliminary calculations, be limited or non-existent as a consequence of the deduction provisions associated with regulatory expected losses since the group's total impairments are lower than these. Given this, it therefore does not appear that SR-Boligkreditt AS will require a 5-year implementation period, which the capital adequacy regulations allow.

## ***Note 27 Events after the balance sheet date***

No material events that have influence on the financial statement for 2016 have been registered after the reporting day. The company is not involved in any legal proceedings. The proposed dividend is NOK 41 per share and will total NOK 84 million.



To the General Meeting of SR-Boligkreditt AS

## **Independent Auditor's Report**

### *Report on the Audit of the Financial Statements*

#### *Opinion*

We have audited the financial statements of SR-Boligkreditt AS, which comprise the balance sheet as at 31 December 2016, income statement, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements are prepared in accordance with law and regulations and present fairly, in all material respects, the financial position of the Company as at 31 December 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by EU.

#### *Basis for Opinion*

We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, included International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company as required by laws and regulations, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

#### *Key Audit Matters*

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

#### **Key Audit Matter**

#### **How our audit addressed the Key Audit Matter**

##### *Loans to customers*

The covered bond company has loans to private individuals amounting to NOK 29 361 million with collateral in residential property and has issued covered bonds. Processes and controls have been established to ensure that the entity complies with the various requirements covered bond companies are subject to.

In order to comply with the requirements in the regulations applicable to issuing covered bonds, the company has established controls in the process of granting and transferring loans. The process includes formal controls and segregation of duties, directed at ensuring that the controls are performed before loan approval or transfer of loans from Sparebank 1 SR-Bank ASA to the covered bond company.

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State authorised public accountants, members of The Norwegian Institute of Public Accountants, and authorised accounting firm



The value of the collateral at any time should be above 75 % of the loan value and above 60 % of the loan value for vacation property. The company has realized only limited losses on loans in 2016. As compliance with these requirements and the established processes and controls are fundamental to the company's operation, we have focused our attention on this subject.

We also refer to note 6, 7, 8 and 9 in the annual report for a description of the company's loans to customers.

Further, in accordance with applicable regulations the company has engaged us as Independent Inspector to control, on a quarterly basis that the company complies with the various requirements, including the required coverage over the loan portfolio of the value of the collateral.

Our work included obtaining documentation and examining whether the controls were conducted appropriately and timely. Our examination includes an assessment of whether the underlying documentation the company has collected supported the conclusions drawn by the company regarding compliance with the requirements in legislation and regulation.

Our testing substantiated that the company's inspection and processes support that the laws and regulations in this area were followed.

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#### *IT-systems supporting processes over financial reporting*

We have addressed this area because it is important for the company's financial reporting systems, and their business model is dependent on complex IT systems. Weaknesses in automated processes and controls can potentially lead to a significant risk in the daily operations and risk of misstatements.

The covered bond company use external service providers to operate some of the key IT systems. The auditor at the relevant service organisation was used to evaluate the design and effectiveness of the established control systems, and test controls designed to ensure the integrity of IT systems relevant to financial reporting.

We concluded on the auditor's objectivity and competence and examined the reports and evaluated possible misstatement and improvements. Furthermore, our own IT specialists tested access controls to the IT systems and the segregation of duties where necessary for our audit.

Our work gave us sufficient evidence to enable us to rely on the operation of the Group's IT systems relevant for our audit.

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#### *Other information*

Management is responsible for the other information. The other information comprises the Board of Directors' report, but does not include the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.



If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

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*Responsibilities of the Board of Directors and the Managing Director for the Financial Statements*

The Board of Directors and the Managing Director (management) are responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

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*Auditor's Responsibilities for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, included International Standards on Auditing (ISAs), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error. We design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the



audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.

- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit

We also provide the Board of Directors with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

#### *Report on Other Legal and Regulatory Requirements*

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##### *Opinion on the Board of Directors' report*

Based on our audit of the financial statements as described above, it is our opinion that the information presented in the Board of Directors' report concerning the financial statements, the going concern assumption, and the proposal for the allocation of the profit is consistent with the financial statements and complies with the law and regulations.

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##### *Opinion on Registration and Documentation*

Based on our audit of the financial statements as described above, and control procedures we have considered necessary in accordance with the International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, it is our opinion that management has fulfilled its duty to produce a proper and clearly set out registration and documentation of the company's accounting information in accordance with the law and bookkeeping standards and practices generally accepted in Norway.

Stavanger, 19 April 2017  
PricewaterhouseCoopers AS

A handwritten signature in blue ink, appearing to read 'Arne Birkeland', is written over the printed name.

Arne Birkeland  
State Authorised Public Accountant (Norway)

## Statement by the Board of Directors and Chief Executive Officer

We hereby confirm that the financial statements for the period 1 January to 31 December 2016 have, to the best of our knowledge, been prepared pursuant to applicable accounting standards, and that the information provided presents a true and fair picture of the company's assets, liabilities, financial positions and profit as a whole.

We also confirm that the Report of the Board of Directors provides a true and fair presentation of the performance, result and position of the company, together with a description of the most important risk and uncertainty factors that the company face.

Stavanger, 19 April 2017



Inge Reinertsen  
Chairman



Stian Helgøy



Merete Eik



Børge Henriksen



Dag Hjelle  
CEO