SPAREBANKEN SØR
BOLIGKREDITT AS

Annual report 2018

Contents

Board of Director's report

GENERAL

Sparebanken Sør Boligkreditt AS is a wholly-owned subsidiary of Sparebanken Sør, and the company's business is operated from Kristiansand. The company is licensed by the Financial Supervisory Authority of Norway to operate as a mortgage company, and is allowed to issue covered bonds. Sparebanken Sør Boligkreditt AS is part of Sparebanken Sør's long-term financial strategy. All shares are owned by Sparebanken Sør, and the financial statements are consolidated into the financial statements of the Sparebanken Sør Group. Sparebanken Sør Boligkreditt AS' s operations are subject to supervision by the Financial Supervisory Authority of Norway. An investigator has been especially appointed for the mortgage company to attend to the quarterly analysis of the company's cover pool.

The cover pool consists of secured mortgages, interest bearing securities and financial derivatives. The mortgages are granted by Sparebanken Sør and later taken over by Sparebanken Sør Boligkreditt AS. The secured mortgages meet the requirements established by the company for inclusion in the company's cover pool. One important requirement is that any outstanding loan balance taken over by the company must not exceed 75 % of the mortgaged property's market value at the date of acquisition.

At the end of 2018, the company had taken on a mortgage loan portfolio totalling NOK 38 737 million, transferred from Sparebanken Sør, of which NOK 38 646 million is included in the qualified cover pool. Sparebanken Sør Boligkreditt AS had issued covered bonds totalling NOK 36 014 million.

Sparebanken Sør Boligkreditt AS has established an EMTCN (European Medium Term Covered Note) Programme which enables the company to diversify funding by issuing covered bonds outside the Norwegian bond market. In 2018 the company issued cover bonds totalling EUR 500 million under the programme.

INCOME STATEMENT / BALANCE SHEET DEVELOPMENT

The financial statements for Sparebanken Sør Boligkreditt AS show a profit after tax of NOK 211.7 million at the end of 2018, compared to NOK 185.8 million in 2017.

The company had net interest income of NOK 378.7 million, compared to NOK 360.3 million in 2017. The increase in net interest income was mainly due to the increase in the mortgage portfolio in the period.

Net income from financial instruments shows a negative contribution of NOK 23.0 million in 2018, compared to a negative contribution amounting to NOK 47.5 million in 2017. In 2018, NOK 1.5 million of the negative contribution relates to basis swaps.

Basis swaps are derivative contracts entered into as part of long term financing in international capital markets, whereby currency is converted to NOK. These are hedging instruments, and assuming the underlying bond is held to maturity, the change in market value over the term of the instruments is zero.

Operating expenses totalled NOK 71.1 million in 2018, compared to NOK 60.2 million in 2017.

Total assets at 31 December 2018 were NOK 42 171 million, of which net loans to customers accounted for NOK 38 729 million. At the same time in 2017, the corresponding figures were NOK 32 332 million and NOK 30 968 million respectively.

As at 31 December 2018 the loan portfolio was financed through the issuance of bonds amounting to NOK 36 014 million and through equity and drawing rights from Sparebanken Sør. At 31 December 2018, the company had paid-in capital totalling NOK 1 625 million, of which NOK 1 125 million is share capital and NOK 500 million is share premium.

Sparebanken Sør Boligkreditt AS has an overdraft facility of NOK 4 000 million with Sparebanken Sør, which at 31 December 2018, was drawn down by NOK 2 891 million.

In accordance with Norwegian accounting legislation, the Board of Directors confirms that the conditions for presenting the financial statements on a going- concern basis are met.

CAPITAL STRENGTH

At the end of 2018, the net common equity tier 1 capital in the company was NOK 3 168 million. This corresponds to both a total capital ratio, tier 1 capital ratio and common equity tier 1 capital ratio of 19.5 per cent, while regulatory minimums requirements are 12.0 per cent, 13.5 per cent and 15.5 per cent respectively. The capital adequacy ratio has been calculated based on the standard method in the Basel II -regulations. The Board of Directors considers the company's financial strength and risk-bearing ability to be very good.

CORPORATE GOVERNANCE

Sparebanken Sør Boligkreditt's corporate governance principles include the objectives according to which the company is managed and governed, to protect the owners and other stakeholders' interests in the company. The principles are based on the Norwegian Code of Practice for Corporate Governance (NUES). The company has adapted this framework, and Sparebanken Sør Boligkreditt AS`s principles and policy are intended to ensure that its corporate governance is in accordance with generally accepted and recognised perceptions and standards, and in compliance with laws and regulations.

The purpose is to clarify the division of roles between the company's governing bodies and the day to day management beyond what follows from the legislation. Furthermore, corporate governance has to ensure good interaction between different interested parties such as shareholders, lenders, customers, employees, governing bodies, management and society as a whole. The corporate governance principles have been specified in various documents governing the company's operations. This includes the company's articles of association, strategies and the governance framework. In the Board of Directors' opinion, the corporate governance of Sparebanken Sør Boligkreditt AS is satisfactory and in compliance with current principles and policies.

Sparebanken Sør Boligkreditt AS's mission follows from the company's articles of association. The company`s mission is to acquire mortgages and to fund lending activities primarily by issuing covered bonds. The operations will be run at satisfactory profitability and low risk. The company is wholly owned by Sparebanken Sør. The company's business strategy is the basis for Sparebanken Sør Boligkreditt's financial return, growth and development.

The Board of Directors of Sparebanken Sør Boligkreditt AS has an annual meeting and conducts an annual review of the company's business strategy. Seven board meetings took place in 2018. Follow-up on operations, strategy, risk and capital management and monitoring of the markets and framework conditions have been the areas of focus for the Board of Directors. The company's risk strategy has been adopted by the Board of Directors, which conducts an annual review of the company's risk management and internal control. Identified areas of risk and any material deviations are followed up and reported on a regular basis.

Sparebanken Sør Boligkreditt AS has signed operating agreements with Sparebanken Sør. These agreements cover, among other things, capital management, risk management, internal audit, financial reporting, internal financial control and internal financial reporting. This includes quarterly financial reporting and the preparation of a fixed template for reporting to ensure complete basis for reporting and consistent application of principle. In addition to reviewing the accounts and risk reporting, the company`s management provides regular operational reporting in relation to the company's objectives to the Board at each Board meeting.

The company's ethical guidelines include a duty to report matters that warrant criticism, including breaches of internal guidelines, laws and regulations, and a procedure for how such information is to be given. Large companies must provide information about their management of corporate social responsibility (cf. Section 3-3c of the Norwegian Accounting Act). The Parent Bank, Sparebanken Sør, delivers such a statement for the Group, which also covers its subsidiaries. For further information, please refer to the Parent Bank's annual report.

Sparebanken Sør Boligkreditt AS is a wholly owned subsidiary of Sparebanken Sør and it is therefore exempt from the requirement for a separate audit committee. The Compliance function is taken care of through the company's agreement with Risk Management in Sparebanken Sør. The company has an independent external auditor (PWC) and internal audit (Sparebanken Sør). PWC has been appointed as an investigator by the Financial Supervisory Authority of Norway. Sparebanken Sør Boligkreditt AS's operations are subject to supervision by the Financial Supervisory Authority of Norway. The Board of Directors and management endeavour to maintain an open and constructive dialogue with the Financial Supervisory Authority of Norway.

RISKS

As a licensed mortgage company, Sparebanken Sør Boligkreditt AS is subject to a number of acts, regulations, recommendations and regulatory provisions. The objective of the company is to finance lending activities through the issuing of covered bonds with a high public rating. This means that Sparebanken Sør Boligkreditt AS strives to maintain risk at a low level. The company has established Board approved guidelines and limits for management and control of various areas of risk, which meet regulatory, rating agency and investor requirements. The company places emphasis on identifying, measuring and controlling elements of risks in such a way that the market has high confidence in the company and that the company can achieve a high rating on issued bonds.

The company's credit strategy and credit policy include requirements imposed on borrowers as well as collateral requirements for loans, that may be taken on by the company. The Board of Directors considers the overall quality of the lending portfolio to be very good and the credit risk to be low.

In accordance with Board approved requirements, stress testing of the value of the cover pool was conducted in 2018 with simulation of a sharp fall in house prices. The Board of Directors believes that the result of the stress tests is satisfactory.

The company's mortgages to customers are in NOK at floating interest rates with six weeks' notice of interest adjustment. Financing is met by issuance of both floating and fixed rate bonds in NOK and EUR. Foreign currency debt is swapped to NOK and fixed rate debt is swapped to floating rate. Foreign currency debt and debt at fixed interest rate, is accounted for by using hedge accounting.

The Board of Directors considers the overall market risk to be low.

The company issues bonds with the unilateral right to extend the maturity period by up to 12 months. In other respects, financing needs are met by equity and credit facilities with Sparebanken Sør. In addition, the company also has a revolving credit facility with Sparebanken Sør, which can be used to refinance outstanding bonds. The Board of Directors considers the company's liquidity risk to be low.

At 31.12.2018 the company satisfied the liquidity requirements imposed on European banks and finance companies (LCR - Liquidity Coverage Ratio). The requirement was 100 % as from 31.12.2017.

A Management Service Agreement has been established with Sparebanken Sør that encompasses the supply of all necessary services for the operation of the company, and the Board of Directors considers the company's operational risk to be low.

EMPLOYEES AND WORKING ENVIRONMENT

At 31 December 2018, the company had no employees and there are no relevant comments regarding the internal working environment. The Board is composed of four persons, one of whom is female.

RATING

Covered bonds issued by Sparebanken Sør Boligkreditt AS have been given an Aaa rating by Moody's.

SOCIAL RESPONSIBILITY

The company requires social responsibility work to take place in close cooperation with and according to the same guidelines as in Sparebanken Sør. The company does not carry out any activities that pollute the external environment.

FUTURE PROSPECTS

The Board of Directors regards the future prospects for the company's operations to be very good. Sparebanken Sør Boligkreditt AS plans to further a acquire loans from Sparebanken Sør, and the company intends to be able to issue covered bonds aimed at investors in Norway or abroad.

Based on the company`s risk profile, losses on loans to customers are expected to be low in 2019.

DISTRIBUTION OF PROFIT

Profit after tax for 2018 is NOK 211.7 million. The Board of Directors proposes that the whole amount is transferred to retained earnings.

Kristiansand, 4 March 2019

The Board of Directors of Sparebanken Sør Boligkreditt AS

Geir Bergskaug	Seunn Smith-Tønnessen	Gunnar P. Thomassen	Bjørn Friestad
Chairman	Member	Member	Member

Marianne Lofthus

Managing Director

Income statement

NOK Thousand	Notes	31.12.2018	31.12.2017
Interest income, assets recognized at amortized cost	12, 21	894 175	774 764
Interest income, assets recognized at fair value	12, 21	26 056	12 655
Interest expenses	12, 21	541 535	427 148
Net interest income	**12, 21**	**378 696**	**360 271**
Commission income		170	149
Commission expenses		5 000	5 000
Net commission expenses		**-4 830**	**-4 851**
Net income from financial instruments	**13**	**-22 969**	**-47 484**
Personnel expenses		54	54
Other operating expenses	14	70 997	60 127
Total expenses		**71 050**	**60 180**
Profit before losses on loans		**279 847**	**247 756**
Losses on loans and undrawn credit	5, 8, 26	-2 427	-
Profit before taxes		**282 275**	**247 756**
Tax expenses	15	70 565	61 939
Profit for the period		**211 709**	**185 817**

Other comprehensive income

NOK Thousand	Notes	31.12.2018	31.12.2017
Profit for the period		**211 709**	**185 817**
Net change in value from basis swaps		-19 511	0
Tax effect		4 878	0
Total profit for the period		**197 076**	**185 817**

Notes 1 to 27 are an integral part of the financial statements.

Balance sheet

NOK Thousand	Notes	31.12.2018	31.12.2017
ASSETS			
Loans to and receivables from credit institutions	16,17,22	343 083	152 957
Net loans to customers	5,6,7,8,16,17	38 728 856	30 967 963
Bonds and certificates	16,17,18	2 625 663	808 817
Financial derivatives	16,17,19	421 929	368 812
Deferred tax assets	15	28 064	14 920
Other assets		23 217	18 097
TOTAL ASSETS		**42 170 810**	**32 331 567**
LIABILITIES AND EQUITY			
Debt to credit institutions	16, 22	2 893 918	3 360 846
Debt incurred due to issuance of securities	10,11,16,20	36 014 179	26 495 406
Financial derivatives	16,17,19	0	22 975
Payable taxes	15	83 336	68 166
Other liabilities		8 743	7 444
Total liabilities		**39 000 176**	**29 954 837**
EQUITY			
Paid-in equity capital	4	1 625 000	1 025 000
Retained earnings	4	1 545 635	1 351 730
Total equity capital		**3 170 635**	**2 376 730**
TOTAL LIABILITIES AND EQUITY CAPITAL		**42 170 810**	**32 331 567**

Notes 1 to 27 are an integral part of the financial statements.

Kristiansand, 4 March 2019

Board of Directors of Sparebanken Sør Boligkreditt AS

Geir Bergskaug	Seunn Smith-Tønnessen	Gunnar P. Thomassen	Bjørn Friestad
Chairman	Member	Member	Member

Marianne Lofthus

Managing Director

Cash flow statement

NOK Thousand	31.12.2018	31.12.2017
Interest received	912 501	783 006
Interest paid	-501 098	-409 601
Operating expenditure	-74 528	-64 567
Changes in loans to customers	-7 751 384	-2 838 082
Income tax paid	-68 099	-82 776
Net cash flow from operating activities	**-7 482 607**	**-2 612 020**
Changes in bonds and certificates	-1 816 845	48 844
Changes in other assets	205 150	72 431
Changes in deposits from credit institutions	-468 551	1 304 427
Changes in other liabilities	1 299	411
Net cash flow from current financing activities	**-2 078 948**	**1 426 113**
Paid-in share capital	600 000	0
Payments received, bond debt	15 559 155	6 201 315
Payments made, bond debt	-6 407 473	-4 916 706
Net cash flow from long-term financing activities	**9 751 682**	**1 284 610**
Net change in liquid funds	**190 127**	**98 702**
Liquid funds at 01.01.	152 957	54 254
Liquid funds at the end of period	**343 083**	**152 957**

Equity statement

NOK Thousand	Equity capital	Share premium reserve	Retained earnings	Total
Balance 31.12.2016	**525 000**	**500 000**	**1 165 913**	**2 190 913**
Profit 2017	0	0	185 817	185 817
Balance 31.12.2017	**525 000**	**500 000**	**1 351 730**	**2 376 730**
Changes according to IFRS 9	0	0	-4 228	-4 228
Tax effect	0	0	1 057	1 057
Balance 01.01.2018	**525 000**	**500 000**	**1 348 559**	**2 373 559**
Share capital increase	600 000	0	0	600 000
Profit 2018	0	0	211 709	211 709
Other income/expenses	0	0	-14 633	-14 633
Balance 31.12.2018	**1 125 000**	**500 000**	**1 545 635**	**3 170 635**

NOTE 1 – ACCOUNTING POLICIES

GENERAL INFORMATION

Sparebanken Sør Boligkreditt AS is a wholly-owned subsidiary of Sparebanken Sør and has its registered office in Kristiansand. The company is licensed to operate as a mortgage company with the right to issue covered bonds.

The main object of Sparebanken Sør Boligkreditt AS is to offer and acquire loans secured through mortgages on residential property up to 75 per cent of the property value, and to issue covered bonds to national and international investors.

All amounts in the financial statements are stated in NOK thousand, unless otherwise indicated. The company's financial statements are presented in Norwegian kroner, which is the functional currency.

The financial statements for 2018 were presented by the Board of Directors on 4 March 2019, and will be adopted with final effect at the General Meeting on 28 March 2019. The General Meeting is the company's supreme body.

BASIS OF COMPILATION OF THE FINANCIAL STATEMENT

The company financial statements have been compiled in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU, in addition to the Norwegian disclosure requirements pursuant to the Norwegian Accounting Act.

The measurement basis for the financial statement is historical cost with the exception of financial assets and liabilities, including derivatives that are assessed at fair value with change in value through profit or loss.

REVENUE

Interest income and costs related to assets and liabilities which are measured at amortised cost, are expensed as incurred using the effective interest method. All charges related to interest-bearing loans and borrowings are included in the calculation of the effective interest rate and are amortised over the expected term.

Commission income, which is direct payment for services provided, is recognised when the services have been delivered. Directly attributable transaction costs associated with financial instruments valued at amortised cost, are amortised over the anticipated lifetime of the instrument.

FINANCIAL INSTRUMENTS

A new accounting standard, IFRS 9, was implemented on 1 January 2018. The standard was implemented in the financial statements at the same time. The company chose not to make use of early adoption of IFRS 9, and this means that all comparative figures from earlier periods have been prepared according to IAS 39.The standard was implemented retrospectively. Hedge accounting was exempted. Retrospective application meant that Sparebanken Sør Boligkreditt AS prepared the opening balance on 1 January 2018 as though the new policies had always been applied.

The effect of the new policies in the opening balance sheet for 2018 was recognised in equity.

Accounting policies applicable before 1 January 2018 are reproduced in Note 27.

Recognition and deductions

Financial assets and liabilities are recognised when the company becomes a party to the contractual decisions.

A financial asset is deducted when the contractual rights to the cash flows from the financial asset expire, or the company transfers the financial asset in such a way that the risk - and profit potential of the asset in question is substantially transferred.

A financial liability is deducted when the liability has been discharged, cancelled or has expired. When an existing financial liability is replaced by a new liability from the same lender under terms that have been materially changed, or the terms of an existing liability have been materially modified, the original liability is deducted and a new liability is recognised. The difference in capitalised value is recognised through profit or loss.

Classification and measurement

Measurement of the financial asset is determined on initial recognition of the asset.

IFRS 9 has a more principle-based approach than IAS 39 with regard to assessing whether financial assets are to be measured at amortised cost or at fair value. The categories of measurement for financial assets in IAS 39 (fair value through profit or loss, available for sale, held to maturity and amortised cost) have been replaced by the following three categories in IFRS 9:

- Fair value with changes in value recognised through profit or loss.
- Amortised cost.
- Derivatives designated as hedging instruments recognised at fair value.

Classification on initial recognition is based on the instruments being held in a business model both to receive contractual cash flows and for sale, and whether contractual cash flows solely consist of payments of interest and principal on given dates.

Financial instruments that are held to receive contractual cash flows are to be measured at amortised cost.

Instruments with cash flows that are not only payments of interest and principal or if the purpose of possessing the instrument is not to receive contractual cash flows, are to be measured at fair value with changes in value recognised through profit or loss.

Derivatives used in connection with hedge accounting are measured according to the principles of hedge accounting. See separate section.

Implementation of IFRS 9 effect from 1 January 2018 resulted in an increase in total impairment losses of NOK 4 million. Implementation of IFRS 9 had a negative effect on the subordinated capital. The company has not made use of the transitional rule for calculation of capital adequacy. The equity effect is also included in the equity statement. Changes in classification are stated in Note 16 – Financial instruments by category. All transitional effects were presented in the annual financial statements for 2017.

The company's financial assets, measured at fair value under IAS 39, are also measured at fair value under IFRS 9. There are no changes in the classification and measurement of the company's financial liabilities.

Fair value with changes in value recognised through profit or loss

All derivatives are to be measured at fair value with changes in value recognised through profit or loss. However, derivatives designated as hedging instruments are to be recognised in accordance with the principles of hedge accounting.

On transition to the new standard, the company is recognising holdings of interest-bearing liabilities and certificates at fair value through profit and loss. These are assets and liabilities that are managed, measured and reported to management at fair value.

This category covers interest rate swaps and currency swaps, established before 1 January 2018 and which are considered as fair value hedging instruments of bond issued at fixed rate. Hedge accounting is discussed further in a separate section below.

Amortised cost

The company measures financial assets at amortised cost if the following conditions are met:

- The financial asset is held in a business model which purpose is to receive contractual cash flows.
- The contractual terms for the financial asset lead to cash flows which consist exclusively of payments of principal and interest on given dates.

Debt instruments which sole purpose is to hold the instrument in order to collect contractual cash flows are to be recognised at amortised cost. All borrowings and lendings at variable interest rates are classified at amortised cost.

Derivatives designated as hedging instruments recognised at fair value

Interest rate swaps and currency swaps used as instruments for the fair-value hedging of bonds issued at fixed interest rates. Hedge accounting is discussed further in a separate section.

Subsequent measurement

Measurement at fair value with changes in value recognised through profit or loss

Fair value is the price that would be obtained upon the sale of an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the time of valuation.

Measurement of financial instruments traded on an active market

Financial instruments traded on an active market are valued at observed market prices.

Measurement of financial instruments not traded on an active market

The fair value of financial instruments not traded on an active market is determined using a suitable valuation method. Valuation techniques are based on recent transactions between independent parties, by reference to instruments with approximately the same content or by discounted cash flows. As far as possible, valuations are based on externally observed parameters.

The fair value of interest-bearing securities is determined on the basis of established market values, reported by leading external market players, or by calculating the fair value on the basis of current market yield and credit spread curves at any time.

In calculating the fair value of swaps entered into, the market value of the relevant prevailing inter-bank interest rate curve is used.

Measurement at amortised cost

Subsequent measurement of financial instruments measured at amortised cost, is performed using the effective interest method and is subject to loss provisions. Gains and losses are recognised through profit or loss when the asset is derecognised, modified or impaired.

Financial assets at amortised cost, include receivables from customers and loans to customers.

Amortised cost is defined as the carrying amount on initial recognition, less received/paid interest and instalments, including accrued effective interest, adjusted for net impairment losses and the net recognised effect of any hedging.

The effective interest method is a method that calculates amortised cost and accrues interest income/expenses for the relevant period. Interest income is recognised using the effective interest method. The effective interest rate is the interest rate that by discounting the loan's cash flows over the anticipated term, gives a value equal to the loan's amortised cost on the date of its establishment.

Derivatives designated as hedging instruments recognised at fair value

Interest rate and currency swaps are measured at fair value in the balance sheet. Changes in value are recognised through profit or loss with the exception of interest rate and currency swaps entered into on or after 1 January 2018. In this case changes in value due to changes in spreads will be recognised through other comprehensive income as a hedging effect.

Offsetting

Financial assets and liabilities are offset and recognised as a net amount in the balance sheet only when the Company has a legally enforceable entitlement to offset, and intends to realise the asset and settle the liability simultaneously.

Impairment of financial assets

Provision is made for expected losses based on relevant information available at the time of reporting, including historical, current and future information.

Impairment losses are calculated on the basis of probability of default (PD), loss given default (LGD) and exposure at default (EAD). The principal rule is that a loss provision is calculated on the basis of the expected credit loss over the next 12 months or expected credit loss over the whole term. Expected credit loss over the whole term is calculated for assets where the credit risk has increased materially since initial recognition, with the exception of assets which regardless of this are assessed as having a low absolute credit risk on the reporting date. If no material increase in credit risk since initial recognition has appeared, the loss provision will be calculated on the basis of the expected credit loss over the next 12 months.

Impairment losses on loans reduce their book value in the balance sheet. In the income statement, losses on loans consist of realised losses, changes in impairment losses, income on loans and provisions for undrawn credit facilities, as well as receipts relating to previously realised losses. Losses on loans are based on an assessment of the company's loan portfolio in accordance with IAS 9.

For a further description, please refer to Note 26.

Provisions for losses

The transition to IFRS 9 has changed the way the company recognises loss provisions for financial assets, by moving from objective evidence that a loss event has occurred in IAS 39 to a model based on expected credit loss (ECL). IFRS 9 requires the company to recognise a provision for expected credit loss for all debt instruments not held at fair value through profit or loss.

The impairment model under IFRS 9 is described in Note 26.

Reduction in the value on loans as a result of qualitative assessments

An impairment loss is recognised when a qualitative assessment provides objective evidence that a loan is impaired as a result of credit loss. An impairment loss is reversed when the loss is reduced and the reduction is objectively attributable to an event occurring after the date on which the impairment loss was recognised. All loans that are considered material will be assessed to see whether there is objective evidence of weakened creditworthiness, and the objective indication is likely to result in reduced future cash flows for the servicing of the commitment. Objective evidence may be default, bankruptcy, debt restructuring, lack of liquidity or other material financial problems.

The company assesses a financial asset as non-performing if contractual payments are overdrawn by more than NOK 1,000 for more than 90 days.

Reduction in the value of loans and undrawn credit facilities as a result of model-based calculations

Loans for which a qualitative impairment has not been recognised, are included in the basis of calculation for model-based impairments. The same applies to undrawn credit facilities.

The model for calculating the impairment of financial assets under IFRS 9 applies to financial assets measured at amortised cost and financial assets measured at fair value through other comprehensive income. The new standard also contains requirements for loss provisions on new loans, by stating that an impairment must be recognised for expected credit losses resulting from default in the next twelve months. The model calculates losses for all customers at the account level. The model also includes, undrawn lines of credit. For loans in which credit risk has increased materially after initial recognition, an impairment loss corresponding to the expected credit loss over the term of the loan is recognised.

Realised losses

When it is highly probable that the loss is final, this is recognised as a realised loss. This includes losses, which imply that the Company has lost its claim against the debtor as a result of bankruptcy, a debt settlement, an unsuccessful distress warrant, a legally binding court ruling or debt remission. This applies even if the company has otherwise suspended enforcement or waived part of or all loans. Some realised losses will be covered through the previous decision made on individual loan loss write-downs, and booked against the former provision. Realised losses, without coverage in individual impairment loss, as well as over - or under coverage in relation to previous impairment loss, are recognised.

Recognition in balance sheet and income statement

Loans

Loans are recorded as either loans and receivables to credit institutions or loans to customers. Interest is included in the income statement under interest income. Changes in value due to impairment charges are recognised in the income statement under losses on loans.

Bonds and certificates

The company`s portfolio of bonds and certificates is included in the balance sheet. Interest is included in the income statement as interest income. Changes in value are recognised through net income from financial instruments.

Financial derivatives (assets and liabilities)

The balance sheet includes financial derivatives. Value adjustments related to derivative instruments are recognised in the income statement under net change in value from financial instruments.

Debt to credit institutions

Balance sheet items include debts to credit institutions. Interests is recognised in the income statement under interest expenses.

Debt incurred due to issue of securities

The balance sheet item includes securities debt. Interests is recognised in the income statement under interest expenses.

HEDGE ACCOUNTING

Sparebanken Sør Boligkreditt AS employs hedge accounting in relation to the company's funding at fixed interest rate terms and in foreign currencies. Hedging instruments are used to counteract the interest risk and foreign exchange risk of the bonds.

The criteria for classification of a derivative as a hedging instrument are:

- The hedge accounting is expected to be very effective, in that it counteracts changes in the fair value of the bond issued.
- Among other things, there must be an economic relationship between the hedging instrument and the hedged object, and the effect of credit risk must not dominate any changes in value in the hedging relationship.
- The effectiveness must be able to be reliably measured.
- Satisfactory documentation has been established prior to hedging, that among other things shows that the hedging is effective and is expected to remain effective throughout the entire period.

Sparebanken Sør Boligkreditt AS utilises fair value hedging. Hedging is measured and documented every quarter to ensure that the hedging is effective. The dollar-offset method is used as a method of measuring the effectiveness of hedging. When the hedging is established and effective, interest rate and foreign exchange swaps will be added to the balance sheet at fair value and added to the income statement under "Net value change from financial instruments".

The hedge object is recognised in the balance sheet at amortised cost. Changes in the fair value associated with the hedged risk are accounted for as an addition to or deduction from the balance-added value of the bond debt and are carried in the income statement under "net value change from financial instruments".

IFRS 9 has simplified the requirements for hedge accounting by linking hedging effectiveness more closely to risk management activities, and consequently provides greater opportunity for assessment. The requirement for a hedging effectiveness of 80-125% has been removed and replaced by more qualitative requirements.

Under IFRS 9 a prospective (future-oriented) effectiveness test is sufficient, while hedging effectiveness under IAS 39 had to be viewed both retrospectively and prospectively.

Ineffectiveness in hedging, defined as the difference between changes in the value of hedging instruments and in the value of the hedged object, is recognised in the income statement as it arises. The exception is that portion of the change in value which is due to a change in the base spread linked to the hedging instruments.

For interest and currency swaps established on or after 1 January 2018, changes in value due to changes in spreads will be recognised through other comprehensive income through other comprehensive income as a hedging effect. Interest rate and currency swaps created before 1 January 2018 are recognised at fair value, through profit or loss until these fall due.

If circumstances should occur in which the hedging is not effective, the company will amortise the change in value associated with the hedged object over the remaining period. The associated hedging instrument will continue to be recognised at fair value with a change in value in the income statement.

ACCOUNTING OF EXCHANGE EFFECTS

Revenues and expenses in currencies are converted to NOK according to the exchange rate at time of transaction.

Balance items in foreign currencies are secured by hedging. Debt in foreign currency is converted to NOK according to the company`s mid-rate at the balance sheet date. Changes in value are recognised in the income statement as net commission from financial instruments. The company`s currency exposure is related to funding and is fully secured by basis swaps.

FIXED ASSETS

Fixed assets are recognised at cost less accumulated depreciation and impairment. Ordinary depreciation is computed on a straight-line basis over the expected economic life of the asset. There is an annual reassessment of the remaining useful life and residual values for each asset.

At each reporting date, it will be assessed whether there are any indications of impairment. If there are indications of impairment of the value of an asset, the company will calculate the utility value of the asset. The asset is written-down to the higher of the fair value and the utility value. The basis of previous write-downs is considered at the same time.

INCOME TAX

Income tax is accrued as a cost, irrespective of the time of payment. Hence the tax charge reflects this year's and future taxes payable as a result of this year's activity. The tax is expected to offset net income included in this year's tax cost and in the balance sheet and is referred to as payable tax. Deferred tax is calculated on the basis of differences between the reported tax and accounting results that will be offset in the future. Tax increasing and tax reducing temporary differences within the same accounting period, are offset against each other.

Any net deferred tax assets are recognised as an asset in the balance sheet when it is probable that the tax reducing differences will be realised.

Any net deferred tax assets are recognised as an asset in the balance sheet when it is probable that the tax reducing differences will be realised.

CASH FLOW STATEMENT

The cash flow statement shows receipts and payments of cash and cash equivalents during the year. Cash and cash equivalents are defined as loans to and receivables from credit institutions.

CHANGES IN ACCOUNTING POLICIES AND NOTES

With effect from 1 January 2018, Sparebanken Sør Boligkreditt AS applieS the following new standards.

IFRS 9 Financial instruments

IFRS 9 Financial Instruments replaced IAS 39, Financial Instruments – Recognition and measurement with effect from 1 January 2018. IFRS 9 concerns recognition, classification and measurement, provisions on loan losses and hedge accounting.

The standard was implemented retrospectively. Hedge accounting was exempted and implemented prospectively from date on transition.

The company has not prepared corresponding figures for the start of 2017. Please refer to note 26, section concerning financial instruments and descriptions.

IFRS 15 Revenue from contracts with customers

The standard came into effect for accounting purposes on 1 January 2018 and replaces the previous IAS 18 Revenue with associated interpretations. The core principle of IFRS 15 is that revenue is recognised to reflect the transfer of contracted goods or services to customers, and in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods or services. The standard applies with a few exceptions to all income-generating contracts with customers and provides a model for recognition and measurement of the sale of certain non-financial assets (for example sales of property, plant and equipment).

IFRS 15 requires businesses to use their best judgment and take account of all relevant facts and circumstances when customer contracts are valued in the model's various stages. The standard also specifies how the marginal expenditure related to fulfilment of a contract and the expenditure incurred by the entity in fulfilling this contract should be recognised. In addition, the standard requires extensive note disclosures.

Sparebanken Sør Boligkreditt AS is affected to a small extent by the implementation of IFRS 15, and no adjustments have been made to the financial statements for the financial year 2018, as a result of the large proportion of financial assets in the balance sheet and income statement that are treated in accordance with IFRS 9. Changes are regarded as not being material for the financial statements.

In addition to the aforementioned new standard and interpretation, changes to other standards may affect the company's future reporting. The management considers the effect of the changes to these standards to have minor significance for the company.

NOTE 2 – DISCRETIONARY ASSESSMENTS, ESTIMATES AND ASSUMPTIONS

With the preparation of financial statements, the management makes estimates and discretionary assessments. Areas that are largely comprised of discretionary estimates have a high degree of complexity, and assumptions and estimates are significant for the company's financial statements, which are presented below.

GENERAL

In applying accounting policies, the company`s management has exercised discretion as a basis for accounting in some areas and has made assumptions about future events. The use of discretion and assumptions about future events in the financial records will naturally inherit uncertainty. In exercising discretion and determining assumptions about future events management will look at available information on the balance sheet date, historical experience with similar assessments and market and third-party assessments of current conditions. Although the management uses its best discretion and estimates and on best estimates available, it must be anticipated that the actual outcome in some cases may differ materially from what is accounted for. Estimates, assumptions and conditions that represent a significant risk of substantial changes in the carrying value of assets and liabilities within the next financial year are discussed below.

WRITE-DOWNS ON LOANS

Assessment of individual and collective write-downs will always be based on a significant degree of discretion. Predictions based on historical information may prove to be incorrect since the relevant historical data for decisions is not certain. The risk associated with the type of lending provided by the company is considered to be limited as the collateral objects consist of private residential property.

NOTE 3 – RISK MANAGEMENT

The objective of Sparebanken Sør Boligkreditt AS is to be a funding instrument for Sparebanken Sør to secure long-term value creation for the Group. With this objective, it is essential that risk is subject to active and satisfactory management.

The objective of Sparebanken Sør Boligkreditt AS is to utilise high-quality residential mortgage portfolios to issue covered bonds. Part of the Sparebanken Sør Group's business strategy is to keep a low to moderate risk profile for all enterprises. Taking on risks is a basic feature of banking, and risk management is therefore a key area in both daily operations and the Board's ongoing work. Reference is made to the Group's Pilar 3 document, which is available on the website of the Parent Bank (www.sor.no).

ORGANISATION

Board of Directors

The Board has overall responsibility for the company's total risk management and aims to ensure that the company has appropriate systems in place for risk management and internal control. The Board determines risk strategies, framework for risk appetite, risk profile and tolerance. The Board also determines the strategy and guidelines for the capital plan and composition of the capital and approves the process to ensure an acceptably adequate capital level at all times.

The company's management

The management and day-to-day operation of Sparebanken Sør Boligkreditt AS is based on a Management Service Agreement between the company and the parent company, Sparebanken Sør.

The Managing Director has overall responsibility for the implementation of the company's credit strategy and credit policy within general mandates and limits adopted by the Board.

Responsibility for implementation of the annual assessment of the risk situation and the capital adequacy requirement has been delegated to the Risk Management division of Sparebanken Sør and is regulated by a supply agreement between the Mortgage Company and Sparebanken Sør. This analysis will be coordinated and integrated with other planning and strategy work for the Group.

Risk management in Sparebanken Sør takes place at Group level and includes Sparebanken Sør Boligkreditt AS. The bank`s department for monitoring risks will identify, measure and evaluate the overall risk, in addition to handle compliance measures.

Internal auditor

Sparebanken Sør`s internal auditors handle internal auditing of Sparebanken Sør Boligkreditt AS, as regulated in a separate agreement. This is a monitoring function independent of the administration in general, designed to perform risk assessments, controls and investigations of the company's internal control and governance processes in order to assess whether these are appropriately taken care of.

Risk control process

There are reasonable and appropriate strategies and processes for risk management and the assessment of capital needs and how this can be maintained. The collective term for this is ICAAP (Internal Capital Adequacy Assessment Process).

RISK CATEGORIES

All risks are managed through a framework for risk appetite and risk tolerance. Targets for the different risk parameters are in place, and these are:

Credit risk /counterparty risk

Credit risk is the risk of loss due to the Company's counterparties or customers not having the ability or willingness to meet its payment obligations to Sparebanken Sør Boligkreditt AS. Credit risk concerns all claims on counterparties/customers. This means loans and credits, securities and counterparty risk arising from derivatives and foreign exchange contracts.

Credit risk is a function of two factors (events): ability and willingness to pay, and the value of underlying collateral. Both factors must occur for losses to take place. The first is the lack of ability to pay or willingness to pay of the debtor, and the other is the value of the underlying collateral not being sufficient to cover the Company's requirements for any default and subsequent realisation of security.

Credit risk is defined as a significant risk, and the Company's policy is that credit risk exposure should be low. The Board approves the Company's credit strategy and credit policy, and credit risk is controlled by adopted limits and measures linked to the risk profile and exposure on portfolio levels.

The Board receives regular reports on credit risk. The development of lending by the various risk classes and migration between these classes are vital in this respect.

Settlement risk

Settlement risk is a form of credit risk where a contracting party fails to fulfil its obligations regarding settlements in the form of cash or securities, upon the Company has given notice of the payment or transfer of a security. Settlement risk that the Company is exposed to is considered to be low.

Liquidity risk

Liquidity risk is defined as the risk of Sparebanken Sør Boligkreditt AS being unable to meet its obligations or unable to fund its assets, but also not being possible to achieve funding without incurring significant additional costs, in the form of an impairment in value of assets that must be realised, or in the form of funding at an above normal cost level. Liquidity risk also includes the risk of the financial markets, which the company wishes to use ceasing to function.

Sparebanken Sør Boligkreditt AS will manage liquidity risk in accordance with regulatory requirements. The risk must be low and comparable with similar companies and meet the requirements of investors in the Company's bonds. The monitoring is done by the control of exposure in relation to adopted limits and control of qualitative requirements. The company`s liquidity risk should be positive.

Market risk

Market risk includes risks related to profit variations on unsecured interest and exchange rate transactions due to changes in interest and exchange rates and adjustments in share prices. market risk is divided into interest rate risk and credit spread risk Sparebanken Sør Boligkreditt AS has a low market risk.

Interest rate risk

Interest rate risk is defined as the risk of revenue losses arising from changes in interest rates if the fixed rate period for the Company's liabilities and assets, does not coincide. The interest rate risk limit is determined as an upper limit on how great the loss on unsecured interest rate positions may be in case of a 2 percentage point parallel shift in the interest rate level.

Currency risk

Risk of financial (earnings-related) losses arising from an unfavorable change in the value of asset and liability items (on and off the balance sheet) measured in the base currency (NOK) due to changes in exchange rates. Exposure is measured as the size of the potential losses in a stress scenario where the exchange rates change by 10 per cent and the currency risk is regulated by limits for maximum aggregated currency position.

Spread risk

Spread risk is defined as the risk of changes in the market value of interest-bearing securities due to a general change in credit spreads. A general increase in credit spreads would lead to a reduction in value of a portfolio of interest-bearing securities. Changes in credit spread are a consequence of changes in investors' requirement for risk premium for a shift in anticipated credit risk and / or changes in other market conditions. The company's credit spread exposure is mainly related to the liquidity portfolio.

Business risk

Business risk is defined as the risk of unexpected revenue fluctuations from other factors than credit risk, market risk and operational risk. The risk can occur in various business and product segments and is linked to cyclical fluctuations and changes in customer behavior. Business risk can also arise as a result of government regulations. The risk also includes the reputational risk, which is associated with increased losses, reduced income and/or increased costs as a result of a detoriation of the company's reputation.

Strategic risk

Strategic risks are defined as internal matters where the risk relates to the strategies, plans and changes that the Company either has or has proposed.

Operational risk

Operational risk is the company`s exposure to financial losses or loss of reputation due to inadequate or failing internal processes or systems, human errors or external events. Operational risk includes risk of default. Examples of operational risk may be several types of adverse actions and events, including money laundering, corruption, embezzlement, insider trading, fraud, robbery, threats to employees, authorisation beaches and breaches of adopted procedures, the failure of IT systems, etc.

Operational risk is monitored by regular qualitative assessments. The estimated capital requirements for operational risk are carried out under the basic method. The operational business in Sparebanken Sør Boligkreditt AS has been secured through supply agreements with Sparebanken Sør. Sparebanken Sør Boligkreditt AS's operational risk is considered to be low.

Concentration risk

Concentration risk is credit risk arising from high overall exposure to a single counterparty or issuer of security, associated Groups of counterparties, counterparties with operations in the same sector or geographical area and enterprises that use the same kind of security, trade in the same goods or have the same type of operations.

With regards to credit risk, it is an objective to avoid major risk concentrations, including large exposure to individual customers or customer Groups and Groups of commitments in classes within high-risk industries or geographic areas.

The company's view is that Sparebanken Sør Boligkreditt AS is not exposed to any additional risk as a result of debtor concentration. This is a result of low credit exposure taking into account the quality of security pledged.

HEDGING INSTRUMENTS

The Company uses the following hedging instruments:

- Interest rate swaps - agreements to exchange interest rates for a particular nominal amount over a specified number of periods
- Basis swaps – agreements to exchange both interest rates and foreign currencies

The purpose of using these instruments is to hedge interest rate- and currency exposure.

NOTE 4 – CAPITAL ADEQUACY

Sparebanken Sør has an objective of maximising long-term value creation. In addition the Group has an objective that the risk profile should be moderate to low. This means that effective risk and capital management is a key strategic element. Sparebanken Sør Boligkreditt AS is an instrument to underpin this objective.

Sparebanken Sør has established a strategy and process for risk measurement, -management and -control that provides an overview of the risks the company is exposed to. This provides the basis for the assessment and calculation of the Group's total capital needs, and how this can be maintained to cover the specific risks in an adequate manner. The process is referred to as ICAAP (Internal Capital Adequacy Assessment Process). The assessment of capital needs includes the evaluation of size, composition and capital distribution according to each risk to which the Group is or will be exposed to. ICAAP includes stresstesting of relevant macroeconomic variables which could inflict significant losses on the company.

Sparebanken Sør Boligkreditt AS uses the standard method for credit- and market risk and applies basic method for operational risk, to calculate capital adequacy in accordance with the capital adequacy rules.

Capital adequacy has to ensure that the company has the necessary buffer capital for events that could arise in addition to ordinary loss provisions. In order to have greater flexibility in terms of strategic choices and business opportunities, the Sparebanken Sør Group has a higher equity and subordinated loan capital above the requirement given by ICAAP.

The minimum requirement for core equity tier 1 ratio was 12.0 per cent, core capital ratio 13.5 per cent and total capital adequacy 15.5 per cent.

NOK Thousand	31.12.2018	31.12.2017
EQUITY CAPITAL		
Equity capital	1 125 000	525 000
Equity premium reserve	500 000	500 000
Other equity capital	1 545 635	1 351 730
Deductions	-3 048	-1 201
Net subordinated capital (common equity tier 1)	**3 167 587**	**2 375 529**
Minimum requirement for equity capital		
Credit risk	1 248 960	990 345
Market risk	0	0
Operational risk	53 614	56 264
CVA addition	0	45 833
Deductions	0	0
Total minimum requirement for equity capital	**1 302 574**	**1 092 442**
Risk-weight-balance (calculation basis)	16 282 175	13 655 525
Commom equity tier 1 capital ratio	**19.5 %**	**17.4 %**
Tier 1 capital ratio	**19.5 %**	**17.4 %**
Total capital ratio	**19.5 %**	**17.4 %**
Leverage Ratio	**7.2 %**	**7.0 %**

NOTE 5 – CREDIT AREA AND CREDIT RISK

Credit risk represents the greatest area of risk for the company. The Board of the Group sets the credit strategy, which together with credit policies and guidelines for credit processes has to ensure that the customer portfolio has an acceptable risk profile and contribute to maximise the long-term value creation of the Group.

Loans broken down by risk classes

The models used have been based on internal and external data for calculation of probability of default (PD) in the next 12 months and expected losses (EL) at customers and portfolio level. Customers are scored each month, and are divided into 11 classes (A – K) based on the probability of default. Class K consists of default loans and commitments with individual write-downs. The table below shows the intervals for the different risk classes based on the probability of default.

All customers must be classified inn terms of risk before the loan is transferred from Sparebanken Sør to Sparebanken Sør Boligkreditt AS, and loans that are taken on by Sparebanken Sør Boligkreditt AS must have a probability of default (PD value) not exceeding 3.00 per cent. Customers who have a weaker risk classification after transfer to the company may remain as part of the cover pool if the requirement of a loan-to-value ratio not exceeding 75 per cent is met.

Selskapet har følgende risikoklasser:

Risk classes	Lower limit of default (PD-values)	Upper limit of default (PD-values)
A	0.00 %	0.10 %
B	0.11 %	0.25 %
C	0.26 %	0.50 %
D	0.51 %	0.75 %
E	0.76 %	1.25 %
F	1.26 %	2.00 %
G	2.01 %	3.00 %
H	3.01 %	5.00 %
I	5.01 %	8.00 %
J	8.01 %	99.99 %
K	100.00 %	

Probability of default	
Low risk (A-D)	0,00 - 0,75%
Medium risk (E-G)	0,76 - 3,00 %
High risk (H-J)	3,01 - 99,99 %
Default (K)	100 %

Specification within risk categories at 31 December 2018

NOK Thousand	Commitments	In %	Gross loans	Potensial exposure
Low risk	34 716 092	82,8 %	31 660 819	3 055 273
Medium risk	6 668 343	15,9 %	6 538 447	129 896
High risk	465 466	1,1 %	464 406	1 060
Non performing and write-downs	0	0,0 %	0	0
Unclassified	82 486	0,2 %	72 862	9 624
Total	**41 932 387**	**100,0 %**	**38 736 534**	**3 195 853**

Specification within risk categories at 31 December 2017

NOK Thousand	Commitments	In %	Gross loans	Potensial exposure
Low risk	27 224 371	81,8 %	25 058 050	2 166 321
Medium risk	5 534 012	16,6 %	5 429 235	104 777
High risk	451 961	1,4 %	445 117	6 844
Non performing and write-downs	0	0,0 %	0	0
Unclassified	51 029	0,2 %	41 561	9 468
Total	**33 261 373**	**100,0 %**	**30 973 963**	**kr 2 287 410**

Commitments include gross loans and potential exposure. Potential exposure consists of unused credit facilities on flexi-loans.

Maximum credit exposure

Maximum exposure towards credit risk in balance items, including derivatives. The exposure appears as gross before eventual pledges and offsettings.

NOK Thousand	31.12.2018	31.12.2017
Assets		
Loans to credit institutions	343 083	152 957
Net loans to customers	38 728 856	30 967 963
Bonds and certficates	2 625 663	808 817
Financial derivatives	421 929	368 812
Total credit exposure balace items	**42 119 531**	**32 298 549**
Potensial exposure		
Undrawn credits	3 195 853	2 287 410
Total potensial exposure	**3 195 853**	**2 287 410**
Total credit exposure	**45 315 384**	**34 585 959**

NOTE 6 - LOANS

NOK Thousand	31.12.2018	31.12.2017
Loans assessed at amortized cost		
Flexi-loans (loans without installments)	8 214 867	7 518 339
Loans with installments	30 521 668	23 455 623
Gross loans	**38 736 534**	**30 973 963**
Impairment losses on lending	-7 679	-6 000
Net loans	**38 728 856**	**30 967 963**
Undrawn credit on Flexi-loans	3 195 853	2 287 410

NOK Thousand	31.12.2018	31.12.2017
Loans distributed to sectors and industries		
Retail customers	38 698 242	30 943 401
Corporate customers*)	0	0
Accrued interests	38 292	30 562
Gross loans	**38 736 534**	**30 973 963**
Impairment losses on lending	-7 679	-6 000
Net loans	**38 728 856**	**30 967 963**

*Loans to corporate customers are mortgage loans for customers in sector 8200.

	31.12.2018		31.12.2017	
Loans broken down by geographical area				
Vest-Agder	15 976 361	41.3 %	13 514 160	43.6 %
Aust-Agder	10 230 536	26.4 %	8 621 345	27.8 %
Telemark	3 788 416	9.8 %	3 052 322	9.9 %
Rogaland	1 106 520	2.9 %	624 913	2.0 %
Oslo	3 890 000	10.0 %	2 324 234	7.5 %
Akershus	1 649 156	4.3 %	1 275 585	4.1 %
Other counties	2 087 867	5.4 %	1 555 404	5.0 %
Total	**38 728 856**	**100.0 %**	**30 967 963**	**100.0 %**

NOTE 7 - DEFAULTED LOANS

NOK Thousand	31.12.2018	31.12.2017
Gross non-performing loans > 90 days	0	0
Individual write-downs	1 337	0
Uther loans in stage 3	14 140	0
Net non performing loans	**15 477**	**0**
Provision ratio impairment losses	8.64 %	
Net non-performing loans > 90 days in % of gross loans	**0.0 %**	**0.0 %**

Based on previous principles, a non-performing loan was defined as the sum of a customer`s total loan amount if part of the loan had been overdrawn, or had arrears exceeding NOK 1000 for more than 90 days. In 2017 none such loans were recognized.

NOTE 8 – LOSSES ON LOANS AND UNDRAWN CREDIT

Provisions on loan losses and total losses for the period, are calculated according to the new IFRS 9 standard based on expected credit loss by using a 3 stage method described in note 26 in the annual report.

Figures for the corresponding period last year are based on IAS 39 loss model. Therefore, figures for the current period iarenot comparable to previous periods.

Different elements included in losses and provisions on loan losses and undrawn credit, is discussed under accounting policies. Please also refer to note 3 – Risk management and note 5 – Credit Area and credit risk.

NOK Thousand	31.12.2018	31.12.2017
Changes in impairment losses for the period, stage 1	286	0
+ Changes in impairment losses for the period, stage 2	-3 695	0
+ Changes in impairment losses for the period, stage 3	982	0
= Total losses for the period	**-2 427**	**0**

	Stage 1	Stage 2	Stage 3	
NOK Million	Excpected losses in the next 12 months	Lifetime excpected credit losses	Lifetime excpected credit losses	Total
Provisions on loan losses as at 01.01.2018	**1 600**	8 200	**400**	**10 200**
Transfers				
Transferred to stage 1	3 900	-3 868	-32	0
Transferred to stage	-157	157	0	0
Transferred to stage 3	**0**	-16	**16**	**0**
Losses on new loans	782	678	6	1 466
Losses on deducted loans *	-326	-2 195	-93	-2 614
Losses on older loans and other changes	**-3 912**	1 610	**1 041**	**-1 261**
Provisions on loan losses at 31.12.2018	1 888	4 565	1 337	7 791
Provisions on loan losses	1 840	4 521	1 317	7 679
Provisions on undrawn credit	48	44	20	112
Total provisions on losses as at 31.12.2018	**1 888**	**4 565**	**1 337**	**7 791**

* Losses on deducted loans are related to losses on fully repaid loans and loans transferred between the company and the Parent Bank. Write-downs on off-balance items (undrawn credit on flexi-loans) are also included in the table above.

Stage	Commitment amount	In %	Calculated loss	In %
1	37 541	95.5 %	2	24.2 %
2	1 745	4.4 %	5	60.7 %
3	14	0.0 %	0	2.2 %
Total	**39 301**	**100.0 %**	**8**	**100.0 %**

NOTE 9 – COVER POOL COMPOSITION AND LOAN-TO-VALUE RATIO

	Fair value	
NOK Thousand	31.12.2018	31.12.2017
Loans secured by mortgages on residential properties (1)	38 728 856	30 967 963
Deduction of ineligible loans (2)	-82 734	-87 624
Pool of eligible loans	38 646 122	30 880 339
Certificates and bonds	2 166 143	556 484
Financial derivatives	422 884	345 837
Total cover pool	**41 235 150**	**31 782 659**
Debt incurred due to issuance of securities	**36 079 881**	**26 704 357**
Collateralisation ratio (OC)	**14.3 %**	**19.0 %**

1) Cover pool composition is defined in the Norwegian Financial Institution Act Section 11-8.
2) Loans with LTV (loan to value) > 75 % is included in the cover pool. However, the part of the loans exceeding 75 % (ineligibles) is excluded when calculating the OC above.

	Nominal value	
	31.12.2018	31.12.2017
OC based on nominal value, eligibles only	14.1 %	19.0 %
OC based on nominal value, all loans	14.3 %	19.4 %

	31.12.2018	31.12.2017
Average debt to assets ratio in %	56.8 %	57.0 %
Portfolio divided into intervals of debt to assets ratio		
Less than or equal to 40%	16.1 %	16.9 %
41 - 50 %	12.5 %	12.3 %
51 - 60 %	20.5 %	19.4 %
61 - 70 %	34.3 %	31.9 %
71 - 75 %	12.1 %	13.3 %
More than 75%	4.4 %	6.1 %
Total	**100.0 %**	**100.0 %**

NOTE 10 - INTEREST RATE RISK

Interest rate risk occurs in connection with the company's ordinary lending and borrowing activities and in relation to the activities in the Norwegian and international money and capital markets. Interest rate risk exists when fixed-interest periods for assets and liabilities differ. An interest risk limit has been adopted by the Board of Directors, and is measured as maximum loss as a result of parallel displacement of the yield curve by two percentage points as well as assumed changes to the yield curve.

Interest rate risk is managed through fixing of interest rates for asset and liability items and by use of financial derivatives. The company reports to the Board of Directors on a quarterly basis.

At 31 December 2018, Sparebanken Sør Boligkreditt AS`s portfolio of loans to customers consists solely of floating rate loans.

Two NOK denominated fixed rate interest bonds have been issued, and swapped to floating interest rate. In addition EUR denominated fixed rate bond have been issued, and converted into NOK and floating interest rate by the use of basis swaps (cross currency interest rate swaps). Hedge accounting is applied for all fixed interest rate and foreign currency financing.

The interest risk exposure was NOK 0.3 million at 31.12.2018 (NOK 6.9 million at 31.12.2017).

According to the company`s internal rules, the total accounting effect by a 10 percent exchange rate movement should not exceed NOK 10 million. The currency exposure was NOK 0 million as at 31.12.2018 (NOK 0 million as at 31.12.2017).

NOTE 11 - LIQUIDITY RISK

Liquidity risk is defined as the risk of the company failing to fulfill its obligations as they fall due. The company's liquidity risk was generally low in 2018, as illustrated by the fact that most of the company's loans were financed on a long-term basis through covered bonds. Long-term financing is defined as financing from the money and capital markets with maturities exceeding one year, as well as unutilised committed drawing rights. The company has to have sufficient liquid funds in order to fulfil its obligations at all times. In 2018, the company's funding structure complied with requirements imposed by law and instructions by the Board of Directors.

As of 31 December 2018, Sparebanken Sør Boligkreditt AS has an overdraft facility amounting to NOK 4 000 million with Sparebanken Sør. In addition, the company has a revolving credit facility with the Parent Bank, which can be used to refinance outstanding bonds. Annual commission is paid on the drawing rights.

Covered bonds issued by Sparebanken Sør Boligkreditt AS contain a clause giving the borrower an option to extend the loan by 12 months beyond the maturity date.

LIQUIDITY RISK

The table shows cash flows including contractual interest payments. The figures therefore cannot be reconciled with the balance sheet.

NOK Million	Total	1 mth.	3 mth.	1 year	5 years	Over 5 years
Liabilities / non derivative obligations						
Debt to credit institutions	2 894	2 894				
Debt incurred due to issuance of securities	30 552	20	109	1 823	25 500	3 100
Other liabilities	92	4	4	84		
Loan commitments and undrawn credit facilities	3 195	3 195				
Total liabilities	**36 733**	**6 113**	**113**	**1 908**	**25 500**	**3 100**
Derivative commitments						
Financial derivative gross payments						
Payments made	-14 898				-14 898	
Payments received	14 324				14 324	
Total derivative commitments	**-574**	**0**	**0**	**0**	**-574**	**0**

						31.12.2017
NOK Million	**Total**	**1 mth.**	**3 mth.**	**1 year**	**5 years**	**Over 5 years**
Liabilities / non derivative obligations						
Debt to credit institutions	3 360	3 360				
Debt incurred due to issuance of securities	27 442	20	73	843	25 523	983
Other liabilities	75	3	3	69	0	0
Loan commitments and undrawn credit facilities	2 287	2 287				
Total liabilities	**33 164**	**5 670**	**76**	**912**	**25 523**	**983**
Derivative commitments						
Financial derivative gross payments						
Payments made	-9 847				-9 847	
Payments received	9 454				9 454	
Total derivative commitments	**-393**	**0**	**0**	**0**	**-393**	**0**

Debt securities issued as at 31.12.2018

ISIN Number	Ticker	Currency	Nominal value	Interest		Due date	Book value	Fair value
NO0010679806	SORB10	NOK	5 000 000	Floating	3M Nibor	22.05.2019	5 014 680	5 018 596
NO0010664659	SORB07	NOK	28 000	Floating	3M Nibor	27.11.2019	28 070	28 167
NO0010714058	SORB24	NOK	5 000 000	Floating	3M Nibor	24.06.2020	4 983 420	5 017 927
XS1383921803		EUR	500 000	Fixed	0.250 %	22.03.2021	4 987 561	5 010 807
NO0010778954	SORB27	NOK	5 000 000	Floating	3M Nibor	22.11.2021	5 009 574	5 056 957
XS1622285283		EUR	500 000	Fixed	0.125 %	30.05.2022	4 985 692	4 976 170
NO0010671597	SORB09	NOK	350 000	Fixed	3.85 %	13.02.2023	384 248	386 586
XS1775786145		EUR	500 000	Fixed	0.375 %	20.02.2023	5 053 954	5 020 003
NO0010832637	SORB28	NOK	5 000 000	Floating	3M Nibor	24.09.2025	4 990 828	4 988 708
NO0010670409	SORB08	NOK	500 000	Fixed	4.00 %	24.01.2028	576 153	575 960
Total							**36 014 179**	**36 079 881**

NOTE 12 - INTEREST INCOME AND INTEREST EXPENSES

NOK Thousand	31.12.2018	31.12.2017
Interest on loans given to and receivables from credit institutions	872	645
Interest on loans given to customers	893 303	774 119
Interest on certificates/bonds/interest-bearing securities	26 056	12 655
Total interest income	**920 231**	**787 419**
Interest on debt to credit institutions	65 552	33 474
Interest on issued securities	475 984	393 673
Other interest expenses	0	1
Total interest expenses	**541 535**	**427 148**
Net interest income	**378 696**	**360 271**

NOTE 13 - INCOME FROM FINANCIAL INSTRUMENTS

NOK Thousand	31.12.2018	31.12.2017
Profit (loss) and change in value from covered bonds	-5 820	-541
Net income from covered bonds	**-5 820**	**-541**
Change in value fixed rate bonds - hedge accounting	-330 753	-573 039
Change in value derivatives fixed rate bonds - designated as hedging instruments	314 715	547 802
Net income hedging	**-16 038**	**-25 237**
Whereof effects from basis swaps (1)	-1 537	-31 072
Profit (loss) buyback own bonds - amortized cost	-1 111	-21 706
Net other financial instruments and derivatives	**-1 111**	**-21 706**
Net income from financial instruments	**-22 969**	**-47 484**

1) The company has issued covered bonds in Euro that have been hedged using basis swaps. Change in the value of the basis swaps as a result of changes in market conditions, is presented as hedging-inefficiency. This ineffective portion is recognised in the income statement.

Basis swaps are derivative contracts used to convert obligations in foreign currency into NOK. Basis swaps are used when the company has entered into long term funding in international capital markets. These are hedging instruments, and assuming the underlying bond is held to maturity, the change in market value over the instruments duration equals zero. Accounting effects are therefore reversed over time.

NOTE 14 - OTHER OPERATING EXPENSES

NOK Thousand	2018	2017
External fees	1 587	1 769
Management of loans / services purchased	65 857	55 459
Other operating expenses	3 553	2 898
Total other operating expenses	**70 997**	**60 127**

Remuneration to auditors is included in other operating expenses

NOK Thousand	2018	2017
Ordinary audit fees, statutory audit	128	137
Other attestation services	258	363
Fees on other services	30	0
Total remuneration of elected auditor (incl. VAT)	**416**	**500**

NOTE 15 - TAX

NOK Thousand	31.12.2018	31.12.2017
Tax-increasing temporary differences		
Fixed assets	-177	-222
Bond debt - adjusment of hedge accounting	-754 809	-487 188
Total tax-increasing temporary differences	**-754 986**	**-487 410**
Financial derivatives	672 218	428 477
Change in value from basis swaps recognised over OCI	-19 511	0
Accounting effects of transistion to IFRS 9	-4 228	0
Bond assets	-5 749	-748
Total tax-reducing temporary differences	**642 729**	**427 729**
Basis for deferred tax (+) / deferred tax assets (-)	**-112 257**	**-59 681**
Calculated deferred tax (+) / deferred tax assets (-)	**-28 064**	**-14 920**
Deferred tax / deferred tax assets as at 01.01.	-14 920	-8 694
Change in deferred tax in the profit	-7 209	-6 227
Change in deferred tax in the total profit	-4 878	
Accounting effects of transistion to IFRS 9	-1 057	
Deferred tax / deferred tax assets as at 31.12.	**-28 064**	**-14 920**
Profit before tax expenses	282 275	247 756
Permanent differences	-13	0
Change in temporary differences	33 065	24 906
Taxable income	**315 327**	**272 662**
Tax payable (25%)	**78 832**	**68 166**
Tax not settled for 2017	5 561	0
Other changes	-1 057	0
Tax payable in the balance sheet	**83 336**	**68 166**
Tax payable	78 832	68 166
Changes in deferred tax	-7 209	-6 227
Effects of transistion to IFRS 9	-1 057	0
Tax cost for the year	**70 565**	**61 939**
Effective tax rate	25.0 %	25.0 %

Deferred tax assets are recognised and justified based on expected future earnings.

NOTE 16 - FINANCIAL INSTRUMENTS BY CATEGORY

On 1 January 2018, IFRS 9 Financial instruments replaced IAS 39, Financial Instruments – Recognition and measurement.

From that point in time, the company changed its accounting policies in accordance with the new standard. The company chosed not to make use of an early adaptation of IFRS 9, which means that all corresponding figures from previous periods have been prepared according to IAS 39.

Amortised cost

Debt instruments, which sole purpose is to hold the instrument in order to collect contractual cash flows will be recognised at amortised cost. In the company, all borrowing and lending with floating interest rates are classified at amortized cost.

Fair value through profit

All derivatives will be measured at fair value, with the changes in value through profit and loss.

Sparebanken Sør Boligkreditt AS has also chosen to keep holdings of interest-bearing liabilities, certificates and shares at fair value through profit and loss. These are assets and liabilities that are managed, measured and reported to the management at fair value.

Fair value through other comprehensive income (OCI)

For interest and currency swaps used as hedging instruments, and signed after and including 1 January 2018, the changes in value due to changes in currency basis, will be recognised through other comprehensive income.

Hedge accounting

Sparebanken Sør Boligkreditt AS employs hedge accounting in relation to the company's funding at fixed interest rate terms and in foreign currencies. Hedging instruments are used to counteract the interest risk and foreign exchange risk of the bonds.

Upon transition to the new standard on 1 January 2018, we saw the following changes in the balance sheet items.

NOK Thousand	IAS 39		IFRS 9		
Financial assets	**Measurement**	**Book value**	**Measurement**	**Book value**	**Change**
Loans to and receivables from credit institutions	Amortized cost	152 957	Amortized cost	152 957	0
Net loan to customers	Amortized cost	30 967 963	Amortized cost	30 963 735	-4 228
Bonds and certificates	Fair value	808 817	Fair value	808 817	0
Financial derivatives	Fair value	368 812	Fair value	368 812	0
Financial liabilities	**Measurement**	**Book value**	**Measurement**	**Book value**	**Change**
Debt to credit institutions	Amortized cost	3 360 846	Amortized cost	3 360 846	0
Debt incurred due to issue of securities	Amortized cost	26 504 804	Amortized cost	26 504 804	0
Financial derivatives	Fair value	22 975	Fair value	22 975	0

All changes are dues to the new measurement model.

Classification as at 31.12.2018

NOK Thousand	Fair value	Hedge accounting	Amortized cost (1)	31.12.2018 Total
Loans to credit institutions			343 083	343 083
Net loans to customers			38 728 856	38 728 856
Bonds and certificates	2 625 663			2 625 663
Financial derivatives		421 929		421 929
Total financial assets	**2 625 663**	**421 929**	**39 071 938**	**42 119 530**
Debt to credit institutions			2 891 358	2 891 358
Debt incurred due to issuance of securities			36 014 179	36 014 179
Financial derivatives		0	0	0
Total financial liabilities	**0**	**0**	**38 905 537**	**38 905 537**

1 – Debt included in hedge accounting is presented as financial assets and liabilities at amortized cost.

Classification as at 31.12.2017

NOK Thousand	Financial instruments categorised at fair value (1)	Financial derivatives used as hedging instruments	Financial assets and liabilities at amortized cost (2)	31.12.2017 Total
Loans to credit institutions			152 957	152 957
Net loans to customers			30 967 963	30 967 963
Bonds and certificates	808 817			808 817
Financial derivatives		368 812		368 812
Total financial assets	**808 817**	**368 812**	**31 120 920**	**32 298 550**
Debt to credit institutions			3 359 909	3 359 909
Debt incurred due to issuance of securities			26 495 406	26 495 406
Financial derivatives		22 975		22 975
Total financial liabilities	**0**	**22 975**	**29 855 315**	**29 878 291**

1 – Maximum credit risk is equivalent to the recognised value of financial instruments voluntarily categorised at fair value.
2 – Debt included in hedge accounting is presented as financial assets and liabilities at amortised cost.

NOTE 17 - FAIR VALUES OF FINANCIAL INSTRUMENTS

METHODS TO DETERMINE FAIR VALUE

General

For financial instruments, for which the booked value is a reasonable approximation of fair value, valuation methods to calculate fair value are not used. This relates mainly to assets and liabilities that mature within three months or where interest is due or fixed within three months.

Interest rate swaps

Valuation of interest rate swaps at fair value is done through the use of valuation techniques, in which the expected future cash flows are discounted to the present value. The calculation of expected cash flows and the discounting of these are carried out by the use of observable market rates for different currencies and observable exchange rates. The estimated present value is checked against the corresponding estimates from the counterparties in the contracts.

Certificates and bonds

The valuation of certificates and bonds is through the use of valuation techniques, based on future cash flows and credit risk, assessed on the balance sheet date. The valuation is based on interest rates which cab be observed in the market. The Company's assessment of credit risk is based on information from various brokers.

Loans

For loans with a floating interest rate, fair value is considered to be equal to the nominal value.

Debt

For debt the valuation is made through the use of valuation techniques and the discounting of expected future cash flows. A risk-free interest rate is regarded as the interest rate on loans between credit-worthy banks. The mark-up for credit is made on the basis of the ongoing assessments which other market players make of the Company's creditworthiness.

Deposits

For floating rate deposits, the fair value is considered to be equal to nominal value.

Classification of financial instruments

Financial instruments are classified in different levels.

Level 1:

Includes financial assets and liabilities valued using the unadjusted observable market values. This includes listed shares, derivatives traded on active market places and other securities with quoted market values.

Level 2:

Instruments valued based on valuation techniques, and includes assumptions based on directly or indirectly observable market data. Values can be obtained from external market players or reconciled with the external market players that offer these types of services.

Level 3:

Instruments are based on valuation techniques, in which at least one essential requirement cannot be supported based on observable market values. This category includes investments in unlisted companies and fixed rate loans, for which no market information exists.

				31.12.2018
	Recognised		Fair value	
NOK Thousand	value	Level 1	Level 2	Level 3
Assets recognised at amortised cost				
Loans to and receivables from credit institutions	343 083		343 083	
Net loans to customers (floating interest rate)	38 728 856			38 728 856
Assets recognised at fair value				
Bonds and sertificates	2 625 663		2 625 663	
Financial derivatives	421 929		421 929	
Total financial assets	**42 119 530**	**0**	**3 390 674**	**38 728 856**
Liabilities recognised at amortised cost				
Debt to credit institutions	2 891 358		2 891 358	
Debt incurred due to issue of securities	36 014 179		36 079 881	
Liabilities recognised at fair value				
Financial derivatives	0		0	
Total financial liabilities	**38 905 537**	**0**	**38 971 239**	**0**

				31.12.2017
	Recognised		Fair value	
NOK Thousand	value	Level 1	Level 2	Level 3
Assets recognised at amortised cost				
Loans to and receivables from credit institutions	152 957		152 957	
Net loans to customers (floating interest rate)	30 967 963			30 967 963
Assets recognised at fair value				
Bonds and sertificates	808 817		808 817	
Financial derivatives	368 812		368 812	
Total financial assets	**32 298 550**	**0**	**1 330 587**	**30 967 963**
Liabilities recognised at amortised cost				
Debt to credit institutions	3 359 909		3 359 909	
Debt incurred due to issue of securities	26 495 406		26 645 880	
Liabilities recognised at fair value				
Financial derivatives	22 975		22 975	
Total financial liabilities	**29 878 291**	**0**	**30 028 764**	**0**

Hedge accounting

Sparebanken Sør Boligkreditt AS uses hedge accounting for debt issued at fixed interest rate and for bonds issued in foreign currency. The bonds included in hedge accounting are initially recognised at cost. Subsequent measurements at amortised cost, with the change in fair value related to the hedged risk. Derivative instruments are used as a hedge of interest rate and foreign currency risk. Hedge accounting requires the Company to measure and document hedge effectiveness.

All bonds issued at fixed rate or in foreign currency are accounted for using hedge accounting. Sparebanken Sør Boligkreditt AS uses fair value hedge accounting. The hedge is measured and documented every quarter to ensure that it is effective to maturity.

Result of hedge accounting

NOK Thousand	2018	2017
Result / ineffectivenes in hedge accounting		
Net income from other financial instruments	-16 038	-25 237
Total	**-16 038**	**-25 237**
Whereof effects from basis swap	-1 537	-31 072

Inefficiency in hedge accounting is recognised as a change in value and also appears in Note 13.

Hedge accounting in the balance sheet

The hedging instrument is recognised as financial derivatives. Value related to the hedged risk is recognised as debt incurred due to issuance of securities.

NOK Thousand	2018	2017
Recognitions concerning hedge accounting		
Finansial derivatives (clean value)	672 218	411 126
Total financial assets	**672 218**	**411 126**
Nominal hedge items	15 174 250	10 215 404
Adjustments of hedge items - hedged risk	754 809	458 987
Finansial derivatives (clean value)	0	13 222
Total financial liabilities	**15 929 059**	**10 687 612**

The table shows changes in value of the hedging instrument during the financial year.

Change in fair value of the hedged item that relates to the hedged risk is recognised as an adjustment of the hedged item in the balance sheet.

NOTE 18 - BONDS AND CERTIFICATES

NOK Thousand	31.12.2018	31.12.2017
Short-term investmets designated at fair value trough profit		
Certificates and bonds issued by public sector	154 105	151 047
Certificates and bonds issued by others	2 467 262	656 270
Accrued interests	4 295	1 500
Total	**2 625 663**	**808 817**

Classification of financial investments

Certificates and bonds are rated externally. For securities with an official rating this will be used, and in cases where an official rating does not exist an external broker will provide a credit assessment as a basis for risk classification.

Sparebanken Sør Boligkreditt AS owns only instruments with the lowest credit risk (Aaa rated) as at 31 December 2018.

NOTE 19 - FINANCIAL DERIVATIVES

Mill. kroner	31.12.2018	31.12.2018 (1) presented as net	31.12.2017	31.12.2017 (1) presented as net
Assets				
Financial derivatives	421 929	421 929	368 812	345 837
Debt				
Financial derivatives	0		22 975	0

1) Shows assets and liabilities if the company had netted their financial derivatives for individual counterparty.

The company's counter-claim rights comply with general Norwegian law. Sparebanken Sør Boligkreditt AS has the right to offset other outstanding accounts under ISDA agreements in cases where certain events occur. The amounts have not been offset in the balance sheet at 31 December 2018 or 31 December 2017 because the transactions are generally not settled on a net basis.

NOTE 20 - DEBT DUE TO ISSUANCE OF SECURITIES

NOK Thousand	31.12.2017	Issued	Matured / redeemed	Other changes in period	31.12.2018
Bonds, nominal value	26 409 900	15 581 000	-6 396 000	-14 716 900	20 878 000
Value adjustment	27 030			15 027 972	15 055 002
Accrued interest	58 476			22 701	81 177
Total debt due to issuance of securities	**26 495 406**	**15 581 000**	**-6 396 000**	**333 773**	**36 014 179**

NOK Thousand	31.12.2016	Issued	Matured / redeemed	Other changes in period	31.12.2017
Obligasjoner, nominell verdi	24 718 000	6 194 250	-4 895 000	392 650	26 409 900
Verdireguleringer	-146 038			173 068	27 030
Påløpte renter	61 316			-2 840	58 476
Sum gjeld stiftet ved utstedelse av verdipapirer	**24 633 278**	**6 194 250**	**-4 895 000**	**562 878**	**26 495 406**

NOTE 21 - AVERAGE INTEREST EXPENSES

NOK Thousand	31.12.2018	31.12.2017
Debt to credit institutions		
Debt to credit institutions	3.03 %	1.94 %
Debt incurred due to issuance of securities		
Bond debt, floating interest rate	1.63 %	1.19 %
Bond debt, fixed interest rate	3.94 %	3.94 %
Bond debt, fixed interest rate in Euro	0.25 %	0.19 %

Average interest rate, defined as annual interest in arrears, has been calculated as a weighted average of the actual interest rate conditions at 31 December 2018. No liabilities have special conditions. For fixed rate covered bonds, the coupon rate is specified. Fixed rate in NOK and foreign currency are swapped to floating rate in NOK.

NOTE 22 - RELATED PARTIES

NOK Thousand	31.12.2018	31.12.2017
Income statement		
Interest income from Sparebanken Sør on deposits	872	645
Interest expenses and commissions from Sparebanken Sør on loans/credit	70 552	38 474
Interest expenses on bond debts to Sparebanken Sør	6 536	0
Paid administration fees to Sparebanken Sør	65 655	55 409
Balance sheet		
Bank deposit in Sparebanken Sør	343 083	152 957
Cover bonds	5 711 000	0
Loans/credit in Sparebanken Sør	2 891 358	3 359 909

Sparebanken Sør Boligkreditt AS has a revolving credit facility with Sparebanken Sør, that can be used to refinance outstanding bonds.

NOTE 23 - EMPLOYEES, MANAGEMENT AND REPRESENTATIVES

The company had no employees at 31 December 2018.

External board members receive a fixed annual fee determined by the General Meeting.

NOTE 24 - SHARE CAPITAL AND SHARE OWNERS

NOK Thousand						2018
Shareholders	Number of shares	Nominal value per share	Share capital (1)	Dividend (1)	Profit for the period (1)	Profit per share (1)
Sparebanken Sør	100 000	11 250	1 125 000	0	197 076	1 970,76

NOK Thousand						2017
Shareholders	Number of shares	Nominal value per share	Share capital (1)	Dividend (1)	Profit for the period (1)	Profit per share (1)
Sparebanken Sør	100 000	5 250	525 000	0	185 817	1 858,17

1) For equity movements and allocations, we refer to the equity statement.

NOTE 25 - SEGMENT REPORTING

The company consists of only one segment, lending to consumers in Norway. Please refer to Note 6 regarding the geographical break down of loans. The company's activity consists of residential mortgages up to 75% of the property's market value. None of the company's customers individually accounts for more than 10% of the turnover. This applies to both 2018 and 2017.

NOTE 26 - DESCRIPTION OF THE LOSS MODEL UNDER IFRS 9

Impairment model

The model assessing the impairment of financial assets under IFRS 9 applies to financial assets measured at amortised cost and financial assets measured at fair value through other comprehensive income. The new standard entered into force on 1 January 2018. See Note 1 for a discussion of accounting policies implemented to comply with a new standard. The same calculation model is used for Sparebanken Sør Boligkreditt AS, the Parent Bank and the Group, but with different dates being defined for initial recognition.

Under IFRS 9, provision must be made for expected losses, based on relevant information available at the time of reporting, including historical, current and future information. The difference compared with the previous standard is that the loss is shown in the accounts before a loss event has occurred, and that future expectations are included in the calculations.

Impairment losses are calculated on the basis of probability of default (PD), loss given default (LGD) and exposure at default (EAD). The principal rule is that the loss provision is calculated on the basis of expected credit loss over the next 12 months or expected credit loss over the whole term. Expected credit loss over the whole term is calculated for assets where the credit risk has increased materially since initial recognition, with the exception of assets which are nevertheless assessed as having a low absolute credit risk on the reporting date. If there has not been a material increase in credit risk since initial recognition, a loss provision will be calculated for expected credit loss in the next 12 months. IFRS 9 also introduces requirements for loss provisions on new loans, by stating that impairment must be recognised for expected credit losses resulting from default in the next twelve months.

Assessment of a material worsening of credit risk

A material worsening of credit risk is assessed on the basis of both the relative increase in PD and the absolute change. It requires the relative change to be material and the level of risk itself to be not insignificant compared with that considered to be a low risk. In addition, any large absolute change must, under any circumstances, be regarded as a material worsening.

The limits for material worsening and PD checks are summarised in the table below.

Parameter	RM
Absolute limit (a)	0.75 %
Relative change (b)	2 %
Absolute change (c)	5 %

The absolute limit corresponds to risk class D. Risk class D for RM corresponds to the range 0.5% to 0.75%.

If the economic climate or special national/regional development trends indicate that there is a higher risk in individual sectors/industries, this is taken into account by changing the PD level of customers in the sectors/industries concerned.

Population

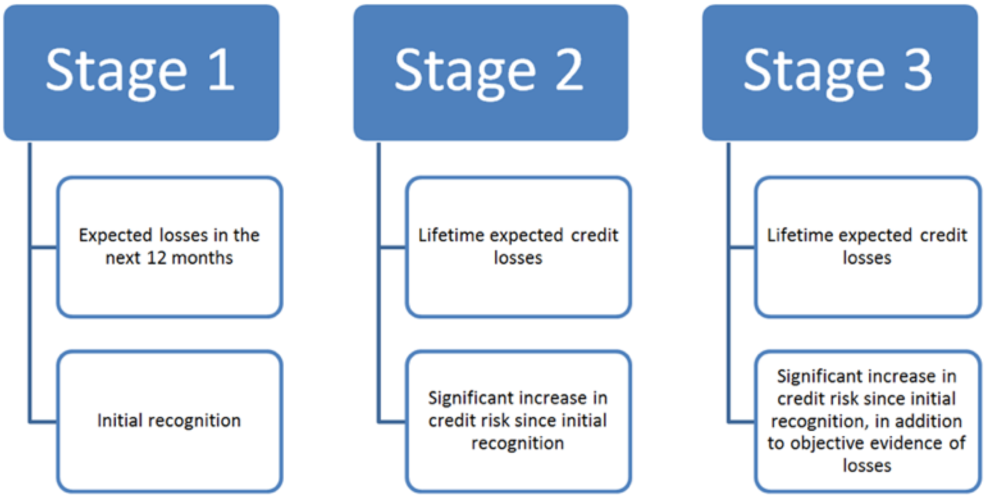
The model is intended to calculate expected loss for all customers, at the account level and not already recognised losses. The model also includes undrawn credit on flexi loans. For loans where the credit risk has increased materially after initial recognition, an impairment loss must be recognised for expected credit losses over the term of the loans. The calculation of impairment losses under IFRS 9 is based on status extracts at the end of the previous month for all the customers. All model calculations are made at the account level. Data that exists only at the customer level is linked to the individual account. For example, risk class is allocated at the customer level so that all the customer's accounts have the same score. The most important variables in the extract are risk class and PD with associated interest, balance, approval and collateral at the time of calculation.

Loans approved but not discounted at the time of measurement must also be included in the basis of calculation.

Under IFRS 9, an expected loss must also be calculated on receivables from central banks and credit institutions. The company has made no loss provisions with respect to these receivables for the financial year 2018. This is because the bulk of its loans to credit institutions relates to Norwegian banks. These are allocated to risk class B and have a PD of 0.175%. LGD are regarded as being low as they have a high rating from external agencies. The company considers the requirements for low credit risk to have been met as of the balance sheet date.

After the dataset has been defined, the various account commitments are noted and allocated to the different stages. Allocation to one of the three "stages" in the model is based on their change of risk since approval (change of credit risk). For a description of the individual "stages", see the subsequent explanations. All commitments are placed in stage 1 upon initial recognition, and are subsequently moved to stage 2 or 3 if there has been a material increase in credit risk. Commitments for which qualitatively assessed impairment losses have been recognised are excluded from the model-based calculation of impairment losses. Qualitatively assessed impairment losses are added to those in stage 3.

Non-performing account commitments are defined in the model as all account commitments where the customer has risk class K. For an overview of the company`s risk classes, refer to Note 5 –Credit and credit risk. A customer's commitment is assessed as being non-performing if an instalment has not been paid 90 days after its due date, or a line of credit has been overdrawn for more than 90 days. Where a customer has one or more non-performing loans, it is the customer's total commitment that is reported as being in default and not just the individual loan. See also Note 7.



Stage 1

In most cases, this is the starting point for all financial assets that come under the general impairment model. Financial instruments that have the same credit risk as at initial recognition and which have not been classified under stage 2 and 3 comes under this stage. The estimated expected losses recognised in the balance sheet are equivalent to the expected losses over the next 12 months.

Stage 2

The financial assets that have had a significant increase in credit risk since initial recognition are placed in stage 2. Whether an account commitment has been significantly deteriorated or not, is defined as a function of the probability of default (PD) at the measurement date and the probability of default on the date of initial recognition (loan approval) . Expected losses on assets in stage 2 are calculated over the remaining term of the asset.

The model has the following additional indicators and overriding rules for customer commitments (loans to customers):

- For commitments that qualify for a one-year loss calculation (stage 1), it will be checked whether there is a 30-day default/account overdrawn. If this exists, the loan commitment will be transferred to lifetime ECL (stage 2). This applies to overdraws from the first krone, but older than 30 days.
- For commitments that qualify for a one-year loss calculation (stage 1), it will be checked whether there is a larger overdraw. If this exists, the loan commitment will be transferred to lifetime ECL (stage 2). This applies to overdraws exceeding the credit limit, starting from the first day.
- Commitment with changed payment obligations or refinancing (forbearance) is automatically moved to stage 2.

Stage 3

Stage 3, includes assets that have had a significant change in credit risk since initial recognition and where there is objective evidence of loss at the time of reporting. This is defined as commitments in default or commitments where individual write-downs have been made. In this stage, the model calculates an expected loss over the remaining term of the asset. If individual write-downs have been made, these override the model-based calculation.

The model used by Sparebanken Sør Boligkreditt AS is the same model used by the Parent Bank Sparebanken Sør.

Estimated losses will be calculated on the basis of 12 months probability of default (PD), loss given default (LGD) and exposure at default (EAD). The data basis contains historical data about the observed PD and LGD. This will form the basis for producing estimates of future PD and LGD values. The Parent Bank's PD model gives PD at individual customer level, one year ahead. The Parent Bank does not have a lifetime PD model. When calculating the expected credit loss over the lifetime of the commitment it is the probability of default over the same lifetime that should be used.

Migration to a lower stage

A commitment that has migrated to stage 2 can migrate back to stage 1 if it no longer fulfils the criteria for migration stated above. Migration to a lower stage is not subject to any explicit quarantine period. Commitments that have gone into default will migrate to stage 1 or 2 when they are no longer in default.

Macroeconomic conditions and scenarios

The model contains data for macroeconomic conditions, and relevant parameters must be adjusted to take account of any changes in economic climate or macro conditions before the model can be run. The parameters are mostly set on the basis of empirical evidence.

The company has made use of 9 macro-variables in the model for 2018. These are based on a monetary policy report / financial stability assessment, obtained from Norges Bank. The macro-variables include national and international growth in GDP, growth in house prices, growth in employment, level of key interest rate and oil prices.

Three scenarios are defined in the model, realistic (base) scenario, optimistic scenario and pessimistic scenario. All the scenarios are applicable with effect from the date of calculation. This means that the first scenario period is in progress at the time calculation. This is done so that the scenarios will have an impact on the whole calculation, including stages 1 and 3. The background to the assessments is an overall assessment of all the central elements affecting the development of the Norwegian and regional economy, and whether these factors suggest that changes should be made to the PD and/or LGD level in individual sectors, product and market segments or the whole portfolio.

The realistic (base) scenario is a macroeconomic scenario that represents expected future economic growth over the next 5 years. The realistic scenario is comparable to the ICAAP scenario Base Case. The scenario is based on stable and moderate global economic growth being expected, as well as stable growth in the Norwegian economy over the next 5 years. It is further expected that regional economic growth over the next 5 years will be on a par with the rest of the country.

The optimistic scenario is a macroeconomic scenario that represents an economic upturn with strong economic growth. In year 5, the scenario converges towards balance with the realistic scenario. Positive development and strong economic growth over the next 5 years are expected in this scenario. Oil prices will rise and the Norwegian economy will experience strong economic growth. Regional economic growth is expected to be on a par with the rest of the country.

The pessimistic scenario represents a downturn, with weak economic growth. The pessimistic scenario may represent an economic downturn based on a 25-year cycle, but one that will be considerably milder than the credit crisis in the early 1990s. In year 5, the scenario converges towards balance with the realistic scenario. In this scenario, it is expected that growth in emerging markets will decline. Increased protectionism will create barriers to trade and global economic growth will stall. Oil prices fall and, taken together with weak economic growth among our most important trading partners, this will lead to weak development and growth in the Norwegian economy. Regional economic growth is expected to be on a par with the rest of the country.

Sensitivities

Loan to customers in the company is secured by real estate. This is considered to be one of the parameters that most affect LGD. Another important parameter that significantly affects the loss expense relates to the probability of default (PD). A sensitivity analysis relating to changes in the portfolio's collateral and increased probability of default was therefore performed as at 31 December 2018. The analysis has been carried out by assuming a fall in collateral of 10% and 20% respectively, over the coming year. The changes have the following impact on the company's loss expense:

		31.12.2018
NOK Thousand	Collateral reduction of 10%	Collateral reduction of 20%
Increased provisions on loans	3 933	8 925

The company has further assessed the scenarios described above and weighted them to determine ECL. Weighting was performed on the basis of an expectation that a realistic scenario will occur in 3 out of 5 years (60% probability), while the other two scenarios will occur in 1 out of 5 years (20% probability each).

Parameter	RM
Weighted optimistic scenario	20.00%
Weighted realistic scenario	60.00%
Weighted pessimistic scenario	20.00%

NOTE 27 – ACCOUNTING POLICIES USED PRIOR TO 1 JANUARY 2018

A new accounting standard, IFRS 9, was implemented on 1 January 2018. The standard was implemented in the financial statements at the same time. The Group had not chosen to make use of early adoption of IFRS 9, which means that all comparative figures from earlier periods have been prepared according to IAS 39.

Accounting policies under IAS 39 are reproduced below and taken from the annual report for 2017.

FINANCIAL INSTRUMENTS

Recognition and deductions

Financial assets and liabilities are recognised when the company becomes a party to the contractual decisions. A financial asset is deducted when the contractual rights to the cash flows from the financial asset expire, or the company transfers the financial asset in such a way that the risk - and profit potential of the asset in question is substantially transferred. A financial liability is deducted when the financial liability is discharged, cancelled or expired.

Offsetting

Financial assets and liabilities are offset and recognised as a net amount in the balance sheet only when the Company has a legally enforceable entitlement to offset, and intends to realise the asset and settle the liability simultaneously.

Classification

Financial instruments are classified into one of the following categories at initial recognition.

- Financial instruments designated as hedging instruments
- Financial instruments voluntarily categorised at fair value through profit or loss
- Loans and receivables at amortised cost
- Other liabilities at amortised cost

Financial instruments designated as hedging instruments

Financial derivatives must be valued at fair value with changes in value recognised through the income statement. Sparebanken Sør Boligkreditt AS has used interest rate and currency swaps. Financial derivatives will be recognised in the balance sheet at fair value with changes in value being recognised through the income statement. When calculating fair value, the applicable interest rate curve for the market at the time in question is used as a basis. The category includes interest swaps used as hedging instruments for fair value hedging of bonds issued with a fixed rate of interest.

Financial instruments voluntarily categorised at fair value with changes in value over profit or loss

Financial instruments included in a portfolio measured on an ongoing basis and reported at fair value are chosen to be recognised at fair value. For Sparebanken Sør Boligkreditt AS this concerns bonds and certificates that are assets.

Loans and receivables at amortised cost

This category includes loans and receivables that are measured at amortised cost.

Other liabilities at amortised cost

This category includes borrowings and liabilities that are measured at amortised cost.

MMeasurement at initial recognition

Initial recognition of financial assets and liabilities is at fair value. , Transaction costs that are directly attributable to the acquisition or the issuing of the financial asset or financial liability are added for instruments that are not derivatives or are measured at fair value through the income statement.

Subsequent measurement

Valuation at fair value

Fair value is the price that would be obtained upon the sale of an asset or the price that would be paid to transfer a liability in an orderly transaction between market participants at the time of valuation.

Measurement of financial instruments which are not traded in an active market

The fair value of financial instruments not traded in an active market is determined using a suitable valuation method.

Valuation techniques are based on the recently signed transactions between independent parties, by refering to instruments with virtually the same content or by discounting cash flows. As far as possible, valuations are based on externally observed parameter values.

In calculating the fair value of interest swaps entered into, the market value of the relevant inter-bank interest rate curve is used at all times.

NOTE 28 – SUBSEQUENT EVENTS

Events of major significance to the accounts have not occurred after the balance sheet date.

Declaration from the Board of Directors and Managing Director

Declaration in accordance with Section 5-5 of the Securities Trading Act

The Board of Directors and Managing Director of Sparebanken Sør Boligkreditt AS hereby confirm that the Company's 2018 financial statements have been prepared in accordance with applicable accounting standards and that the information provided in the financial statements gives a true and fair view of the Company's assets, liabilities, financial position and overall result of operation.

In addition, we confirm that the Report of the Board of Directors gives a true and fair view of the Company's development, results and financial position, together with a description of the most central risks and uncertainties facing the Company.

Kristiansand, 4 March 2019

The Board of Directors of Sparebanken Sør Boligkreditt AS

Geir Bergskaug	Seunn Smith-Tønnessen	Gunnar P. Thomassen	Bjørn Friestad
Styreleder	Styremedlem	Styremedlem	Styremedlem

Marianne Lofthus
Daglig leder

To the General Meeting of Sparebanken Sør Boligkreditt AS

Independent Auditor's Report

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Sparebanken Sør Boligkreditt AS, which comprise the balance sheet as at 31 December 2018, the income statement, other comprehensive income, equity statement and cash flow statement 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 give a true and fair view of the financial position of the Company as at 31 December 2018, 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, including 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.

The company's business activities are largely unchanged compared to the year before. We have not identified regulatory changes, transactions or other events that qualify as new Key Audit Matters. As a result, the focus areas of our audit have been the same in 2018 as in the previous year.

Key Audit Matter	How our audit addressed the Key Audit Matter
Loans to customers and regulations related to cover pool	
Sparebanken Sør Boligkreditt AS has provided mortgage loans to private individuals, secured by real estate, that are subject to special requirements related to over-collateralisation and has issued	In accordance with regulations, the company has engaged us as independent investigator to test, each quarter, that the cover pool fulfils the requirements for companies that issue covered bonds. Our procedures included assessment and testing of the company's

PricewaterhouseCoopers AS, Gravane 26, Postboks 447, NO-4664 Kristiansand
T: 02316, org. no.: 987 009 713 VAT, www.pwc.no
State authorised public accountants, members of The Norwegian Institute of Public Accountants, and authorised accounting firm

Independent Auditor's Report - Sparebanken Sør Boligkreditt AS

covered bonds. Processes have been implemented to ensure the company complies with the requirements related to the cover pool when covered bonds are issued. The processes include formal controls and segregation of duties to ensure controls have been performed prior to sale of loans from the parent company to Sparebanken Sør Boligkreditt AS. We focused on this area because compliance with regulations is fundamental to the company’s operation.	systems and controls as well as scrutinizing documentation on the composition and value of the cover pool. Further, we performed sample testing of loans sold from the parent company to Sparebanken Sør Boligkreditt AS during the year to test whether these loans fulfilled the requirements. Our procedures showed that the company complied with the requirements for companies that issue covered bonds. Refer to note 9 to the financial statements for information about the cover pool. We have examined the information disclosed in the financial statements and found this to be sufficient and adequate.
IT systems supporting financial reporting	
We focused on this area because the company’s financial reporting system and business as a whole are dependent on complex IT systems. Potential weaknesses in automated processes and related IT dependent manual controls may disrupt the continuous operation of the IT systems and cause risk of misstatements.	The company used external service organisations to operate certain key IT systems. The auditors of the respective service organisations evaluated design and tested operating effectiveness of the controls addressing integrity of the IT systems that are relevant to financial reporting. We satisfied ourselves regarding the auditor’s competence, capacity and objectivity and examined the reports received and assessed potential weaknesses and remediation initiatives. We also performed testing of access controls related to the company’s IT systems and segregation of duties where this was considered necessary to our audit. Our assessments and tests showed that we could rely on the IT systems relevant to our audit.

Other information

Management is responsible for the other information. The other information comprises information in the annual report, except 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.

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 in accordance with law and regulations, including 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.

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, including 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

Independent Auditor's Report - Sparebanken Sør Boligkreditt AS

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 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

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 proposed allocation of the result is consistent with the financial statements and complies with the law and regulations.

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.

Kristiansand, 4 March 2019
PricewaterhouseCoopers AS

Reidar Henriksen
State Authorised Public Accountant

Note: This translation from Norwegian has been prepared for information purposes only.

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SPAREBANKEN SØR
BOLIGKREDITT AS

Sparebanken Sør Pb. 200, 4662 Kristiansand | www.sor.no | tlf. 38 10 92 00