

MOODY'S

INVESTORS SERVICE

Rating Action: Moody's places Orkuveita Reykjavikur's Ba3 issuer rating on review for possible upgrade

Global Credit Research - 13 Jun 2016

London, 13 June 2016 -- Moody's Investors Service, ("Moody's") has today placed Orkuveita Reykjavikur's Ba3 long-term issuer rating on review for possible upgrade.

Today's rating action was driven by the potential strengthening of the Icelandic government's credit profile, as captured by Moody's review for possible upgrade of Iceland's Baa2 issuer and government bond ratings initiated on 10 June 2016. For details, please refer to: https://www.moodys.com/research/Moody's-places-Iceland's-Baa2-sovereign-rating-on-review-for-upgrade--PR_349992.

RATINGS RATIONALE

Orkuveita Reykjavikur (OR) is considered a government-related issuer under Moody's methodology because of its ownership by municipal authorities, which include the City of Reykjavik (93.5%), the Town of Akranes (5.5%) and the Municipality of Borgarbyggd (1%). The owners provide a guarantee of collection in support of OR, which currently covers more than 95% of the total outstanding debt.

The current issuer rating of OR does not represent a credit view of debt subject to the guarantee of collection provided by its owners, but it does incorporate an assumption of a moderate level of support to avoid a payment default if this were required. This recognises that despite the very strong incentives of the owners to provide timely financial support to OR its ability to do so in potential stress case scenarios may be constrained, given OR's very significant debt burden relative to the financial resources of its shareholders. Therefore, considering the critical nature of utility services that OR provides to the City of Reykjavik and the surrounding communities, covering more than 70% of the Icelandic population, Moody's would expect the central government to try and coordinate with the local governments to arrange timely intervention, if necessary. We note that instances of default by municipalities in Iceland during the 2008 crisis indicate a low probability of extraordinary support could be forthcoming directly from the central government in the event that OR were to face financial distress.

Overall, the Ba3 rating of OR incorporates one notch of uplift for potential extraordinary support to its standalone credit quality, as expressed by OR's baseline credit assessment (BCA) of b1.

WHAT COULD CHANGE THE RATING UP/DOWN

In its review, Moody's will consider whether the strengthening of the Icelandic government's credit profile will translate into a higher ability and willingness to provide financial support to OR, directly or indirectly through support to the company's shareholders, in case of need. In addition, the review will focus on the potential liberalization of capital controls in Iceland, the improving macroeconomic environment, the strengthening of the sovereign credit profile, and the impact of these on OR's standalone credit profile. Moody's will endeavour to conclude the rating review within 90 days.

The principal methodology used in this rating was Government-Related Issuers published in October 2014. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Reykjavik, Orkuveita Reykjavikur is the largest multi-utility in Iceland. The company operates its own power plants, electricity distribution system, geothermal district heating system and provides cold water and waste services in 20 communities in the southwest of the country, covering more than 70% of the Icelandic population.

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