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Transaction Update: Kommunalkredit Austria AG (Public Sector Covered Bonds)

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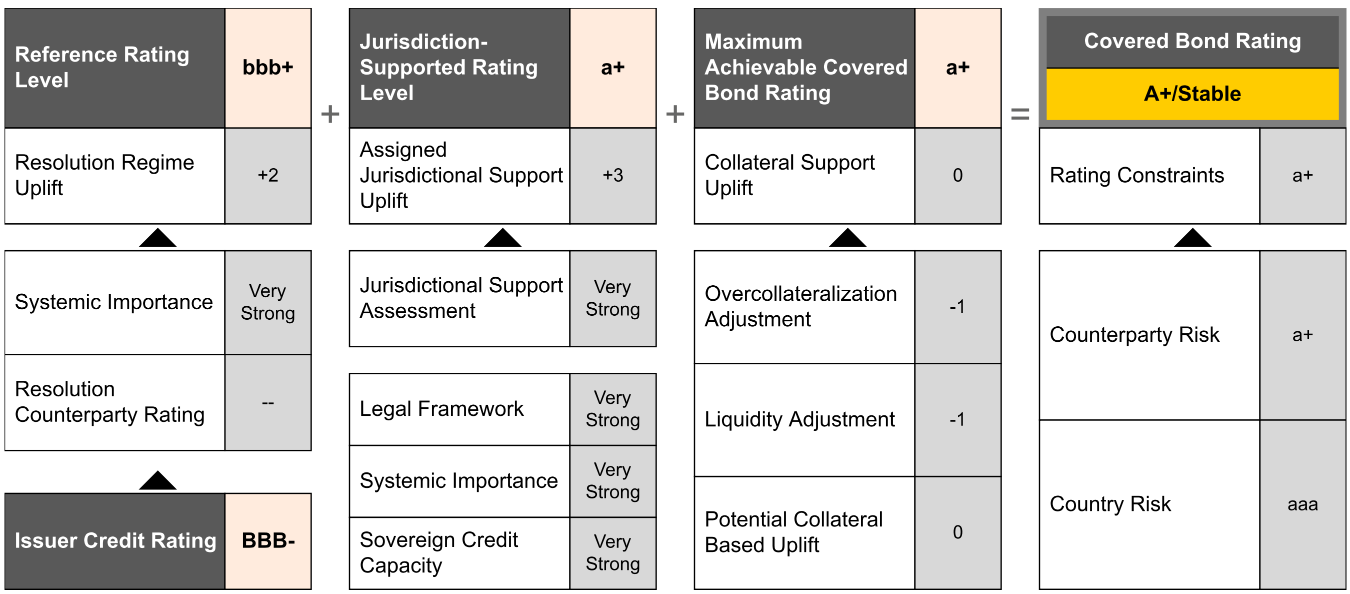
Ratings Detail



Major Rating Factors

Strengths

- Very strong jurisdictional support assessment for Austrian public sector covered bonds.
- High credit quality portfolio of predominantly Austrian public sector assets.

Weakness

- Counterparty risk currently caps the covered bond ratings at 'A+'.
- High obligor concentration drives credit risk in the portfolio, but available credit enhancement covers this risk.

Outlook: Stable

The stable outlook on our covered bond ratings reflects that the combination of the issuer credit rating (ICR) and counterparty risk in the program currently caps the covered bond ratings at 'A+'.

Our outlook on the ICR is positive. However, raising the ICR would not lead to an elevation of the covered bond ratings, because counterparty risk would still cap the covered bond ratings at the current level.

We would lower the ratings on the covered bonds if we were to lower our ICR on Kommunalkredit Austria AG, all else assumed unchanged.

Rationale

We are publishing this transaction update as part of our annual review of Kommunalkredit Austria AG's public sector covered bond program and related issuances.

Our covered bond ratings process follows the methodology and assumptions outlined in our "Covered Bonds Criteria," published on Dec. 9, 2014, and "Covered Bond Ratings Framework: Methodology And Assumptions," published on June 30, 2015.

Based on our analysis of the legal and regulatory framework for Austrian covered bonds, we conclude that the assets in the cover pool are isolated from the issuer's insolvency risk, which allows us to rate the covered bonds at a higher rating level than the long-term ICR on Kommunalkredit Austria (BBB-/Positive/A-3).

Kommunalkredit Austria is domiciled in Austria, which is subject to the EU's Bank Recovery and Resolution Directive (BRRD). We consider that public sector covered bonds have a very strong systemic importance in Austria. These factors increase the likelihood that the issuer would continue servicing its covered bonds without accessing the cover pool or receiving jurisdictional support, even following a bail-in of its senior unsecured obligations.

Under our covered bonds criteria, we assess the reference rating level (RRL) as 'bbb+'.

Based on our very strong assessment for jurisdictional support, the program potentially benefits from up to three notches of uplift from the RRL. Therefore, we assess the jurisdiction-supported rating level (JRL) as 'a+'.

We have reviewed the asset and covered bond information provided as of Sept. 30, 2023. The available credit enhancement in the program is below the level that we deem commensurate with any collateral based uplift.

The overcollateralization needed for the 'A+' rating is 3.24%, which covers unhedged foreign exchange risk, in our view.

Further, the replacement framework on the interest rate derivatives is not in line with our counterparty criteria (see "Counterparty Risk Framework: Methodology And Assumptions," published on March 8, 2019). Therefore, our counterparty criteria also cap our ratings on the program and related issuances at 'A+'.

Legal, operational, and sovereign risks do not constrain the ratings on the program and related issuances.

We have based our analysis on the criteria articles referenced in the "Related Criteria" section.

Program Description

Kommunalkredit Austria (BBB-/Positive/A-3) is a privately owned Austrian specialist bank engaging in infrastructure and energy financing in Europe and internationally, providing project structuring and financing services in social infrastructure and communications technology. It is also active in the energy and environment, transport, and natural resources sectors.

The covered bond program was established in 2003, by the issuer's predecessor entity. The covered bonds constitute a senior secured unsubordinated obligation, rank pari passu with other obligations secured by the cover register, and are governed by the Austrian Covered Bond Act ("Pfandbriefgesetz").

The assets in the cover pool are public sector assets located primarily in Austria and are almost exclusively euro-denominated. About one-fifth of the outstanding covered bonds are denominated in Swiss francs. Foreign exchange risk positions are hedged at the bank level, outside the cover pool. As no cross-currency swap is registered in the cover pool, the covered bond program is exposed to unhedged foreign exchange risk. We calculate this risk in our collateral analysis.

The program includes interest rate swaps, where the replacement framework is not in line with our counterparty criteria. Therefore, counterparty risk currently caps the ratings on the covered bonds at 'A+'.

Table 1

Program overview*	
Jurisdiction	Austria
Covered bond type	Legislation-enabled
Redemption profile	Mixed§
Cover pool balance (EURm)	1.275
Outstanding covered bonds (EURm)	1.134§
Underlying assets	Public sector and related entities, sovereigns, covered bonds
Assigned jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Available credit enhancement (%)	12.42
Target credit enhancement (%)	37.64
Credit enhancement commensurate with current rating (%)	3.24
Collateral support uplift	0
Unused notches for collateral support	0
Total unused notches	0

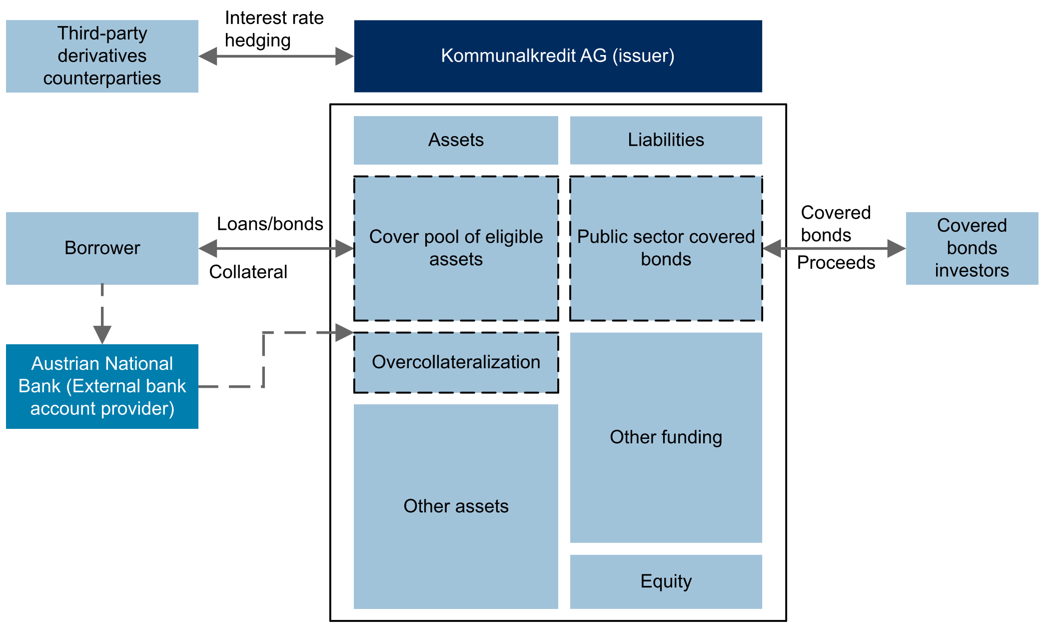
*Based on data as of Sept. 30, 2023. §On Oct. 10, 2023 €50 million soft-bullet covered bonds were issued.

Table 2

Program participants

Role	Name	Rating	Rating dependency
Issuer	Kommunalkredit Austria AG	BBB-/Positive/A-3	Yes
Bank account provider	Austrian National Bank	--	Yes

Kommunalkredit Austria AG (Public Sector Covered Bonds)



Rating Analysis

Legal and regulatory risks

We base our legal analysis on our "Asset Isolation And Special-Purpose Entity Methodology," published on March 29, 2017, and our covered bond ratings framework.

Kommunalkredit Austria's covered bonds are governed by the Austrian Covered Bond Act (CBA). Covered bonds issued prior to July 8, 2022 are grandfathered under the Austrian Law on Secured Bank Bonds (Law of 12/27/1905, "Gesetz betreffend fundierte Bankschuldverschreibungen--FBSchVG").

The CBA implemented the EU's Covered Bonds Directive and entered into force on July 8, 2022. The legislation merged the three previous laws ("Hypothekenbankgesetz," "Pfandbriefgesetz," and the "Gesetz betreffend fundierte Bankschuldverschreibungen") into one, lessening the legal complexity for Austrian covered bonds.

The CBA includes--among others--a 180-day liquidity buffer requirement, a 2% minimum overcollateralization requirement, the possibility for the special cover pool administrator to extend the maturity of the covered bonds by a maximum of 12 months subject to certain conditions, the appointment of a cover pool monitor (which can be internal or external at the issuer's choice), and the requirement of borrower consent for a loan to be registered as a cover pool asset.

Covered bonds that were issued before July 8, 2022 are not required to fulfill all requirements of the new law. We understand that Kommunalkredit Austria's outstanding bonds issued before July 8, 2022 have been grandfathered with the original designation.

The issuer holds the cover pool assets on its balance sheet. This means that the covered bonds are an unconditional obligation of the issuer, rather than a direct claim (solely) on the cover pool assets. If the issuer becomes insolvent, the cover pool assets will form a pool separate from the issuer's other assets, and a special cover pool administrator will be appointed to manage the cover pool assets. The covered bondholders have a preferential claim on the cover pool assets.

Derivatives are allowed for risk hedging purposes and must be registered in the cover register subject to the counterparty's prior approval. Claims of counterparties under registered derivative transactions rank pari passu with the claims of the covered bond holders.

Borrowers cannot set off any deposits they have with the issuer against their loans in the cover pool register. The prohibition of setoff does not apply to derivative contracts, when netting occurs for receivables arising under one and the same master agreement.

From our analysis of the Austrian Pfandbriefgesetz, we have concluded that the cover pool assets are effectively isolated from the issuer's insolvency for the covered bondholders' benefit. Upon issuer insolvency, a cover pool administrator is appointed by a bankruptcy court after consultation with the Austrian regulator (the Financial Market Authority) to continue the management of the cover pool and to satisfy the claims of the covered bondholders and registered derivative counterparties. The protection of the assets and continued management of the cover pool allows us to assign a higher rating to the covered bond program than the ICR on Kommunalkredit Austria.

Operational and administrative risks

Our analysis of operational risk follows the principles laid out in our covered bonds rating framework and our covered bonds criteria. We consider the procedures used by the issuing bank in the origination and monitoring of the cover pool assets.

In our opinion, there are no operational risks from the cover pool's management and loan origination that would constrain the covered bond ratings to the same level as our assessment of the issuer's creditworthiness. In our view, potential back-up servicers would be available if the issuer became unable to manage the program, considering that Austria is an established covered bond market and that the cover pool does not comprise product features that would materially limit the range of available servicers.

Resolution regime analysis

The RRL on the issuer, which is the starting point for any further uplift in our analysis, is 'bbb+'. We consider the following factors:

- The issuer is domiciled in Austria, which is subject to the EU's BRRD that excludes covered bonds from bail-in-able debt.
- We assess the systemic importance for Austrian public sector covered bonds as very strong.

Therefore, the RRL is the greater of (1) the ICR on Kommunalkredit Austria plus two notches; and (2) the resolution counterparty rating (RCR) on the issuer, where applicable. Because we do not assign an RCR to Kommunalkredit Austria, the RRL is 'bbb+', two notches above the ICR.

Jurisdictional support analysis

The covered bond program's JRL is 'a+'. The JRL is our assessment of the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of liquidating cover assets in the open market.

Our jurisdictional support analysis assesses three factors: the legal framework's strength, the covered bonds' systemic importance, and the sovereign's credit capacity. For Austrian public sector covered bonds, we assess all three factors as very strong, leading to an overall jurisdictional support assessment of very strong. In addition, our long-term sovereign rating on Austria (AA+/Stable/A-1+) does not constrain the JRL. As a result, the covered bonds benefit from three notches of jurisdictional support uplift above the RRL.

In order to assign full jurisdiction-based uplift in the absence of any collateral-based uplift (see "Collateral support analysis"), we expect the available credit enhancement to cover unhedged risks.

We have identified currency risk in the program as unhedged risk. The available credit enhancement of 12.42% exceeds the credit enhancement commensurate to cover this risk (3.24%). Therefore, we elevate the ratings on the covered bonds by three notches from the RRL to 'A+'.

Collateral support analysis

We base our analysis on the cover pool data provided by the issuer as of Sept. 30, 2023, and on our "Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," criteria, published on Dec. 9, 2014.

While the notional amount of the cover pool has reduced by about 3%, its composition and credit quality have remained stable since our last analysis. In addition to the primarily Austrian public sector assets (88.15%), the portfolio also includes exposures to French (4.54%), Portuguese (2.62%), and Belgian and German assets. The latter two categories each represent about 2% of the portfolio. The current cover pool includes no cash, in contrast to about 3% cash one year earlier.

Close to 75% of the cover pool represents exposures to local and regional governments (LRGs). The remaining assets are primarily non-LRG public finance assets (15%), and, to a limited degree, assets guaranteed by the German and French sovereigns, as well as one public sector covered bond.

The scenario default rate (SDR) that we consider to be commensurate with a 'AAA' credit stress increased to 27.12% in September 2023 from 25.69% one year earlier. While we now view the credit quality of about 77% of the cover pool as 'A-' or higher compared to 75% previously, obligor concentration has increased. The notional on the public sector assets has slightly increased and the number of obligors decreased year-on-year in September 2023. Consequently, the share of the twenty largest obligors has increased to 56.05% from 53.51%.

Our weighted-average recovery rate at the 'AAA' stress level of 73.33% has increased slightly since our previous review (73.15%) due to a small increase in the share of LRG assets. Recovery rates for public sector assets are based on our classification of the cover pool assets under our criteria for assessing public sector cover pools (see table 5).

Our analysis also considers obligor and industry concentration risk by applying a largest obligor test (LOT) and largest industry test (LIT), as outlined in our public sector criteria. The LIT consists of a primary and an alternative LIT. In Kommunalkredit Austria's cover pool, the alternative LIT shows the highest concentration, driven by Austrian LRGs.

For the purpose of the LIT, we treat LRGs in different countries as separate industries. The alternative LIT assesses if the rated security can withstand the default of two times the number of assets in the same industry when the largest obligor test is applied to that industry only. Our calculation includes fixed assumed recovery rates, factoring the underlying assets' credit quality. Based on our calculation, 15.90% credit enhancement is required to cover concentration risk in the program. Given that this is higher than the 'AAA' credit risk, the concentration test drives the results of our analysis and floors the credit risk at the 'AAA' rating level.

The results of our credit analysis represent inputs to our cash flow analysis. In addition, we have assumed a weighted-average stressed refinancing spread for the cover pool assets of 424 basis points. Our stressed weighted-average recovery period assumption is three years.

We stress the cover pool's cash flows, incorporating various default patterns, default timings, interest rate paths, and currency stresses (euro versus Swiss francs). Our analysis determines the target credit enhancement needed to achieve the maximum potential collateral-based uplift, inclusive of 100% refinancing costs and the credit enhancement required to cover 'AAA' credit risk assuming no asset-liability maturity mismatch.

'AAA' credit risk, as calculated based on cash flow stresses, is lower than the credit risk calculated based on concentration risk (LIT). Therefore, the latter floors 'AAA' credit risk at 15.90% (14.62% previously). The target credit enhancement commensurate with the maximum potential collateral-based uplift of four notches is 37.64% (36.02% previously).

We have not assigned any notches of collateral-based uplift above the JRL, because counterparty risk caps the rating at the JRL level.

Table 3

Key credit metrics

	As of Sept. 30, 2023	As of Sept. 30, 2022
Weighted-average cover pool asset rating	'BBB'	'BBB-'
Weighted-average loan asset maturity (years)	6.87	6.74
Largest obligor (percentage of the cover pool; %)	8.16	9.22
20 largest obligors (percentage of the cover pool; %)	56.05	53.51
Credit analysis results		
'AAA' scenario default rate (%)	27.12	25.69
Weighted-average recovery rate (%)	73.85	73.15
Weighted-average time to recovery (years)	3.04	3.06
Largest industry concentration test result (percentage of covered bonds; %)	15.90	14.62

Table 4

Breakdown by geography

	As of Sept. 30, 2023	As of Sept. 30, 2022
	Percentage of cover pool	
Austria	**88.15**	**88.21**
of which		
Lower Austria	22.67	21.86
Upper Austria	20.01	22.55
Burgenland	8.85	10.01
Carinthia	7.74	8.75
Styria	9.31	10
Vorarlberg	4.29	4.26
Tirol	4.17	4.72
Salzburg	2.68	3.14
Wien	8.43	2.92
Other countries		
France	4.54	2.12
Portugal	2.62	2.73
Belgium	2.41	4.44
Germany	2.27	1.70
Poland	0.00	0.81

Table 5

Recovery assumptions for cover pool assets*

			Percentage of cover pool	
Borrower type	**'AAA' recovery rate (%)**	**Time to recovery (years)**	**As of Sept. 30, 2023**	**As of Sept. 30, 2022**
Category A LRG without currency stress	90	4	73.7	73.42
Category A LRG with currency stress	75	4	0.00	0.66
Category B LRG without currency stress	75	4	2.62	2.73
Non-LRG international public finance assets	18	0	15.03	16.77
Covered bond	30	1	3.22	3.23
Sovereigns	37	0	5.43	3.20

*According to our criteria for pools of public sector assets. LRG--Local and regional governments.

Table 6

Asset distribution by rating*

	As of Sept. 30, 2023	As of Sept. 30, 2022
	Percentage of cover pool	
'AAA'	2.09	1.49
'AA'	25.67	27.14
'A'	48.95	46.23

Table 6

Asset distribution by rating* (cont.)

	As of Sept. 30, 2023	As of Sept. 30, 2022
'BBB'	17.16	18.62
'BB' or lower	6.13	6.52
Total	100.00	100.00

*Includes S&P Global Ratings' stressed assumptions.

Table 7

Collateral uplift metrics

	As of Sept. 30, 2023	As of Sept. 30, 2022
Asset WAM (years)	6.99	6.74
Liability WAM (years)	3.41	4.50
Maturity gap (years)	3.58	2.24
Available credit enhancement (%)	12.42	12.41
'AAA' credit risk (%)	15.90	14.62*
Required credit enhancement for first notch of collateral uplift (%)	16.73	17.59
Required credit enhancement for second notch of collateral uplift (%)	23.70	23.74
Required credit enhancement for third notch collateral uplift (%)	30.67	29.88
Target credit enhancement for maximum uplift (%)	37.64	36.02
Potential collateral-based uplift (notches)	0	0
Adjustment for liquidity (Y/N)	Y	Y
Adjustment for committed overcollateralization (Y/N)	Y	Y
Collateral support uplift (notches)	0	0

*Floored by the largest industry concentration test applicable under our public sector criteria. WAM--Weighted-average maturity.

Counterparty Risk

Bank accounts

For amounts channeled to dedicated accounts with Austrian National Bank, the account provider for the program, we would cap our rating on the program to our assessment of the credit worthiness of the Austrian National Bank.

Derivatives

We have analyzed the counterparty risks according to our counterparty criteria.

There are two interest rate derivatives registered in the cover pool with counterparties that are unrelated to the issuer. The replacement framework for these derivatives, which includes a credit support annex, is not in line with our counterparty criteria, and the swap termination costs are not subordinated (swap termination costs rank pari passu with the covered bonds under the law). Under our counterparty risk criteria, we consider the collateral replacement framework to be at least moderate.

As a result of the above and considering the RRL on the issuer, our criteria cap the rating on the covered bond program at the higher of (i) the issuer's RRL plus one notch; and (ii) the lowest RCR on the counterparties. Consequently, counterparty risk caps the ratings on the covered bonds at 'A+'.

Sovereign risk

We analyze sovereign risk under our criteria "Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumptions," published Jan. 30, 2019).

This is a multi-jurisdictional pool of public sector assets. The issuer is located in Austria, which is part of a monetary union. The outstanding covered bonds are hard bullet and have no structural coverage of refinancing needs for at least a 12-month period. The multi-jurisdictional treatment for covered bonds under the above criteria, including the supplemental tests--largest sovereign test and largest transfer and convertibility test--results in the rating on the program not being constrained by sovereign default risk.

Environmental, social, and governance credit factors

Governance factors are a moderately negative consideration in our ICR analysis of Kommunalkredit Austria, which is reflected in our governance assessment of the covered bond program. We acknowledge that environmental, social, and governance factors are enshrined in Kommunalkredit Austria's business model. Being a specialist bank, it engages in infrastructure and energy financing in Europe and internationally, providing project structuring and financing services in the areas of social infrastructure and communications technology. It is also active in the areas of energy and environment, transport, and natural resources. Kommunalkredit Austria was also the first Austrian Bank to issue a social covered bond with the proceeds used to finance the educational sector, social housing, and the health sector, with some of these loans being part of its public sector covered pool.

Related Criteria

- Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Counterparty Risk Framework: Methodology And Assumptions, March 8, 2019
- Incorporating Sovereign Risk In Rating Structured Finance Securities: Methodology And Assumption, Jan. 30, 2019
- Legal Criteria: Structured Finance: Asset Isolation And Special-Purpose Entity Methodology, March 29, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria - Structured Finance - Covered Bonds: Covered Bond Ratings Framework: Methodology And Assumptions, June 30, 2015
- Criteria - Structured Finance - Covered Bonds: Covered Bonds Criteria, Dec. 9, 2014
- Criteria - Structured Finance - Covered Bonds: Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities, Dec. 9, 2014
- Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Covered Bond Insights Q1 2024, Dec. 15, 2023
- Covered Bonds Outlook 2024: Stability Amid Turbulence, Dec. 11, 2023

- Kommunalkredit Austria AG, July 21, 2023
- S&P Global Ratings Definitions, June 9, 2023
- Glossary Of Covered Bond Terms, April 27, 2018