S&P Global
Ratings

Research

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

Fundierte Bankschuldverschreibungen

Primary Credit Analyst:
Natalie Swiderek, Madrid (34) 91-788-7223; natalie.swiderek@spglobal.com

Research Contributor:
Parashar Tendolkar, CRISIL Global Analytical Center, an S&P affiliate, Mumbai

Table Of Contents

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

Fundierte Bankschuldverschreibungen

Ratings Detail

Reference Rating Level	**--**
Resolution Regime Uplift	--
Systemic Importance	Very Strong
Resolution Counterparty Rating	--
Issuer Credit Rating	**--**

+

Jurisdiction-Supported Rating Level	**--**
Assigned Jurisdictional Support Uplift	--
Jurisdictional Support Assessment	Very Strong
Legal Framework	Very Strong
Systemic Importance	Very Strong
Sovereign Credit Capacity	Very Strong

+

Maximum Achievable Covered Bond Rating	**a**
Collateral Support Uplift	0
Overcollateralization Adjustment	-1
Liquidity Adjustment	-1
Potential Collateral Based Uplift	0

=

Covered Bond Rating	**A/Stable**
Rating Constraints	a
Counterparty Risk	a+
Country Risk	aaa

Major Rating Factors

Strengths

- Very strong jurisdictional support assessment for Austrian public sector covered bonds.
- Good credit quality portfolio of Austrian and German public sector assets with 73% of the cover assets pertaining to a rating category of 'A' and above.

Weakness

- The portfolio exhibits credit concentrations with the top 20 obligors accounting for about 56% of the cover pool, which we reflect in our credit analysis.

Outlook: Stable

The stable outlook on our covered bonds ratings reflects our view of the credit strength of the issuer.

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 of "Fundierte Bankschuldverschreibungen".

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.

The 'A' ratings on the covered bonds reflect our reference rating level (RRL) and jurisdiction-supported rating level (JRL) of the covered bonds and the coverage of foreign exchange risk. The overcollateralization needed for the 'A' rating represents our hard credit enhancement floor at 'A', or 1.50%. It is the minimum required credit enhancement to achieve the current 'A' rating, on the sole basis of the available jurisdictional support. We have not assigned any notches of collateral-based uplift above the JRL, because the available credit enhancement of 12.2% as of September 2019 is below the level that we would consider to be commensurate with the first notch of collateral-based uplift, which is 24.75%. This is driven by the result of our largest industry default test, which is applicable under our public sector criteria (see "Methodology And Assumptions For Assessing Portfolios Of International Public Sector And Other Debt Obligations Backing Covered Bonds And Structured Finance Securities," published on Dec. 9, 2014).

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

Lastly, the ratings on the program and related issuances are not constrained by legal, operational, or country risks.

Program Description

Kommunalkredit Austria is a privately owned Austrian specialist bank focused on infrastructure/public sector financing.

The covered bond program was established in 2003 (by the predecessor entity) and several covered bond series have been issued since then. The covered bonds are issued under the Austrian Law on Secured Bank Bonds ("Gesetz betreffend fundierte Bankschuldverschreibungen") and constitute senior secured unsubordinated obligations of the issuer and rank pari passu with all other obligations secured by the cover pool register. Covered bondholders have recourse first to Kommunalkredit Austria, and should insolvency proceedings against the issuer be launched, to the assets in the cover pool register.

The assets in the cover pool represent public sector assets located primarily in Austria and are mostly euro-denominated.

Covered bonds are denominated in euro (50.6%) and in Swiss francs (CHF; 49.4%). As no cross currency swap is registered in the cover pool, the covered bond program is exposed to unhedged foreign exchange risk. We understand that the issuer reduced the foreign exchange risk in the past and will continue to do so (e.g. upon Swiss franc-denominated covered bonds scheduled redemptions or euro-denominated issuances). Foreign exchange risk positions are hedged at the bank book level, outside the cover pool.

In addition, the program also includes interest rate swaps, where the replacement framework is not in line with our counterparty criteria.

Table 1

Program Overview*	
Jurisdiction	Austria
Covered bond type	Legislation-enabled
Redemption profile	Hard bullet
Underlying assets	Public sector
Jurisdictional support uplift	--
Unused notches for jurisdictional support	0
Target credit enhancement (%)§	24.75
Credit enhancement commensurate with current rating (%)	1.50
Available credit enhancement (%)	12.17
Collateral support uplift	0
Unused notches for collateral support	0
Total unused notches	0

*Based on data as of Sept. 30, 2019. §Floored by the largest industry concentration test applicable under our public sector criteria.

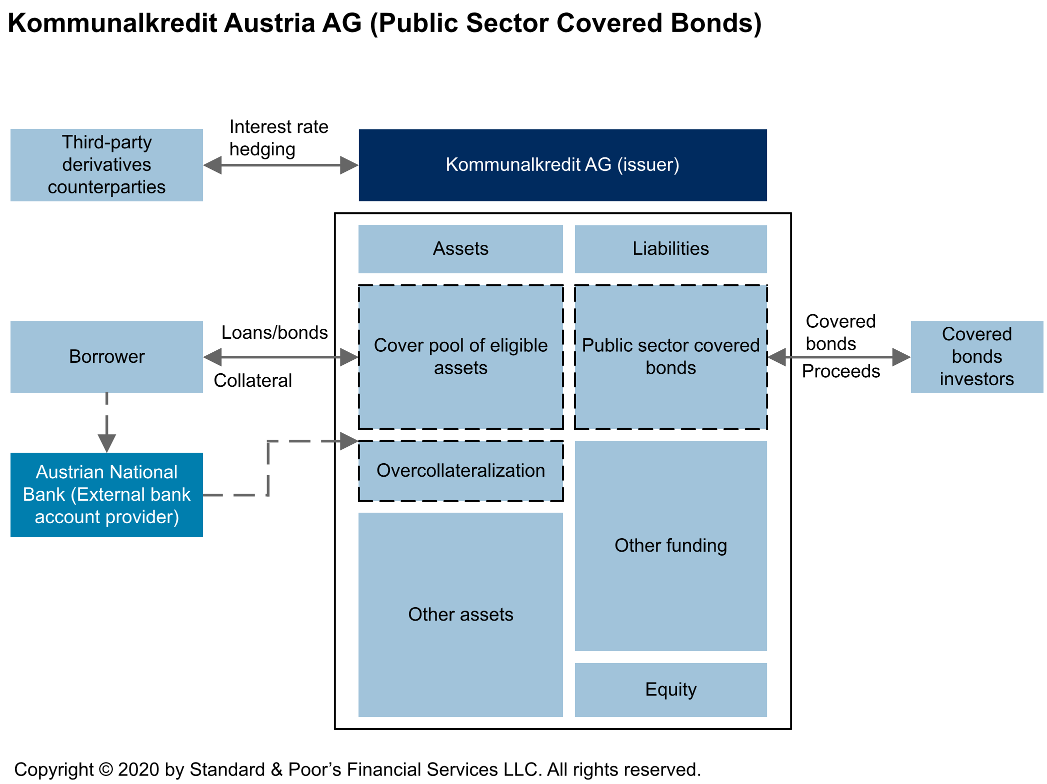
Table 2

Program Participants

Role	Name	Rating	Rating dependency
Issuer	Kommunalkredit Austria AG	--	Yes
Bank account provider	Austrian National Bank	NR*	Yes

*We consider Austrian National Bank's credit standing to be indistinguishable from that of the European Central Bank (unsolicited; AAA/Stable/A-1+). NR--Not rated.

Chart 1



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.

The covered bonds are governed by the Austrian Law on Secured Bank Bonds (Law of 12/27/1905, "Gesetz betreffend fundierte Bankschuldverschreibungen"). As of Sept. 30, 2019, the €1.001 billion of public sector covered bonds are secured by €1.123 billion of public sector assets recorded by the issuer in a cover pool register. The cover pool register is monitored by a trustee ("Regierungskomissär") appointed by the Ministry of Finance. The trustee has to ensure among other factors, that the prescribed cover for the covered bonds exists at all times and that the assets are recorded correctly. Assets may not be removed from the register without the approval of the trustee. The issuer is also subject to audits by the Austrian Financial Market Authority.

The Law on Secured Bank Bonds provides, among other things, that the total volume of assets in the cover pool register must at least cover the total nominal amount of the outstanding covered bonds, the interest payable on the outstanding covered bonds, and the potential running costs if the issuer becomes insolvent. Furthermore, we understand that according to the issuer's articles of association, a minimal overcollateralization of at least 2% on a net present value basis is maintained at all times. The issuer also calculates a risk-adjusted cover value to take into account currency, interest, and credit risk of the cover pool assets, which is included in the monthly reporting to the cover pool monitor.

From our analysis, we have concluded that the cover pool assets are effectively isolated from the insolvency of the issuer for the benefit of the covered bondholders. Upon issuer insolvency, a cover pool administrator is appointed by a court to continue the management of the cover pool and to satisfy the claims of the covered bondholders. 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 that corresponding to Kommunalkredit Austria's credit strength.

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 issuerś 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 above our assessment of the issuerś creditworthiness. We consider the following factors:

- The issuer is domiciled in Austria, which is subject to the EU's Bank Recovery And Resolution Directive (BRRD).
- Absent an assigned resolution counterparty rating for Kommunalkredit Austria, we add two notches of uplift to our assessment of the issuerś creditworthiness because we assess the systemic importance for Austrian public covered bonds programs as very strong.

Jurisdictional support analysis

In our jurisdictional support analysis, we assess the likelihood that a covered bond program facing stress would receive support from a government-sponsored initiative instead of from the liquidation of collateral assets in the open market.

Our assessment of the expected jurisdictional support for Austrian public sector covered bond programs is very strong, allowing up to three notches of uplift from the RRL (see "Assessments For Jurisdictional Support According To Our Covered Bonds Criteria," published on published on Oct. 16, 2018).

In order to assign full jurisdiction-based uplift in the absence of any collateral-based uplift (see "Collateral support analysis"), and as the covered bond program is exposed to unhedged foreign exchange risk, coupled with the local legislation's lack of provisions to address this additional risk (such as stress testing the exposure, or the ability to require increased minimum overcollateralization levels, for example), we have considered foreign exchange risk when calculating the required credit enhancement for a 'A' rating.

The available credit enhancement is sufficient to cover the foreign exchange risk, in our view. We expect the covered bonds to be supported by a minimum amount of credit enhancement of 1.5% for a 'A' rating.

Collateral support analysis

We base our analysis on the loan-level data provided by the issuer as of Sept. 30, 2019. The pool mostly comprises public sector assets located in Austria (94.7%). We do not assign any notches of collateral-based uplift above the JRL, currently.

Of the total cover pool assets, 79.5% represent Austrian local and regional governments (LRGs). The remaining assets are principally non-LRG public finance assets located mainly in Austria and, to a limited degree, assets guaranteed by the German sovereign, and German and Portuguese LRGs.

Since our previous review, the collateral pool's composition and credit quality have remained stable. As the cover pool balance reduced slightly, the credit enhancement also reduced to 12.2% from 14.8% but remains well above the required credit enhancement of 1.5% commensurate with a 'A' rating based on JRL.

The scenario default rate (SDR) that we consider to be commensurate with a 'AAA' credit stress is 24.4% as of September 2019 down from 27.6% as of September 2018. The reduction in the SDR is mainly due to a higher share of assets in the 'AA' rating category, which is driven by an increase of exposures to Upper Austria (AA+/Stable/A-1+; see tables 5 and 7).

Our weighted-average recovery rate at the 'AAA' stress level of 77.5% has remained stable since our previous review. 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 6).

We have not assigned any notches of collateral-based uplift above the JRL, as the available credit enhancement of 12.2% is below the level that we would consider commensurate with any notch of collateral-based uplift (24.7%). This is driven by the result of the largest industry concentration test applicable under our public sector criteria. The industry concentration test assesses if the covered bonds can withstand the default of a certain number of largest obligors within the same industry.

The tables below further summarize the results of our collateral based analysis.

Table 3

Key Credit Metrics

	As of Sept. 30, 2019	As of Sept. 30, 2018
Weighted-average cover pool asset rating	'BBB+'	'BBB+'
Weighted-average loan asset maturity (years)	5.61	5.82
Largest obligor (percentage of the cover pool; %)	15.14	11.56
20 largest obligors (percentage of the cover pool; %)	56.05	52.88
Credit analysis results		
'AAA' scenario default rate (%)	24.42	27.59
Weighted-average recovery rate (%)	77.53	77.03
Weighted-average time to recovery (years)	3.34	3.27

Table 3

Key Credit Metrics (cont.)

	As of Sept. 30, 2019	As of Sept. 30, 2018
Largest industry concentration test result (percentage of covered bonds; %)	24.75	22.53

Table 4

Asset Distribution By Geography

By sovereign

	As of Sept. 30, 2019	As of Sept. 30, 2018
	Percentage of cover pool (%)	
Austria	94.68	97.96
Germany	1.76	2.04
Portugal	3.56	0.00
Total	100.00	100.00

Table 5

Asset Distribution By Geography (Austrian LRGs)

	As of Sept. 30, 2019	As of Sept. 30, 2018
	Percentage of Austrian LRGs only (%)	
Lower Austria	23.11	22.92
Upper Austria	27.45	23.22
Burgenland	15.66	16.51
Carinthia	12.54	14.38
Styria	14.20	14.30
Vorarlberg	2.53	3.26
Tirol	1.92	2.19
Salzburg	1.42	1.72
Wien	1.16	1.50
Total Austrian LRG	100.00	100.00

LRG--Local and regional governments.

Table 6

Recovery Assumptions For Cover Pool Assets*

As of Sept. 30, 2019

Borrower type	'AAA' recovery rate (%)	Time to recovery (years)	Percentage of cover pool (%)
Category A LRG without currency stress	90	4	77.98
Category A LRG with currency stress	75	4	1.57
Category B LRG without currency stress	75	4	3.94
Non-LRG international public finance assets	18	0	15.21
Sovereigns	37	0	1.30

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

Table 7

Asset Distribution By Rating*

	As of Sept. 30, 2019	As of Sept. 30, 2018
	Percentage of cover pool (%)	
'AAA'	1.30	1.49
'AA'	35.08	32.42
'A'	36.72	40.00
'BBB'	22.88	25.60
'BB' or lower	4.01	0.48
Total	100.00	100.00

*According to S&P Global Ratings' stressed assumptions.

Table 8

Collateral Uplift Metrics

	As of Sept. 30, 2019	As of Sept. 30, 2018
Asset WAM (years)	5.61	5.92
Liability WAM (years)	3.81	4.81
Available credit enhancement (%)	12.17	14.78
'AAA' credit risk (%)	24.75*	22.53*
Required credit enhancement for first notch of collateral uplift (%)	24.75*	22.53*
Required credit enhancement for second notch of collateral uplift (%)	24.75*	22.53*
Required credit enhancement for third notch collateral uplift (%)	24.75*	22.53*
Target credit enhancement for maximum uplift (%)	24.75*	22.53*
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 the rating on the Austrian National Bank. We view Austrian National Bank's creditworthiness to be identical to that of the European Central Bank (unsolicited; AAA/Stable/A-1+).

Derivatives

We have analyzed the counterparty risks according to our counterparty criteria (see "Counterparty Risk Framework Methodology And Assumptions," published on March 8, 2019).

There are three 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 taking into account 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 resolution counterparty rating 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).

The cover pool predominantly includes exposures to Austrian public sector entities, and to limited extent exposures to German and Portuguese domiciled assets. We classify public sector loans as a having high sensitivity to country risk, allowing for a maximum rating uplift of up to two notches above the sovereign rating. Our long-term foreign currency sovereign rating on Austria is 'AA+'. In addition, exposures to assets located in Portugal are not material enough to constrain the ratings on the covered bonds. As a result sovereign risk does not constrain the ratings on the covered bonds.

Related Criteria

- 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
- General Criteria: Methodology: Credit Stability Criteria, May 3, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Covered Bond Insights Q4 2019, Dec. 12, 2019
- Global Covered Bond Characteristics And Rating Summary Q4 2019, Dec. 12, 2019
- Global Outlook: Covered Bond Harmonization Set To Raise The Bar In 2020, Nov. 26, 2019
- Summary: Austria, Sept. 14, 2019

- Covered Bond Monitor: Technical Note, Sept. 6, 2019
- S&P Global Ratings' Covered Bonds Primer, June 20, 2019
- Local Government Debt 2019: Slower Debt Reduction For German States And Little Change For Swiss And Austrian LRG Debt, March 1, 2019
- Transaction Update: Kommunalkredit Austria AG (Public Sector Covered Bonds), February 19, 2019
- Assessments For Jurisdictional Support According To Our Covered Bonds Criteria, Oct. 16, 2018
- Assessments for Target Asset Spreads according To Our Covered Bonds Criteria, Oct. 16, 2018
- Glossary Of Covered Bond Terms, April 27, 2018