

22 MAR 2021

Fitch Assigns Kommunalkredit Austria 'BBB-' Long-Term IDR; Outlook Stable

Fitch Ratings - Frankfurt am Main - 22 Mar 2021: Fitch Ratings has assigned Austrian infrastructure and energy financing bank Kommunalkredit Austria AG (KA) a Long-Term Issuer Default Rating (IDR) of 'BBB-' with a Stable Outlook and a Viability Rating (VR) of 'bbb-'. A full list of rating actions is below.

KA's ratings reflect its well-established niche franchise in infrastructure and energy finance, strong record of asset quality, experienced management team and adequate risk-management structure. The ratings also reflect the bank's small capital base (in absolute terms), which leads to concentration risks and increases the bank's sensitivity to individual credit events or outsized operational losses, as well as its reliance on a diversified base of syndication partners.

Key Rating Drivers

IDRs and VR

KA's Long-Term IDR is aligned with its VR and reflects the bank's solid record in operating its niche franchise, focusing on European infrastructure and energy financing under variable market conditions and so far without asset-quality deterioration since the outbreak of the Covid-19 pandemic. The growth of the infrastructure and energy finance loan portfolio appears to have been well controlled so far.

Fitch believes that KA's highly experienced management team and risk-management infrastructure are adequate to control the risk that inherently arises from the bank's business model, strategy and growth ambitions.

KA's small capital base results in a significant number of large single loan exposures in relation to its capital. This limits the benefits arising from the loan portfolio's sound diversification by geography, asset class and industrial sector. This is unlikely to change in the foreseeable future as we believe that capital injections by KA's owners to support its growth would only moderately improve concentration risk relative to its equity.

The combination of relatively large project-financing transactions and KA's small capital base renders the bank dependent on a reliable and diversified base of syndication partners both pre- and post-commitment under variable market conditions. This is mitigated by the "originate to collaborate" approach (i.e. syndication to a pool of recurring investors) of KA's credit approval process, its established and diversified syndication pipeline and its infrastructure debt fund targeted at non-bank institutional investors.

KA has adequate returns, enabled by its clearly defined niche strategy (which allows a focus on infrastructure and energy financing transactions with adequate risk/return profiles), lean cost base, and flexibility derived from its small size. Its underwriting standards and risk controls appear satisfactory. Its targeting of rapid new-business growth, planned small equity participations and selected higher-risk project financing in recent years indicate some appetite for higher-risk, opportunistic transactions, although we expect the bank's exposure to such transactions to remain moderate and well-controlled.

KA's main source of risk is project risk inherent in the infrastructure assets that represent an increasing proportion of its loan book, while market and operational risks appear relatively limited. The bank's asset quality benefits from its low-risk municipal loan book (largely in Austria), which will continue to decrease but still makes up about 40% of the loan book.

To date and one year since the outbreak of the pandemic, the bank has not reported any non-performing loans (NPLs), but impairments may arise as its infrastructure loan book seasons. Given the bulky nature of the bank's loan book, single NPLs could significantly inflate its NPL ratio.

The bank's funding profile is stable, with a sizeable and growing stock of customer deposits. Funding diversification is adequate and likely to increase as KA plans to make more substantial use of capital market funding. Its liquidity is healthy.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

KA's IDRs are driven by its VR and do not assume that extraordinary external support can be relied upon. The SR and SRF reflect KA's lack of systemic importance and our view that the EU's resolution framework is likely to require senior creditors participating in losses, if necessary, instead or ahead of a bank receiving sovereign support. The SR does not factor in any support from KA's owners either, because Fitch generally considers that support from financial investors, while possible, cannot be relied upon.

RATING SENSITIVITIES

IDRs AND VR

The Stable Outlook on the Long-Term IDR reflects Fitch's view that KA's asset quality, profitability and capitalisation offer adequate headroom to absorb a reasonable stress scenario while remaining commensurate with the current VR level.

Factors that could, individually or collectively, lead to positive rating action/upgrade

An upgrade of the IDRs and the VR is highly unlikely in the medium term and would require a major reduction in single-name concentration. This would necessitate a very substantial growth of KA's capital base, for instance through a large capital injection from the owners.

Factors that could, individually or collectively, lead to negative rating action/downgrade

We could downgrade the ratings if the bank incurs multiple defaults in its project finance portfolio or if it loosens its limits and underwriting standards to enable further opportunistic lending to higher-risk types of projects, more aggressive project-financing structures or junior financing.

We could also downgrade the ratings if aggressive RWA growth without matching capital increases results in an increasing usage of KA's large exposure limit. A downgrade could also result from a significant deterioration in the bank's ability to syndicate its lending commitments to a sizeable pool of external investors, a change in the investment policy of its infrastructure debt fund or a lack of independence in the fund's asset-selection process resulting in lower-quality assets being allocated to the fund.

SR AND SRF

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of the SR and upward revision of the SRF would be contingent on a positive change in the Austrian sovereign's propensity to provide support. In light of the prevailing regulatory framework and KA's low systemic importance, we believe this is highly unlikely.

Factors that could, individually or collectively, lead to negative rating action/downgrade

KA's SR and SRF are at the lowest levels on Fitch's rating scales and therefore cannot be downgraded.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>]

Date of Relevant Committee

11 March 2021

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

| ENTITY/DEBT | RATING | RECOVERY | PRIOR | |
|------------------------------|--------|--|------------|----|
| Kommunalkredit Austria AG | LT IDR | BBB-  | New Rating | WD |

| ENTITY/DEBT | RATING | | RECOVERY | PRIOR |
|-------------|---------------|------|------------|-------|
| | ST IDR | F3 | New Rating | WD |
| | Viability | bbb- | New Rating | WD |
| | Support | 5 | New Rating | WD |
| | Support Floor | NF | New Rating | WD |

RATINGS KEY OUTLOOK WATCH

| | | |
|----------|---|---|
| POSITIVE | ⊕ | ◇ |
| NEGATIVE | ⊖ | ◇ |
| EVOLVING | ◉ | ◆ |
| STABLE | ○ | |

Applicable Criteria

[Bank Rating Criteria \(pub.28 Feb 2020\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

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