

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

## Fundierte Bankschuldverschreibungen

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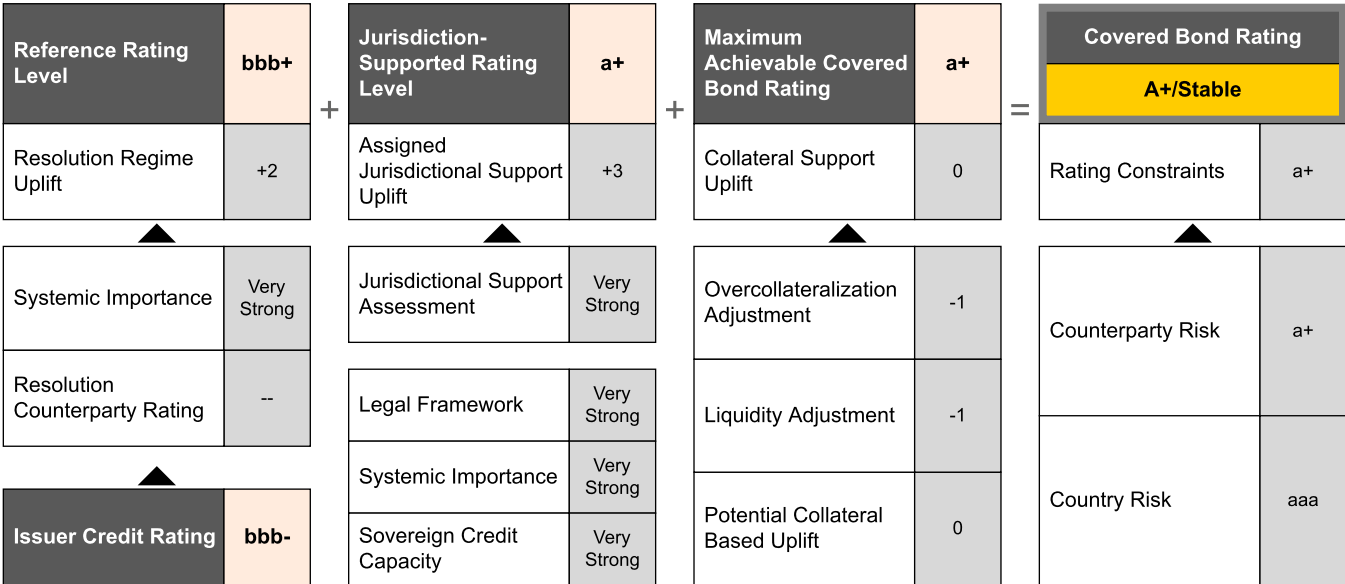
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# Transaction Update: Kommunalkredit Austria AG (Public Sector Covered Bonds)

## Fundierte Bankschuldverschreibungen

### Ratings Detail



### Major Rating Factors

#### Strengths

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

#### Weakness

- The portfolio exhibits credit concentrations with the top 20 obligors accounting for about 57.6% of the cover pool, which we reflect in our credit analysis.

### Outlook: Stable

The stable outlook on our covered bonds ratings reflects the stable outlook on Kommunalkredit Austria AG's long-term issuer credit rating (ICR).

## **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 'bbb+' reference rating level (RRL), the 'a+' jurisdiction-supported rating level (JRL), and the coverage of foreign exchange risk. The overcollateralization needed for the 'A+' rating is 7.16%. It is the minimum required credit enhancement to achieve the current 'A+' rating, on the sole basis of jurisdictional support. We have not assigned any notches of collateral-based uplift above the JRL, because the available credit enhancement of 11.71% as of September 2021 is below the level that we would consider to be commensurate with the first notch of collateral-based uplift, which is 21.72%.

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 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 (BBB-/Stable/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 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 (55%) and in Swiss francs (45%). 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.

Compared to our previous review, the cover pool's composition and credit quality remained fairly stable. The required credit enhancement for the 'A+' rating based on the JRL alone--corresponding to our determination of unhedged foreign exchange risk--has increased to 7.16% from 2.00%. This is due to our recalibration of the parameters for the foreign exchange rate projections for the Swiss Franc versus the euro in our cash flow model, the covered bond monitor.

**Table 1**

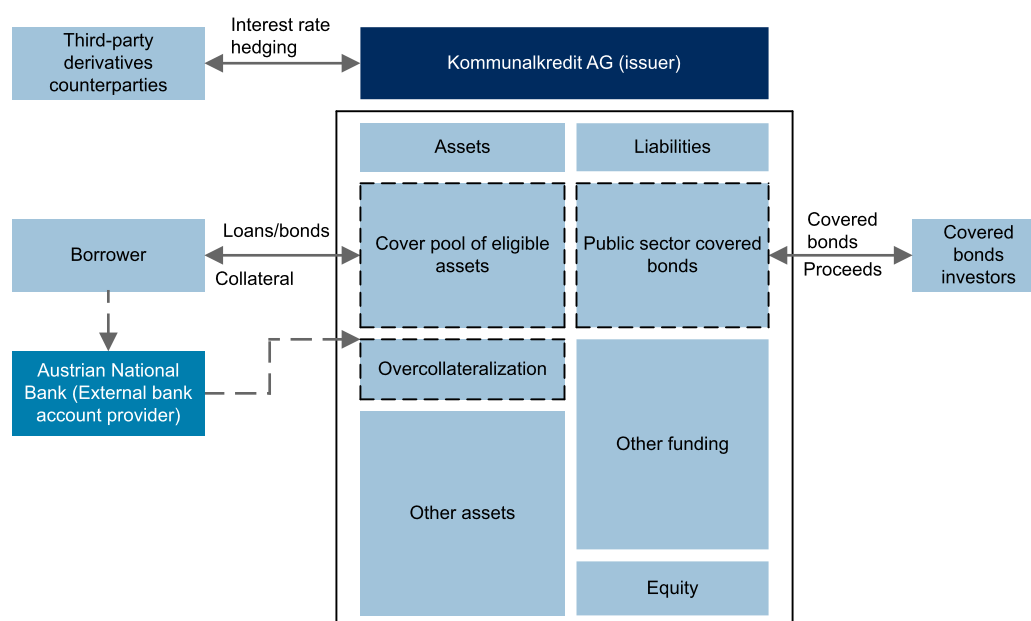
<b>Program Overview*</b>	
Jurisdiction	Austria
Covered bond type	Legislation-enabled
Redemption profile	Hard bullet
Underlying assets	Public sector exposures, sovereign exposures, and covered bonds
Assigned jurisdictional support uplift	3
Unused notches for jurisdictional support	0
Available credit enhancement (%)	11.71
Target credit enhancement (%)	36.88
Credit enhancement commensurate with current rating (%)	7.16
Collateral support uplift	0
Unused notches for collateral support	0
Total unused notches	0

\*Based on data as of Sept. 30, 2021.

**Table 2**

<b>Program Participants</b>			
<b>Role</b>	<b>Name</b>	<b>Rating</b>	<b>Rating dependency</b>
Issuer	Kommunalkredit Austria AG	BBB-/Stable/A-3	Yes
Bank account provider	Austrian National Bank	--	Yes

## Kommunalkredit Austria AG (Public Sector Covered Bonds)



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## 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, 2021, the €869 million of public sector covered bonds are secured by €971 billion of public sector assets recorded by the issuer in a cover pool register. The cover pool register is monitored by a trustee ("Regierungskommissär") 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. Additionally, the issuer is voluntarily committed to maintain overcollateralization at 10%. The issuer calculates a risk-adjusted cover value to consider 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 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 Bank Recovery And Resolution Directive (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"), and as the covered bond program is exposed to 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.

As of Sept. 30, 2021, the available credit enhancement of 11.71% is sufficient to cover the foreign exchange risk, determined in our cash flow analysis. We expect the covered bonds to be supported by a minimum credit enhancement of 7.16% for a 'A+' rating. The increase in the required credit enhancement compared to our previous review (2.00%) is due to our recalibration of the parameters for the foreign exchange rate projections for the Swiss Franc versus the euro in our cash flow model. The updated parameters reflect the trend we observed in the historical data of the euro appreciating against the Swiss Franc.

### **Collateral support analysis**

We base our analysis on the loan-level data provided by the issuer as of Sept. 30, 2021. The pool mostly comprises public sector assets located in Austria (96.6%). We do not assign any notches of collateral-based uplift above the JRL, currently.

Of the total cover pool assets, 72.93% 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 and French sovereigns, German LRGs, and one public sector covered bond.

Since our previous review, the collateral pool's composition and credit quality have remained stable. As the cover pool balance reduced more than the outstanding covered bonds, the credit enhancement reduced to 11.71% from 17.82% but remains above the required credit enhancement of 7.16% 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 26.43% as of September 2021, slightly up from 25.67% as of September 2020. The increase in the SDR is mainly due to a slightly higher share of assets with a stressed rating assumption of 'BB' or lower, which is driven by an increase of exposures to non-LRG assets (see tables 5 and 6).

Our weighted-average recovery rate at the 'AAA' stress level of 71.56% has reduced slightly 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 5).

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 assets of 394 basis points. Our stressed weighted-average recovery period assumption is 2.94 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.

We have calculated a 'AAA' credit risk of 21.43% and a target credit enhancement commensurate with the maximum potential collateral-based uplift of four notches of 36.88%. The 'AAA' credit risk 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.

We have not assigned any notches of collateral-based uplift above the JRL, as the available credit enhancement of 11.71% is below the level that we would consider commensurate with the first notch of collateral-based uplift of 21.72%--determined as 'AAA' credit risk--and 25% of the refinancing costs.

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

**Table 3**

Key Credit Metrics		
	As of Sept. 30, 2021	As of Sept. 30, 2020
Weighted-average cover pool asset rating	'BBB-'	'BBB+'
Weighted-average loan asset maturity (years)	5.24	5.02
Largest obligor (percentage of the cover pool; %)	13.35	14.83
20 largest obligors (percentage of the cover pool; %)	57.56	57.30
<b>Credit analysis results</b>		
'AAA' scenario default rate (%)	26.43	25.67
Weighted-average recovery rate (%)	71.56	74.50
Weighted-average time to recovery (years)	2.97	3.16
Largest industry concentration test result (percentage of covered bonds; %)	21.43	23.30

**Table 4**

Breakdown by Geography		
	As of Sept. 30, 2021	As of Sept. 30, 2020
	Percentage of cover pool (%)	
<b>Austria</b>		
Lower Austria	20.55	19.99
Upper Austria	23.99	25.53
Burgenland	12.27	12.65
Carinthia	11.94	10.70
Styria	15.54	14.92
Vorarlberg	3.54	3.56
Tirol	4.12	4.22
Salzburg	4.17	4.37
Wien	0.73	0.65
<b>Total Austria</b>	<b>96.85</b>	<b>96.61</b>
<b>Germany</b>		
North Rhine-Westphalia	0.31	0.33
Hesse	0.04	0.06
Republic of Germany	1.56	1.13



Table 4

Breakdown by Geography (cont.)		
<b>Total Germany</b>	<b>1.91</b>	<b>1.52</b>
<b>Portugal</b>		
Madeira	0.00	1.87
<b>Total Portugal</b>	<b>0.00</b>	<b>1.87</b>
<b>France</b>		
Republic of France	1.25	0.00
<b>Total France</b>	<b>1.25</b>	<b>0.00</b>

Table 5

Borrower type	'AAA' recovery rate (%)	Time to recovery (years)	Percentage of cover pool (%)	
			As of Sept. 30, 2021	As of Sept. 30, 2020
			Category A LRG without currency stress	90
Category A LRG with currency stress	75	4	1.41	1.70
Category B LRG without currency stress	75	4	0.00	1.87
Non-LRG international public finance assets	18	0	19.80	19.91
Covered bond	30	1	4.12	0.00
Sovereigns	37	0	2.81	1.13

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

Table 6

	As of Sept. 30, 2021	As of Sept. 30, 2020
	Percentage of cover pool (%)	
'AAA'	1.56	1.13
'AA'	33.84	32.33
'A'	36.48	37.79
'BBB'	23.56	26.43
'BB' or lower	4.56	2.32
Total	100.00	100.00

\*Includes S&P Global Ratings' stressed assumptions.

Table 7

	As of Sept. 30, 2021	As of Sept. 30, 2020
Asset WAM (years)	5.24	5.02
Liability WAM (years)	4.59	3.14
Maturity gap (years)	0.65	1.88
Available credit enhancement (%)	11.71	17.82
'AAA' credit risk (%)	21.43*	23.30*

**Table 7**

Collateral Uplift Metrics (cont.)		
	As of Sept. 30, 2021	As of Sept. 30, 2020
Required credit enhancement for first notch of collateral uplift (%)	21.72	23.30*
Required credit enhancement for second notch of collateral uplift (%)	26.78	23.30*
Required credit enhancement for third notch collateral uplift (%)	31.83	23.30*
Target credit enhancement for maximum uplift (%)	36.88	27.76
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

\*Flooded 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).

The cover pool predominantly includes exposures to Austrian public sector entities, and to limited extent exposures to German and French 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+'. Our unsolicited long-term sovereign rating on Germany is 'AAA'. In addition, exposures to assets located in France 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.

## **Environmental, social, and governance (ESG) credit factors**

The rating on Kommunalkredit Austria's public sector covered bonds is based on the jurisdiction-supported rating level. Therefore, we do not identify any environmental and social credit factors from the cover pool itself. We acknowledge that ESG 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. We also note that Kommunalkredit Austria was the first Austrian Bank to issue a social covered bond (€300 million) 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. Kommunalkredit Austria has committed to maintain overcollateralization of at least 10% for its covered bonds, which is below the level for any collateral-based uplift. That said, the Austrian Law on secured bank bonds, under which the bonds are issued, lacks liquidity provisions, which would limit the maximum collateral-based uplift above the jurisdiction-supported rating level. However, given that we don't assign any collateral-based uplift to Kommunalkredit Austria's covered bond program, we consider governance factors to have a neutral effect on our rating on the program.

## **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 Q4 2021, Dec. 13, 2021
- Covered Bonds Outlook 2022, Dec. 9, 2021
- S&P Global Ratings Definitions, Nov. 10, 2021
- Kommunalkredit Austria AG, May 14, 2021
- Kommunalkredit Austria AG Public Sector Covered Bonds Ratings Raised To 'A+'; Outlook Stable, March 4, 2021

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

- Transaction Update: Kommunalkredit Austria AG (Public Sector Covered Bonds), Jan. 21, 2021
- ESG Industry Report Card: Covered Bonds, Nov. 9, 2020
- Glossary Of Covered Bond Terms, April 27, 2018

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