FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Kommunalkredit Austria at 'BBB-'; Outlook Stable

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Fitch Ratings - Frankfurt am Main - 02 Mar 2022: Fitch Ratings has affirmed Kommunalkredit Austria AG's (KA) Long-Term Issuer Default Rating (IDR) at 'BBB-' with a Stable Outlook and Viability Rating (VR) at 'bbb-'.

A full list of rating actions is at the end of this rating action commentary.

Rating Withdrawals

Fitch has withdrawn the bank's Support Rating and Support Rating Floor following the update of its Bank Rating Criteria on 12 November 2021 as it is no longer considered by Fitch to be relevant to the agency's coverage. In line with the updated criteria, we have assigned KA a Government Support Rating (GSR) of 'no support'.

KEY RATING DRIVERS

KA's Long-Term IDR is driven by its VR. Its 'F3' Short-Term IDR is the only option mapping to a 'BBB-' Long-Term IDR as per our bank rating criteria.

KA's VR reflects its established niche franchise in infrastructure and energy (I&E) 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.

Niche I&E Franchise: KA has a solid record in operating its niche franchise focusing on European I&E financing. KA's balance sheet-light business model relies on a recurring and diversified base of syndication partners, both pre-and post-commitment, including the bank's own infrastructure debt fund targeted at institutional investors. We also believe that KA's highly experienced management team and risk-management infrastructure are adequate to control the inherent risk from the bank's business model, strategy and growth ambitions.

Satisfactory Risk Controls: KA's main source of risk is the inherent project risk in the infrastructure assets that represent an increasing proportion of its loan book. Its underwriting standards and risk controls appear satisfactory. The bank's 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 these transactions to remain moderate and well-controlled.

Strong Asset Quality Metrics: Asset quality benefits from the bank's low-risk public sector portfolio (largely loans to Austria municipalities), which accounts for about half of the loan book. To date, 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.

Improved Profitability: Operating profit has steadily improved over the last five years due to the rising revenue contribution of higher-margin I&E business, lower funding spreads and a lean cost structure. The I&E business also enhances revenue diversification by generating advisory, commitment and placement fees. However, the earnings and profitability score will remain constrained within the 'bbb' range in the medium term, because KA's small earnings base (in absolute terms) provides limited headroom to absorb asset quality swings.

Small Capital Base: 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.

Improving Funding, Sound Liquidity: The bank's funding profile is stable, with a sizeable and growing stock of mostly term online 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.

No Support Assumed: The GSR reflects 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 IDRs do 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

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 risk-weighted asset growth without matching capital increases results in increasing use 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.

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

Upgrades of the IDR and the VR are 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.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The long-term senior preferred (SP) debt rating is aligned with the bank's Long-Term IDR. This reflects Fitch's expectation that KA will not be subject to a minimum requirement for own funds and eligible liabilities, and that the bank will not build and maintain buffers of junior and senior non-preferred debt sustainably in excess of 10% of its risk-weighted assets.

The SP notes constitute direct, unsecured and unsubordinated obligations of KA. In the event of KA's insolvency or liquidation of they will rank pari passu among themselves and pari passu with all other unsecured and unsubordinated instruments or obligations of KA except for any instruments or obligations preferred or subordinated by law. According to the Austrian Recovery and Resolution Act, the SP notes rank junior to covered and other eligible deposits and senior to non-preferred senior debt instruments.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

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

The SP notes' rating would be downgraded if KA's Long-Term IDR was downgraded.

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

The SP notes' rating would be upgraded if KA's Long-Term IDR was upgraded.

VR ADJUSTMENTS

The operating environment score of 'a+' has been assigned below the 'aa' category implied score due to the following adjustment reason: international operations (negative).

The business profile score of 'bbb-' has been assigned above the 'bb' category implied score due to the following adjustment reason: strategy and execution (positive)

The asset quality score of 'bbb' has been assigned below the 'aa' category implied score due to the following adjustment reason: concentrations (negative)

The capitalisation and leverage score of 'bb+' has been assigned below the 'aa' category implied score due to the following adjustment reason: size (negative).

The funding and liquidity score of 'bbb-' has been assigned above the 'b' category implied score due to the following adjustment reason: historical and future metrics (positive).

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

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.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Kommunalkredit Austria AG	LT IDR	BBB- Rating Outlook Stable	Affirmed	BBB- Rating Outlook Stable
	ST IDR	F3	Affirmed	F3
	Viability	bbb-	Affirmed	bbb-
	Support	WD	Withdrawn	5
	Support Floor	WD	Withdrawn	NF
	Government Support	ns	New Rating	
Senior preferred	LT	BBB-	Affirmed	BBB-

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 12 Nov 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Kommunalkredit Austria AG	EU Issued, UK Endorsed

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