

Rating Action: Moody's upgrades Kommunalkredit Austria AG's public-sector covered bonds

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London, 25 July 2017 -- Moody's Investors Service has upgraded to Baa1 from Baa2 the ratings assigned to the public-sector covered bonds issued by Kommunalkredit Austria AG (Kommunalkredit; the issuer, not publicly rated). The covered bonds are backed by a pool of Austrian public sector assets and governed by the Covered Bond Act.

RATINGS RATIONALE

The upgrade is prompted by (i) an improvement in the credit profile of the issuer and (ii) a further improvement of the FX mismatch in the programme.

The improved credit profile of the issuer is reflected in the CR assessment, which is not published.

The issuer's recent repurchase of covered bonds denominated in Swiss franc and issuance of covered bonds denominated in euro improved the asset-liability profile of the covered bonds with respect to currency mismatch. The reduced currency mismatch has led to reduced levels of market risk in the covered bond programme.

In addition, the Baa1 rating takes into account over-collateralisation levels the issuer intends to maintain in the covered bond programme. In this respect, Kommunalkredit has limited the OC level that it intends to maintain to a minimum of around 10%.

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor); and (2) the stressed losses on the cover pool assets should the issuer cease making payments under the covered bonds (i.e., a CB anchor event).

The CB anchor for this programme is CR assessment plus 1 notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

The cover pool losses for this programme are 35.1%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 31.5% and collateral risk of 3.6%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 7.2%.

The over-collateralisation in the cover pool is 17.6%, of which the issuer provides 0.0% on a "committed" basis. The minimum OC level consistent with the Baa1 rating is 8.5%, of which the issuer should provide 0.0% in a "committed" form. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

The cover pool losses are an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk and collateral risk. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk is derived from the collateral score, which measures losses

resulting directly from the cover pool assets' credit quality.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly. All numbers in this section are based Moody's most recent modelling (based on data, as of 31 December 2016).

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

For Kommunalkredit's public-sector covered bonds, Moody's has assigned a TPI of probable-high.

Factors that would lead to an upgrade or downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

The TPI Leeway for this programme is not disclosed.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

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