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

Fundierte Bankschuldverschreibungen

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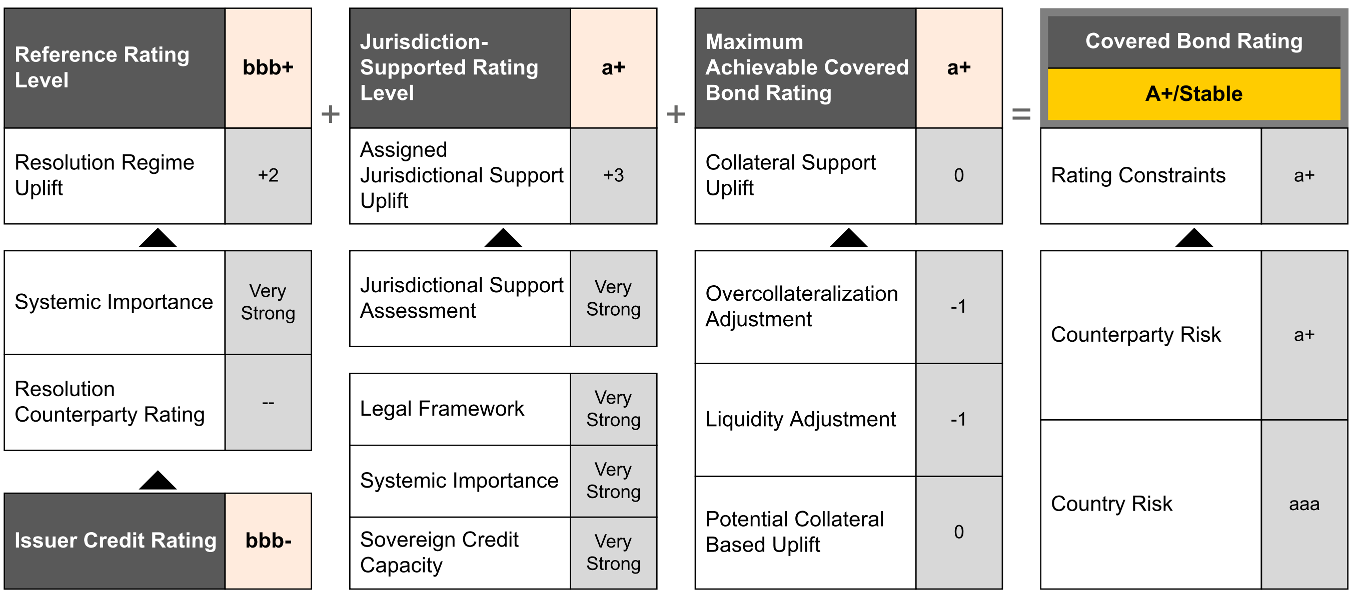
Ratings Detail



Major Rating Factors

Strengths

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

Weakness

- The portfolio exhibits credit concentrations with the top 20 obligors accounting for about 53.5% 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 3.92% (7.16% previously). 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 12.41% as of September 2022 is below the level that we would consider to be commensurate with the first notch of collateral-based uplift, which is 17.59%.

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 currently outstanding were 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. Austria's new covered bond law ("Pfandbriefgesetz") which implements the EU's Covered Bonds Directive was published on Dec. 10, 2021 and entered into force on July 8, 2022. It applies to all covered bonds issued after July 7, 2022. We understand that the issuer has already obtained program approval from the Austrian Financial Market Authority for the issuance of covered bonds out of the same cover pool under the new legislation.

The assets in the cover pool represent public sector assets located primarily in Austria and are almost exclusively euro-denominated, while the €1.134 billion outstanding covered bonds are denominated in euro- (77.34%) (previously 55%) and in Swiss francs (22.66%) (45% previously). As no cross-currency swap is registered in the cover pool, the covered bond program is exposed to unhedged foreign exchange risk. Since our 2022 annual review, the share of Swiss franc-denominated covered bonds has reduced as a result of scheduled redemptions and euro-denominated issuances. Foreign exchange risk positions are hedged at the bank level, outside the cover pool.

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

Compared to our previous review, the cover pool notional amount has increased to €1.274.7 billion (from €970.7 million), and its geographical scope has widened. This has resulted in reduced obligor concentration. The required credit enhancement for the 'A+' rating based on the JRL--corresponding to our determination of foreign exchange risk--has reduced to 3.92% from 7.16%. This is due to the aforementioned reduced share of Swiss franc-denominated covered bonds.

Table 1

Program Overview*	
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 (%)	12.41
Target credit enhancement (%)	36.02
Credit enhancement commensurate with current rating (%)	3.92
Collateral support uplift	0
Unused notches for collateral support	0
Total unused notches	0

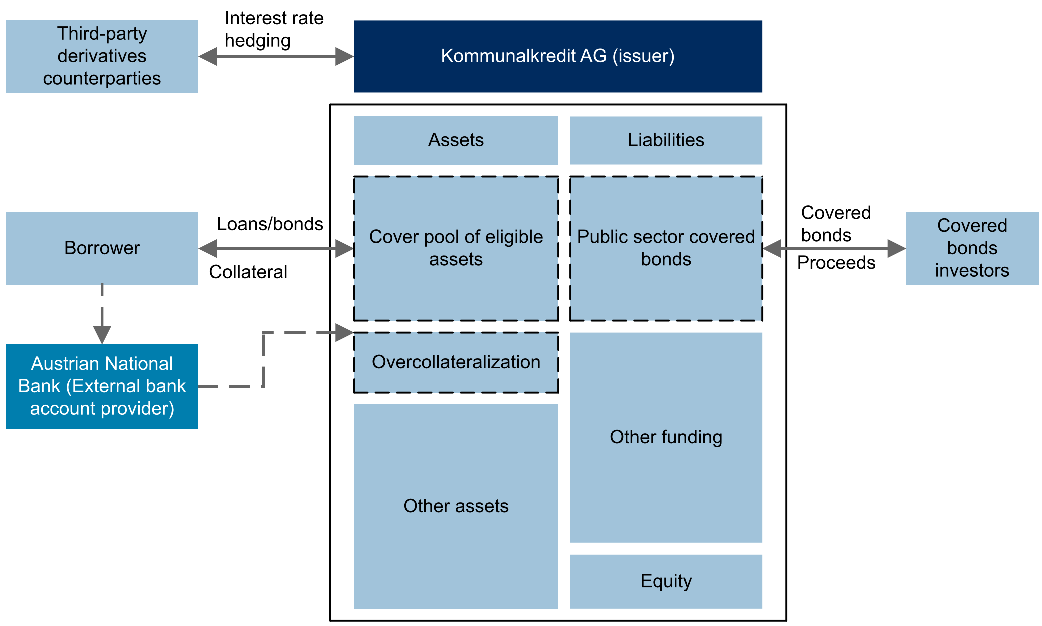
*Based on data as of Sept. 30, 2022.

Table 2

Program Participants

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

Kommunalkredit Austria AG (Public Sector Covered Bonds)



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.

Kommunalkredit Bank's outstanding covered bonds were issued under the Austrian Law on Secured Bank Bonds (Law of 12/27/1905, "Gesetz betreffend fundierte Bankschuldverschreibungen"). Austria's new covered bond law ("Pfandbriefgesetz") which implements the EU's Covered Bonds Directive entered into force on July 8, 2022. It applies to all covered bonds issued after July 7, 2022. The revised law merges the three laws in force before July 8, 2022 ("Hypothekenbankgesetz," "Pfandbriefgesetz," and the "Gesetz betreffend fundierte Bankschuldverschreibungen") into one, lessening the legal complexity for Austrian covered bonds.

Covered bonds issued before July 8, 2022 will not be required to fulfill the new law's requirements, and we understand that the issuer's current outstanding bonds issued before July 8, 2022, will be grandfathered with the original designation.

The €1.134 billion outstanding covered bonds (€869 million previously) constitute direct, unconditional, and unsubordinated obligations of the issuer and rank pari passu among themselves and with all other obligations secured by the cover pool register. Covered bondholders and registered derivative counterparties have recourse to the issuer and--in the event of an issuer insolvency--to the assets included in the cover pool register, which as of Sept. 30, 2022, comprised €1.275 of public sector assets and a small amount of cash.

The new legislation includes--among other requirements,--a 180-day liquidity buffer requirement, a 2% minimum overcollateralization requirement, the possibility for the special cover pool administrator to extend the covered bonds' maturity by a maximum of 12 months subject to certain conditions, the appointment of a cover pool monitor (which can be internal or external at the issuer's choice), and the requirement of a borrower's consent for a loan to be registered as a cover pool asset.

Derivatives are allowed for risk hedging purposes and must be registered in the cover register subject to the counterparty's prior approval. Claims of counterparties under registered derivative transactions rank pari passu with the claims of the covered bond holders.

Borrowers cannot set off any deposits they have with the issuer against their loans in the cover pool register. The prohibition of setoff does not apply to derivative contracts, when netting occurs for receivables arising under one and the same master agreement.

From our analysis of the Austrian Pfandbriefgesetz, we have concluded that the cover pool assets are effectively isolated from the issuer's insolvency for the covered bondholders' benefit. Upon issuer insolvency, a cover pool administrator is appointed by a bankruptcy court after consultation with the Austrian regulator (the Financial Market Authority) to continue the management of the cover pool and to satisfy the claims of the covered bondholders and registered derivative counterparties. 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, we have considered foreign exchange risk when calculating the required credit enhancement for a 'A+' rating.

As of Sept. 30, 2022, the available credit enhancement of 12.41% 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 3.92% for a 'A+' rating. The lower required credit enhancement compared to our previous review (7.16%) is due to Swiss franc-denominated covered bonds' scheduled redemptions and euro-denominated issuances.

Collateral support analysis

We base our analysis on the cover pool data provided by the issuer as of Sept. 30, 2022. The pool mostly comprises public sector assets located in Austria (88.21%) (96.6% previously). We do not assign any notches of collateral-based uplift above the JRL, currently.

Of the total cover pool assets, 68.21% (72.93% previously) 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, French and Belgian LRGs, and one public sector covered bond.

Since our previous review, the cover pool notional has increased and its geographical composition has widened to include Belgian, Portuguese, and Polish exposures. These factors have reduced the cover pool's obligor concentration. The available credit enhancement is 12.41% (11.71% previously) and well above the required credit enhancement of 3.92% commensurate with a 'A+' rating based on JRL.

The scenario default rate (SDR) that we consider to be commensurate with a 'AAA' credit stress was 25.69% as of September 2022, slightly down from 26.43% as of September 2021. The reduction in the SDR is mainly due to reduced obligor concentration and a lower correlation assumption between Austrian LRG assets used in our credit analysis. While exposures to Austrian LRG assets are generally diversified across Austrian regions, LRGs are relatively concentrated in Burgenland when compared to the region's share of Austria's GDP. Therefore, previously we have assumed a 20% correlation between Austrian LRGs. We have now lowered this assumption to the standard 15%

correlation assumption between LRGs within Austria under our public sector criteria. This is based on our observation that exposures to LRGs in Burgenland over the last six years have remained at about 10% to 13% with an overall slight downward trend and our view that these exposures do not represent a material portion of the total cover pool.

These factors have offset the negative impact on the SDR from a slightly higher share of assets with a stressed rating assumption of 'BB' or lower (see tables 5 and 6).

Our weighted-average recovery rate at the 'AAA' stress level of 73.15% has increased slightly since our previous review due to an increased share of LRG assets. 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 pool assets of 424 basis points. Our stressed weighted-average recovery period assumption is 3.1 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 14.62% (21.43% previously) and a target credit enhancement commensurate with the maximum potential collateral-based uplift of four notches of 36.02%. 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. The result of this test has reduced since our previous analysis due to lower obligor concentrations.

We have not assigned any notches of collateral-based uplift above the JRL, as the available credit enhancement of 12.41% is below the level that we would consider commensurate with the first notch of collateral-based uplift of 17.59%.

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

Table 3

Key Credit Metrics

	As of Sept. 30, 2022	As of Sept. 30, 2021
Weighted-average cover pool asset rating	'BBB-'	'BBB-'
Weighted-average loan asset maturity (years)	6.74	5.24
Largest obligor (percentage of the cover pool; %)	9.22	13.35
20 largest obligors (percentage of the cover pool; %)	53.51	57.56
Credit analysis results		
'AAA' scenario default rate (%)	25.69	26.43
Weighted-average recovery rate (%)	73.15	71.56
Weighted-average time to recovery (years)	3.06	2.97
Largest industry concentration test result (percentage of covered bonds; %)	14.62	21.43

Table 4

Breakdown By Geography

	As of Sept. 30, 2022	As of Sept. 30, 2021
	Percentage of cover pool	
Austria		
Lower Austria	21.86	20.55
Upper Austria	22.55	23.99
Burgenland	10.01	12.27
Carinthia	8.75	11.94
Styria	10	15.54
Vorarlberg	4.26	3.54
Tirol	4.72	4.12
Salzburg	3.14	4.17
Wien	2.92	0.73
Total Austria	**88.21**	**96.85**
Germany		
North Rhine-Westphalia	0.21	0.31
Hesse	0.01	0.04
Republic of Germany	1.49	1.56
Total Germany	**1.70**	**1.91**
Portugal		
Madeira	2.73	0.00
Total Portugal	**2.73**	**0.00**
France		
Republic of France	0.91	1.25
Paris	1.21	0.00
Total France	**2.12**	**1.25**
Poland		
Republic of Poland	0.81	0.00
Total Poland	**0.81**	**0.00**
Belgium		
Brussels-Capital	2.02	0.00
French Community of Belgium	2.42	0.00
Total Belgium	**4.44**	**0.00**

Table 5

Recovery Assumptions For Cover Pool Assets*

			Percentage of cover pool	
Borrower type	**'AAA' recovery rate (%)**	**Time to recovery (years)**	**As of Sept. 30, 2022**	**As of Sept. 30, 2021**
Category A LRG without currency stress	90	4	73.42	71.86

Table 5

Recovery Assumptions For Cover Pool Assets* (cont.)

			Percentage of cover pool	
Borrower type	**'AAA' recovery rate (%)**	**Time to recovery (years)**	**As of Sept. 30, 2022**	**As of Sept. 30, 2021**
Category A LRG with currency stress	75	4	0.66	1.41
Category B LRG without currency stress	75	4	2.73	0.00
Non-LRG international public finance assets	18	0	16.77	19.80
Covered bond	30	1	3.23	4.12
Sovereigns	37	0	3.20	2.81

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

Table 6

Asset Distribution By Rating*

	As of Sept. 30, 2022	**As of Sept. 30, 2021**
	Percentage of cover pool	
'AAA'	1.49	1.56
'AA'	27.14	33.84
'A'	46.23	36.48
'BBB'	18.62	23.56
'BB' or lower	6.52	4.56
Total	100.00	100.00

*Includes S&P Global Ratings' stressed assumptions.

Table 7

Collateral Uplift Metrics

	As of Sept. 30, 2022	**As of Sept. 30, 2021**
Asset WAM (years)	6.74	5.24
Liability WAM (years)	4.50	4.59
Maturity gap (years)	2.24	0.65
Available credit enhancement (%)	12.41	11.71
'AAA' credit risk (%)	14.62*	21.43*
Required credit enhancement for first notch of collateral uplift (%)	17.59	21.72
Required credit enhancement for second notch of collateral uplift (%)	23.74	26.78
Required credit enhancement for third notch collateral uplift (%)	29.88	31.83
Target credit enhancement for maximum uplift (%)	36.02	36.88
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 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).

This is a multi-jurisdictional pool of public sector assets. The issuer is located in Austria, which is part of a monetary union. The outstanding covered bonds are hard bullet and have no structural coverage of refinancing needs for at least a 12-month period. The multi-jurisdictional treatment for covered bonds under the above criteria, including the supplemental tests--largest sovereign test and largest transfer and convertibility test--results in the rating on the program not being constrained by sovereign default risk.

Environmental, social, and governance (ESG) credit factors

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	G-2	**G-3**	G-4	G-5
- N/A					- N/A					- Governance structure.				

N/A--Not applicable. ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

Governance factors are a moderately negative consideration in our ICR analysis of Kommunalkredit Austria, which is reflected in our governance assessment of the covered bond program. 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. Kommunalkredit Austria was also the first Austrian Bank to issue a social covered bond 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.

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 2022, Dec. 16, 2022
- Kommunalkredit Austria AG, July 5, 2022
- ESG Credit Indicator Report Card: Covered Bonds, April 7, 2022
- S&P Global Ratings Definitions, Nov. 10, 2021
- Glossary Of Covered Bond Terms, April 27, 2018