

## Kommunalkredit Austria AG

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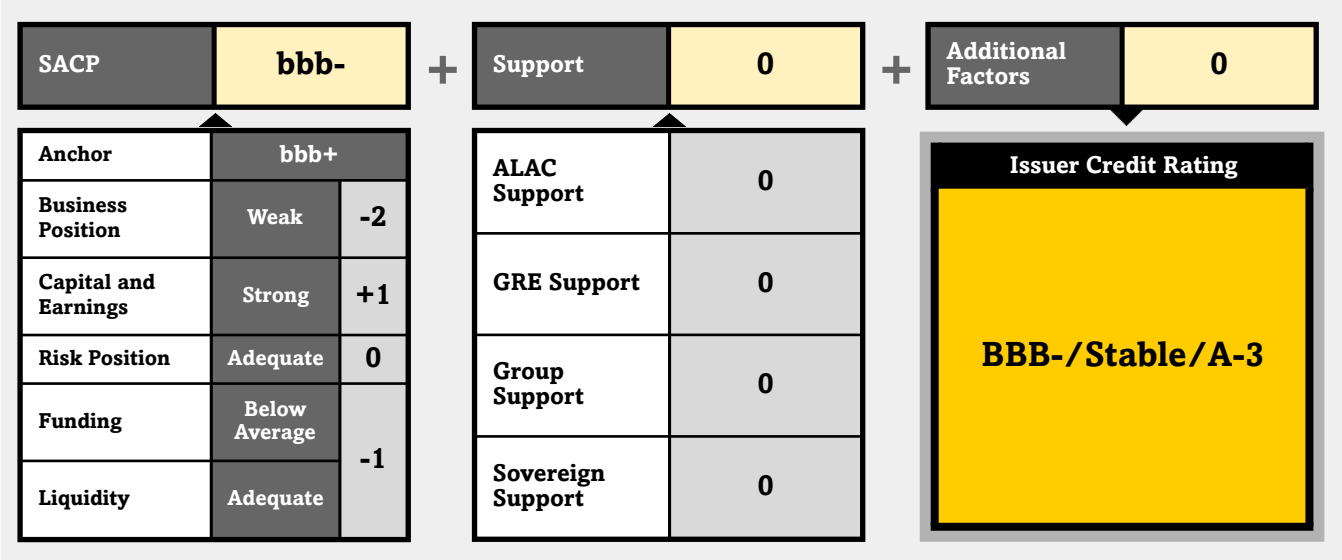
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# Kommunalkredit Austria AG



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>• Strong expertise and a niche franchise in infrastructure, energy, and sustainable finance projects, with historical links to public-sector customers.</li> <li>• Robust asset quality, underpinned by low credit-risk costs and zero nonperforming loans.</li> <li>• Solid risk-adjusted profitability, supporting a high capital buffer.</li> </ul>	<ul style="list-style-type: none"> <li>• Business concentration on niche bespoke products and services, and a limited number of customers.</li> <li>• Tail risks from a small number of opportunistic transactions, high business growth rates, and a high share of syndication risks.</li> <li>• Small size, with high dependence on key personnel.</li> </ul>

**Outlook: Stable**

The stable outlook reflects our expectation that Kommunalkredit Austria AG (Kommunalkredit) will continue to report strong profits and that its business will remain highly resilient to the adverse economic environment over the next 24 months. Moreover, we anticipate that Kommunalkredit will gradually build its franchise and originate-to-collaborate business model in the infrastructure and energy financing markets while maintaining high capitalization. As the bank grows, we will look in particular for enhancements in governance and the broader control environment to keep pace with growth.

**Downside scenario**

We could lower our ratings on Kommunalkredit if the bank experiences a material deterioration in its risk-adjusted profitability or asset quality, or if a delayed economic recovery adversely affects Kommunalkredit's most important markets. Similarly, we could lower the ratings if Kommunalkredit fails to professionalize its organizational and business setup in line with strong business growth, if it shifts unexpectedly to an overly aggressive growth strategy beyond its core competencies, or if material risks from a high level of syndication emerge.

**Upside scenario**

We consider a positive rating action on Kommunalkredit as a remote prospect over the medium term. This reflects some persistent downside risks from the economic environment. More importantly, an upgrade would likely require a much broader franchise and a more diversified earnings profile, with concurrent improvements in controls to improve the bank's alignment with higher-rated peers.

**Rationale**

Our ratings reflect Kommunalkredit's robust niche business model, solid risk management, and earnings resilience to difficult operating conditions amid the COVID-19 pandemic. For example, Kommunalkredit reported a preliminary 15.4% return on equity (RoE) for the full-year 2020, after 10.3% in 2019, aided by strong business growth and robust asset quality.

We also believe that Kommunalkredit has made good progress in building both its reputation and its franchise for arranging infrastructure and energy finance, underwriting, and leading syndications; diversifying into new businesses; and improving its transaction granularity and cost efficiency. We anticipate that Kommunalkredit benefits particularly from its expertise and strong inflows of new business at attractive margins in the sustainable finance-related areas of green energy and social infrastructure such as hospitals. We see the bank's focus as supported by climate change and political support for a green economy, and by renewed political interest in strengthening social and health care infrastructure in a post-pandemic environment.

We balance the material progress Kommunalkredit has made in building its business position in its niche area against its transaction-driven revenue base that relies heavily on syndications. We note improving governance measures, including an increase in the number of members on the management board to three. Despite a large improvement in recent years, we remain mindful that Kommunalkredit remains more dependent on key personnel for business generation and organization than many of its similarly and higher-rated peers in Austria and elsewhere in Europe.

We expect that capitalization will remain Kommunalkredit's particular strength, as indicated by our forecast for the bank's risk-adjusted capital (RAC) ratio of 11%-14% over the next two years. We anticipate that Kommunalkredit's asset-light business model, whereby it syndicates about 50% of new business, above-average earnings buffer, and committed owner provide sufficient funds for significant planned business growth. This ties in with Kommunalkredit's announcement of ambitious targets to deliver RoE before tax of 10% and above, with a common equity tier 1 (CET1) ratio above 15%. So far, Kommunalkredit's credit-risk record is excellent, considering that it had no credit-risk costs or nonperforming loans at year-end 2020, or in recent years, but we remain mindful of its more concentrated portfolio than we see at most other European banks.

We anticipate that Kommunalkredit's combined funding and liquidity assessment will remain weaker than that of many global peers, considering its high share of wholesale funding. Its increasing share of online marketed deposits is positive, but these deposits are more price-sensitive, confidence-driven, and less sticky compared to those at large diversified retail banks.

**Anchor: The economic and industry risk scores reflect Kommunalkredit's geographically diverse exposures**

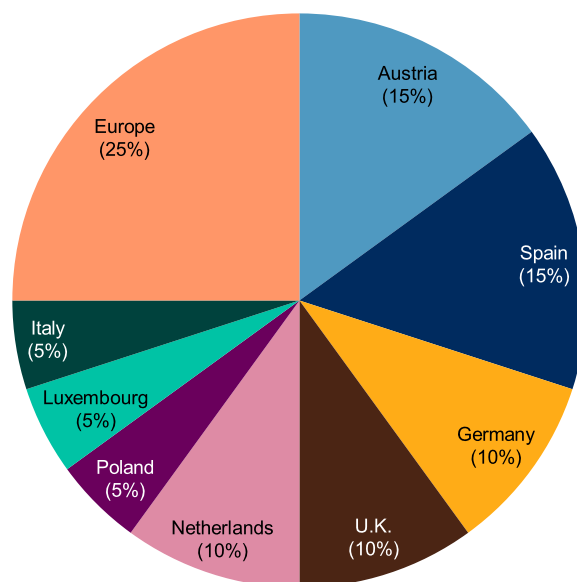
Under our bank criteria, we use our Banking Industry Country Risk Assessment's economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Austria is 'a-', based on an economic risk score of '2' and an industry risk score of '3' (on a scale from '1', the strongest score, to '10', the weakest).

Kommunalkredit pursues lending in several countries (see chart 1), and we take the bank's international corporate exposures into account when analyzing its economic risks. Since more than 60% of the bank's exposures are in countries with weaker economic risk scores than Austria, our weighted economic risk score for Kommunalkredit is '3'. We regard the relevant industry for Kommunalkredit as Austria. Combining a weighted economic risk score of '3' and an Austrian industry risk score of '3', we derive the anchor of 'bbb+', one notch below the anchor of purely domestic banks.

Although more than half of Kommunalkredit's exposures are to countries with negative economic risk trends, we expect the bank's anchor to remain at its current level as the high degree of geographic diversification adds resilience to the business.

**Chart 1****Kommunalkredit Has A Well-Diversified Geographical Footprint**

Weighted average economic risk



Source: S&amp;P Global Ratings. Values are rounded to the nearest 5%.

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**Table 1****Kommunalkredit Austria AG--Key Figures**

(Mil. €)	--Year-ended Dec. 31--				
	2020	2019	2018	2017	2016
Adjusted assets	4422.7	4305.1	3941.6	3663.0	3790.5
Customer loans (gross)	2755.0	3017.0	3086.4	2675.4	2803.5
Adjusted common equity	262.4	218.0	170.0	237.5	241.3
Operating revenues	104.2	83.3	80.7	63.7	50.7
Noninterest expenses	60.9	57.5	59.1	60.9	55.8
Core earnings	31.6	25.6	9.3	13.5	8.6

**Business position: Kommunalkredit is a specialized niche bank with superior resilience to pandemic-related economic shocks**

We think that Kommunalkredit's concentrated business model and small size, along with its high dependence on key personnel, make the bank more sensitive to adverse scenarios compared to peers. We balance this against Kommunalkredit's material strategic and operational progress following its re-privatization and restructuring in 2015. Kommunalkredit has demonstrated high risk-adjusted profitability in difficult markets since the start of the COVID-19 pandemic. We forecast that Kommunalkredit will continue to report high growth in new business and international

business diversification in 2021-2023, supported by an economic recovery in Europe.

Kommunalkredit's business stability was remarkable amid the pandemic in 2020, benefiting from its expertise in environmental and social infrastructure financing. The bank's key focus is on sourcing, underwriting, and advisory services in the early stages of the project life cycle, complemented by an active syndication strategy for long-term investors.

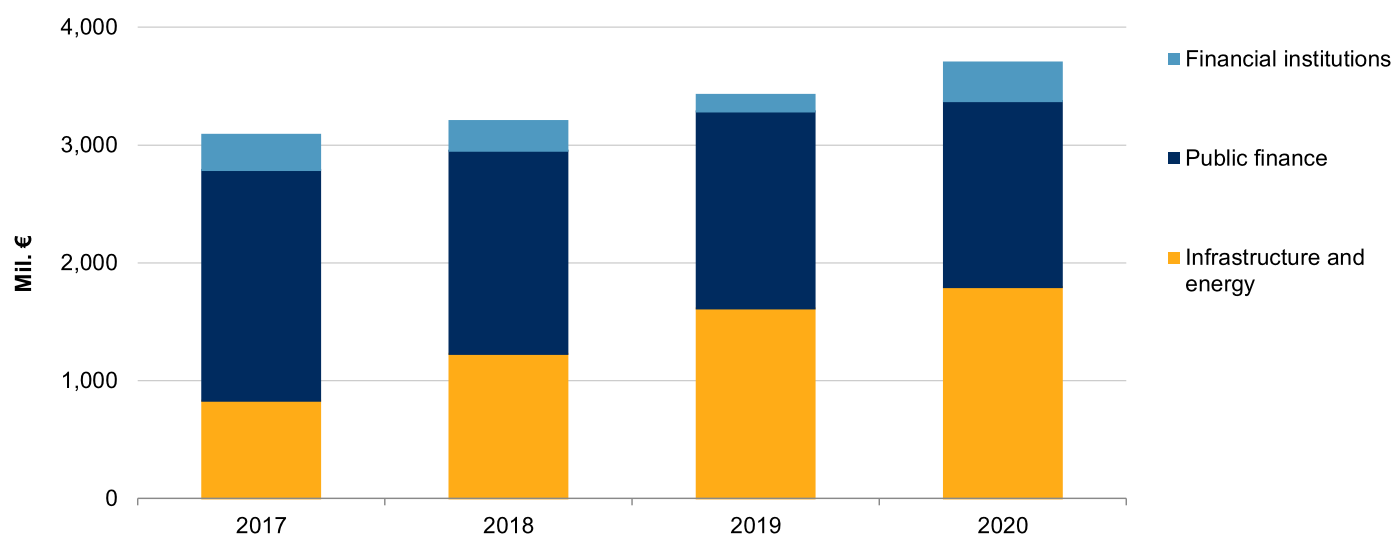
We expect Kommunalkredit to outperform many of its peers and largely deliver on its ambitious targets for 2021-2023, such as RoE of 10%; a cost-to-income ratio of 50%; and a CET1 ratio of 15%. Kommunalkredit has strong inflows of new business at attractive margins, considering its focus on infrastructure and energy financing, particularly green energy, and social infrastructure, such as hospitals (see chart 2). We believe these business inflows will be boosted by climate change and political support to green the economy, and by renewed political interest in strengthening social and health care infrastructure in a post-pandemic environment. Given Kommunalkredit's balance sheet-light business model, with about 50% of new business syndicated, high earnings, and committed owner, we believe that it will find sufficient funds and capital to seize growth opportunities.

**Table 2**

Kommunalkredit Austria AG--Business Position					
	--Year-ended Dec. 31--				
(%)	2020	2019	2018	2017	2016
Return on average common equity	10.4	9.3	4.9	6.2	17.7

**Chart 2**

**Kommunalkredit's Business Model Has Shifted Toward Infrastructure Finance**  
Credit portfolio by borrower type



Source: Company information, S&P Global Ratings.

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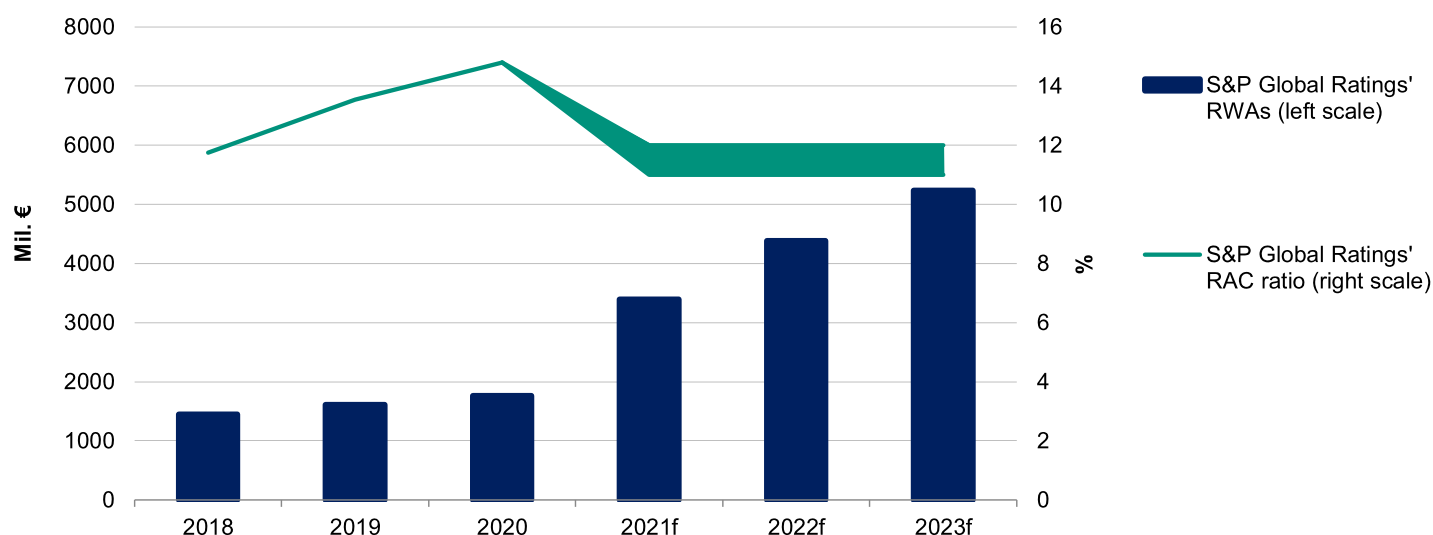
### Capital and earnings: We expect that capital injections will accompany Kommunalkredit's ambitious growth plans

We expect that Kommunalkredit's capitalization will remain a rating strength, as indicated by our forecast that the bank's RAC ratio will range between 11% and 14% over the next two years (see chart 3). We base our expectation for the next two years on the following assumptions:

- An increase in S&P Global Ratings' risk-weighted assets of around 250% over 2021-2022, reflecting the bank's growth ambitions, as well as a structural shift in its portfolio as public-sector exposures expire. We expect total asset growth to understate the bank's growth trajectory due to its balance sheet-light syndication strategy. We expect the bank to accompany its growth ambitions with significant capital increases, allowing it to meet its self-set CET1 target of around 15%.
- A positive net result from the core operations, reflecting increased underwriting activities and a contained cost base.
- A resumption of dividend payments of €3.4 million in financial 2020, after a break in payments in financial 2019 in line with the European Central Bank's recommendations.

Chart 3

#### Kommunalkredit's Capitalization Should Keep Up With Its Ambitious Growth Plans S&P Global Ratings' RWAs and RAC ratio forecast



RWAs--Risk-weighted assets. RAC--Risk-adjusted capital. f--Forecast. Source: S&P Global Ratings. Copyright © 2021 by Standard & Poor's Financial Services LLC. All rights reserved.

Table 3

Kommunalkredit Austria AG--Capital And Earnings					
	--Year-ended Dec. 31--				
(%)	2020	2019	2018	2017	2016
Tier 1 capital ratio	20.3	17.8	19.9	23.5	32.9

Table 3

Kommunalkredit Austria AG--Capital And Earnings (cont.)					
	--Year-ended Dec. 31--				
(%)	2020	2019	2018	2017	2016
S&P Global Ratings' RAC ratio before diversification	14.9	13.5	11.7	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	12.3	10.3	9.6	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	N/A	N/A
Net interest income/operating revenues	74.0	70.4	65.3	55.3	72.0
Fee income/operating revenues	27.4	29.9	22.9	27.1	33.1
Market-sensitive income/operating revenues	(1.6)	(3.5)	0.3	(2.1)	(23.3)
Cost-to-income ratio	58.4	69.1	73.2	95.6	110.0
Preprovision operating income/average assets	1.0	0.6	0.6	0.1	(0.1)
Core earnings/average managed assets	0.7	0.6	0.2	0.4	0.2

RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

Kommunalkredit Austria AG Risk-Adjusted Capital Framework Data					
(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global RWA	Average S&P Global RW (%)
<b>Credit risk</b>					
Government and central banks	2,077	17	1	71	3
Of which regional governments and local authorities	656	2	0	24	4
Institutions and CCPs	538	53	10	62	12
Corporate	1,726	1,404	81	1,294	75
Retail	0	0	0	0	0
Of which mortgage	0	0	0	0	0
Securitization§	0	0	0	0	0
Other assets†	48	32	67	84	176
Total credit risk	4,388	1,507	34	1,511	34
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	13	--	17	--
<b>Market risk</b>					
Equity in the banking book	1	1	116	8	989
Trading book market risk	--	0	--	0	--
Total market risk	--	1	--	8	--
<b>Operational risk</b>					
Total operational risk	--	136	--	220	--
(Mil. €)	Exposure	Basel III RWA	Average Basel II RW (%)	S&P Global RWA	% of S&P Global RWA
<b>Diversification adjustments</b>					
RWA before diversification	--	1,687	--	1,757	100
Total diversification/ concentration adjustments	--	--	--	372	21



Table 4

Kommunalkredit Austria AG Risk-Adjusted Capital Framework Data (cont.)					
RWA after diversification	--	1,687	--	2,129	121
(Mil. €)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global RAC ratio (%)	
<b>Capital ratio</b>					
Capital ratio before adjustments	331	19.6	262	14.9	
Capital ratio after adjustments†	331	19.6	262	12.3	

\*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions.

‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2020, S&P Global Ratings.

### Risk position: A large capital buffer mitigates Kommunalkredit's volatile revenues

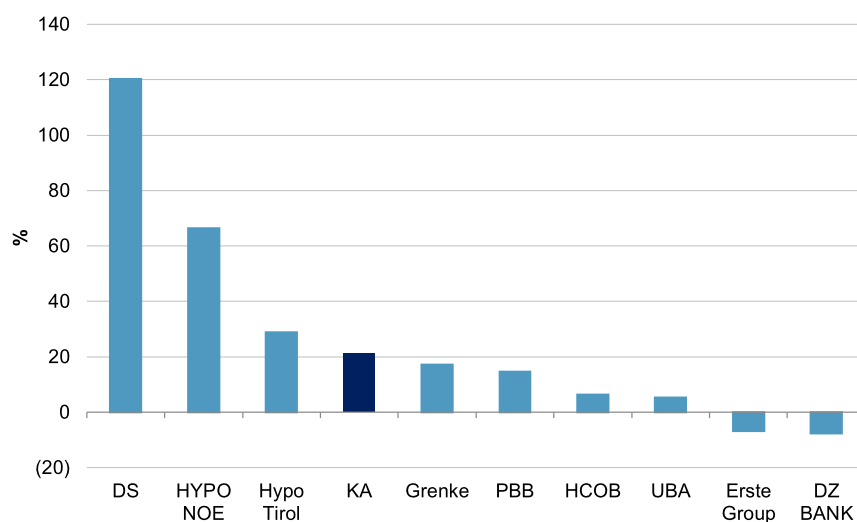
Kommunalkredit's risk position is in line with that of other European niche banks. Apart from complexity in some infrastructure and energy financing transactions, the bank does not have complex products on its balance sheet. Since its setup at the end of 2015, the bank does not have any nonperforming assets either. Kommunalkredit's track record of loan losses has limited informational value due to the restructuring and asset transfer in 2015.

We see concentration risks due to Kommunalkredit's small size, focus on certain sectors (see chart 4), and high lending growth in recent years. We expect the cost of risk to increase but remain manageable in the next 12-24 months.

However, we also expect that the bank's risk metrics will deteriorate to more normal levels in the medium-to-long term.

**Chart 4****Kommunalkredit Has A Relatively High Concentration Surcharge**

Total S&P Global Ratings' RAC concentration adjustment / S&P Global Ratings' RWAs before diversification



RAC--Risk-adjusted capital. RWA--Risk-weighted assets. DS--Danmarks Skibskredit. KA--Kommunalkredit Austria.

PBB--Deutsche Pfandbriefbank. HCOB--Hamburg Commercial Bank. UBA--UniCredit Bank Austria.

Source: S&P Global Ratings.

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**Table 5****Kommunalkredit Austria AG--Risk Position**

(%)	--Year-ended Dec. 31--				
	2020	2019	2018	2017	2016
Growth in customer loans	(8.7)	(2.3)	15.37	(4.6)	(8.8)
Total diversification adjustment/S&P Global Ratings' RWAs before diversification	21.2	31.2	22.6	17.8	27.0
Total managed assets/adjusted common equity (x)	16.9	19.7	23.2	15.4	15.7
New loan loss provisions/average customer loans	0.0	0.1	0.0	0.0	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.0	0.0	0.0	0.0	0.0
Loan loss reserves/gross nonperforming assets	N.M.	N.M.	N.M.	N.M.	N.M.

RWAs--Risk-weighted assets. N.M.--Not meaningful.

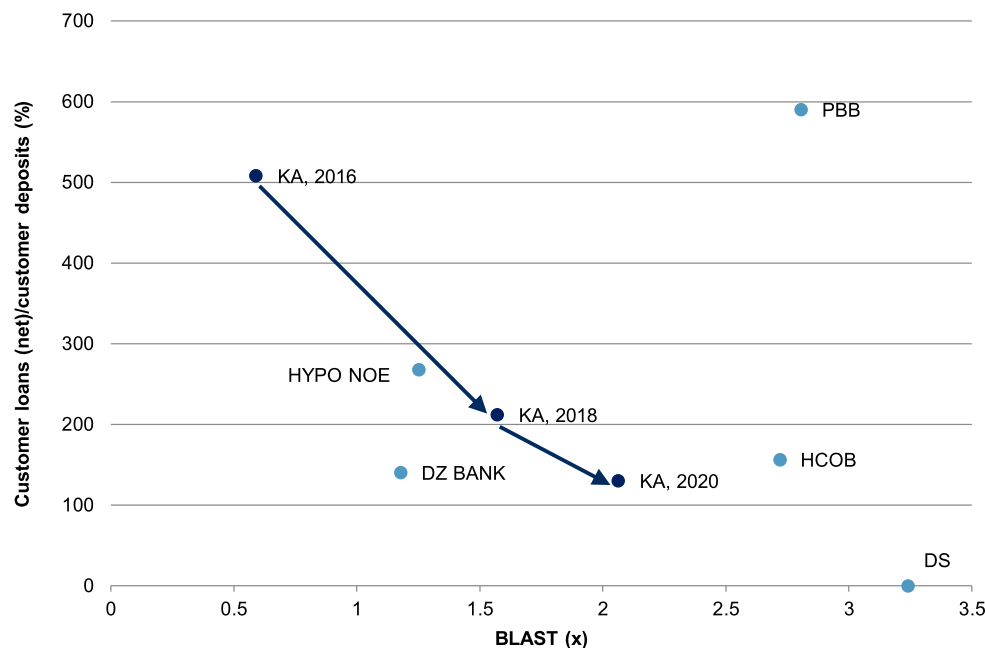
**Funding and liquidity: Deposit funding has a greater role as a funding source**

We consider Kommunalkredit's funding as weaker than that of many of its global peers. Although its share of wholesale funding has decreased against a significant rise in deposits, including term deposits, on the funding side, we consider online marketed deposits to be rather price sensitive and less sticky. We expect the ratio of broad liquid assets to short-term wholesale funding to remain close to current levels of 1.5x-2.0x over the next two years (see chart

5), with a survival period of over six months and no access to the external market.

**Chart 5**

**Kommunalkredit's Liquidity Metrics Improved Over 2016-2020**



KA--Kommunalkredit Austria. PBB--Deutsche Pfandbriefbank AG. DS--Danmarks Skibskredit A/S.

HCOB--Hamburg Commercial Bank AG. BLAST--Broad liquid assets/short-term wholesale funding.

Unless indicated otherwise, all data are as per the latest 2020 report. Source: S&P Global Ratings.

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**Table 6**

**Kommunalkredit Austria AG--Funding And Liquidity**

(%)	--Year-ended Dec. 31--				
	2020	2019	2018	2017	2016
Core deposits/funding base	55.6	50.6	42.6	33.4	17.3
Customer loans (net)/customer deposits	130.1	160.7	211.8	257.7	507.8
Long-term funding ratio	88.0	85.0	93.9	94.6	77.1
Stable funding ratio	111.9	98.1	103.3	108.6	90.3
Short-term wholesale funding/funding base	13.2	16.4	6.6	5.9	25.0
Broad liquid assets/short-term wholesale funding (x)	2.1	1.0	1.6	2.6	0.6
Net broad liquid assets/short-term customer deposits	44.1	2.2	15.6	48.8	-171.8
Short-term wholesale funding/total wholesale funding	29.7	33.2	11.6	8.9	30.3
Narrow liquid assets/3-month wholesale funding (x)	13.1	3.9	2.7	3.1	0.7

**Support: No uplift for government or additional loss-absorbing capacity (ALAC) support, and low systemic importance**

The long-term rating on Kommunalkredit is at the same level as the stand-alone credit profile. We regard the bank as having low systemic importance in the Austrian banking sector. Furthermore, generally, we do not incorporate government support into our ratings on systemic banks in Austria, because we think that the prospects of such support are uncertain.

We recognize that the Austrian bank resolution framework is advanced and therefore we include notches of uplift in our ratings on systemic banks that we expect will build sizable bail-in capital volumes over the coming years. However, we see a resolution scenario for Kommunalkredit as unlikely, reflecting our view of its low systemic importance, and therefore we do not incorporate any uplift under our ALAC criteria.

**Environmental, social, and governance (ESG)**

ESG factors are neutral in our assessment of Kommunalkredit's creditworthiness. Social and environmental credit factors support our comparison of Kommunalkredit with its peers, while the bank's governance standards are in line with practices in Austria. Kommunalkredit's infrastructure-financing business model, with a strong position in social infrastructure and green energy, is supported by ongoing large-scale political initiatives in these fields, even in the post-pandemic economic environment.

**Related Criteria**

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

**Related Research**

- Banking Industry Country Risk Assessment: Austria, June 17, 2020

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

### Ratings Detail (As Of May 14, 2021)\*

#### Kommunalkredit Austria AG

Issuer Credit Rating

BBB-/Stable/A-3

Senior Secured

A+/Stable

#### Issuer Credit Ratings History

24-Feb-2021

BBB-/Stable/A-3

#### Sovereign Rating

Austria

AA+/Stable/A-1+

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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