

## **FITCH DOWNGRADES KOMMUNALKREDIT AUSTRIA'S VIABILITY RATING TO 'B+'; AFFIRMS IDRS AT 'A'/'F1'**

Fitch Ratings-London/Barcelona-02 November 2011: Fitch Ratings has downgraded Kommunalkredit Austria AG's (KA) Viability Rating (VR) to 'b+' from 'bb-'. At the same time, the agency has affirmed KA's Long-term Issuer Default Rating (IDR) and Short-term IDR at 'A' and 'F1' respectively. The Outlook on the Long-term IDR is Stable. A full list of rating actions is at the end of this comment.

The downgrade of KA's Viability Rating largely reflects its sizeable exposure to Greek sovereign bonds, which accounted for around half of Tier 1 capital at end-H111. While a write-down of this exposure will not, in Fitch's view, lead to a breach of regulatory capital ratios, it limits KA's financial flexibility and represents a setback in its attempt to improve internal capital generation.

The affirmation of the IDRs is based on Fitch's view that the Republic of Austria ('AAA'/Stable) would support KA if required, given its 99.78% ownership. KA's ratings are further supported by its domestic importance as a provider of public-sector services in Austria, and the close affiliation with the state on the back of the bank's business relationships with over two-thirds of Austria's municipalities and its role as a trustee for government development funds.

KA's restructuring plan foresees a privatisation of the bank in the medium term. Fitch does not expect the privatisation of KA before 2013 and expects the Republic of Austria to provide the bank with the necessary financial resources until its privatisation. The European Commission approved the state aid procedure, together with the restructuring plan, on 31 March 2011.

Fitch acknowledges that KA has made progress in focussing on higher-margin and fee-generating businesses, diversifying its funding base and controlling costs. However, the agency believes that the increasingly challenging conditions on wholesale funding markets will make successfully implementing KA's revised business model more difficult. Moreover, while KA's longer-dated and low-margin credit exposure is gradually reducing through annual run-offs, an accelerated reduction through opportunistic sales may, in Fitch's opinion, become increasingly difficult given the funding constraints of potential buyers.

KA's earnings base continues to be relatively concentrated and its underlying operating profitability remains vulnerable to single credit events despite the absence of credit losses in the past three years. Further, the tightening of public budgets in Europe may translate into spending cuts by municipalities, and hence lower demand for KA's services. In Fitch's view, higher net fee income and increasing revenue from infrastructure financing and corresponding advisory services may only partially mitigate this adverse trend.

KA is the result of a demerger of KA Old in November 2009. KA Old, a wholesale-funded public sector lender, was acquired by the Republic of Austria in November 2008 following severe funding and liquidity difficulties. KA holds KA Old's core operating assets, and focuses on advisory-intensive and fee-generating municipal and infrastructure financing.

The rating actions are as follows:

Kommunalkredit Austria AG (KA)  
Long-term IDR: affirmed at 'A'; Outlook Stable  
Short-term IDR: affirmed at 'F1'  
Viability Rating: downgraded to 'b+' from 'bb-'  
Individual Rating: affirmed at 'D'  
Support Rating: affirmed at '1'  
Support Rating Floor: affirmed at 'A'

Long-term senior unsecured notes: affirmed at 'A'  
Short-term senior unsecured notes: affirmed at 'F1'  
Senior market-linked notes: affirmed at 'Aemr'  
Government guaranteed notes: affirmed at 'AAA'

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Additional information is available on [www.fitchratings.com](http://www.fitchratings.com). The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 16 August 2011, 'Treatment of Hybrids in Bank Capital Analysis', dated 11 July 2011 and 'Rating Hybrid Securities', dated 28 July 2011, are available at [www.fitchratings.com](http://www.fitchratings.com).

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=649171](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=649171)

Treatment of Hybrids in Bank Capital Analysis

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=641269](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=641269)

Rating Hybrid Securities

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=647091](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=647091)

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