

Rating Action: Kommunalkredit Austria AG

Moody's downgrades Kommunalkredit Austria's BFSR and hybrids

All ratings including the Aa3 debt/deposit ratings remain on review for downgrade

New York, February 17, 2009 -- Moody's Investors Service has today downgraded the bank financial strength rating (BFSR) of Kommunalkredit Austria AG (Kommunalkredit) to D from C-. At the same time, the Tier 1 preferred securities of Kommunalkredit and Kommunalkredit Capital I Limited were downgraded to Caa1 from A2, and the upper Tier 2 securities of Kommunalkredit were downgraded to B1 from A1. All ratings (including the Aa3 senior debt and deposit ratings as well as the P-1 short-term rating) remain on review for further downgrade.

Moody's downgrade of the BFSR was partly prompted by the announcement on 13 February 2009 that Kommunalkredit International Bank Ltd -- a wholly owned subsidiary of Kommunalkredit, located in Limassol, Cyprus -- expects its losses for 2008 to exceed its total capital.

Although the review of the BFSR cannot yet be concluded due to limited availability of relevant data, Moody's says that the BFSR downgrade to the D level better reflects (i) Kommunalkredit's reliance on outside support for both liquidity and capital, and (ii) the rating agency's concern about a erosion of the group's franchise, as it continues to suffer limited access to debt capital markets, which is vital for its monoline business model of public sector finance. Further important factors underpinning today's downgrade are the uncertainty regarding the extent of the required government support and its duration, as well as the bank's ability to return to profitability in the foreseeable future.

"The bank's capacity to restore its funding franchise and secure viable terms for new market funds to allow for adequate profitability will partly depend on the expected recapitalisation measures from the Austrian sovereign, and on Kommunalkredit's ability to meet the evolving restructuring targets," says Dominique Nutolo, a Moody's Assistant Vice President -- Analyst in the Frankfurt-based Financial Institutions Group. "As a result of these uncertainties, the ratings will remain on review for further downgrade," explains Mr. Nutolo.

Notwithstanding the pressure on the BFSR, Moody's has retained the bank's senior debt and deposit ratings at their current Aa3 level, as these ratings strongly benefit from the 100% ownership and implicit strong support of the Republic of Austria. The rating agency believes that the government will implement all the necessary measures to support Kommunalkredit Group, in particular through the injection of new capital and the provision of guarantees for the bank's future debt issuances. Moody's review of these ratings focuses on the size of the support measures as well as the government's long-term commitment to Kommunalkredit Austria.

Downgrade of Tier 1 and upper Tier 2 instruments

The multi-notch downgrade of the Tier 1 instruments of Kommunalkredit and Kommunalkredit Capital I Limited reflects Moody's view of the increased risk of coupon losses in the coming years. The Caa1 ratings of the Tier 1 instruments mirror the higher expected loss due to the fact that any missed coupon payments are non-cumulative. By contrast, the upper Tier 2 instruments are cumulative with a remaining maturity of more than 10 years, thus warranting a less severe downgrade to the B1 rating level.

Moody's previous rating action on Kommunalkredit Austria was implemented on 3 November 2008, when the rating agency downgraded the BFSR to C- from B- and placed all ratings (including the Aa3 senior debt and deposit ratings, the A1 subordinated debt ratings and the A2 rating of the Capital I hybrid issue and junior sub-debt, as well as the Prime-1 short-term rating) on review for possible downgrade.

The principal methodologies used in rating Kommunalkredit are "Bank Financial Strength Ratings: Global Methodology" and "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", which can be found on www.moody.com in the Credit Policy & Methodologies directory, in the Ratings Methodologies sub-directory. Other methodologies and factors that may have been considered in the process of rating Kommunalkredit can also be found in the Credit Policy & Methodologies directory.

Headquartered in Vienna, Kommunalkredit Austria reported consolidated assets of EUR35.5 billion and an after-tax loss of EUR84.7million at the end of September 2008.

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