FitchRatings

Banks
Wholesale Commercial Banks
Germany

Berlin Hyp AG

Update

Key Rating Drivers

Support Drives IDRs: Berlin Hyp AG's Issuer Default Ratings (IDRs) and Shareholder Support Rating (SSR) are aligned with the IDRs of Landesbank Baden-Wuerttemberg (A+/Stable/F1+/bbb+), its sole shareholder. This reflects both that Berlin Hyp is part of LBBW's resolution perimeter and that LBBW's reputation would be greatly damaged if it did not support its subsidiary if needed. The Stable Outlook on Berlin Hyp's Long-Term IDR mirrors that on LBBW.

Berlin Hyp's VR reflects the bank's monoline business model and concentrated loan book, which are balanced by its focus on the German market, where it has an established franchise, and sound financial metrics.

Focus on Domestic CRE: Berlin Hyp is a specialised commercial real estate (CRE) lender focused on investment and development financing, mainly in German metropolitan areas and large cities, where it has expertise. The bank's franchise and business model benefit from its integration into Sparkassen Finanzgruppe (SFG; A+/Stable/F1+) and its strong ties to a large number of savings banks, resulting in enhanced loan origination and cheaper funding compared with independent peers.

Good Underwriting Record: Berlin Hyp's risk profile benefits from a long record of underwriting CRE loans, adequate loan collateralisation and a fairly stable CRE portfolio mix, including mainly modern office, residential, retail and logistics properties in resilient geographies. However, Berlin Hyp has a higher appetite for real estate development financing than other German CRE focused peers, and a business with historically higher default rates and lower recoveries than cash-flow-generating CRE.

Concentrated Loan Book: Berlin Hyp's impaired loan ratio increased in 2023 as a result of higher interest rates and structural changes affecting valuations in the bank's office and retail investment and development portfolios. However, we maintain the asset quality score's outlook on stable because our assessment of the bank's asset quality is already adjusted downward for the cyclical performance of CRE markets and the high single-borrower concentration in Berlin Hyp's CRE loan book.

Resilient Profits: Berlin Hyp's operating profit has outperformed that of most German commercial banks in the past decade. We expect the bank's four-year average operating profit/risk-weighted assets (RWAs) ratio to remain at 1.0%–1.5% through the cycle, but profitability could fall below this level if loan demand weakens and loan impairment charges (LICs) increase. Berlin Hyp's revenues also rely on only one business line, with a low contribution of fee income relative to peers, which also weighs on our assessment of the bank's profitability.

Adequate Capital: Berlin Hyp's common equity Tier 1 (CET1) ratio (end-2023: 15.4%) and Basel leverage ratio (4.5%) are adequate for the bank's risk profile, and provide a reasonable buffer over regulatory requirements to absorb probable negative rating migrations in the bank's CRE portfolio in the next two years. Berlin Hyp is also likely to continue to retain a material part of its operating profit to match regulatory RWA inflation.

Wholesale-Funded: Berlin Hyp funds itself mainly through mortgage covered bonds and unsecured debt and does not have meaningful deposits from customers. Its membership in SFG's institutional protection scheme (IPS) also ensures privileged access to SFG's large excess liquidity. Issuance of unsecured debt should decline in 2024 due to the bank's inclusion in LBBW's resolution perimeter, its low upcoming redemptions, and declining new business.

Liquidity metrics are adequate and the bank can tap the overcollateralisation of its mortgage pool in case of need.

Ratings

Foreign Currency	
Long-Term IDR	A+
Short-Term IDR	F1+
Viability Rating	bbb+
Shareholder Support Rating	a+
Sovereign Risk (Germany)	
Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (March 2024)

Related Research

Fitch Upgrades Berlin Hyp to 'A+'; Outlook Stable (July 2024)

Fitch Upgrades LBBW's IDR to 'A+'/Stable; Affirms VR at 'bbb+' (July 2024)

German Banks' Commercial Real Estate: Credit Losses to Stay High (February 2024)

Berlin Hyp AG (November 2023)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

A downgrade of LBBW's IDRs, or a change in the ownership structure or the owner's strategic commitment to Berlin Hyp, could lead to a downgrade of its IDRs and SSR.

Berlin Hyp's VR has moderate headroom should the metrics deteriorate more than we forecast. We could downgrade the VR if we expect severe and sustained pressure on the performance of the CRE market to durably weaken the bank's impaired loans and operating profit/RWAs ratios to above 3.0% and below 0.8%, respectively.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of the IDRs and SSR would require an upgrade of LBBW's ratings. An upgrade of Berlin Hyp's VR would require a record of substantially stronger lending margins and a more diversified business model, with significant revenue sources independent from CRE lending.

Other Debt and Issuer Ratings

Rating Level	Rating
Long-term deposits	AA-
Short-term deposits	F1+
Long-term senior preferred	AA-
Short-term senior preferred	F1+
Long-term senior non-preferred	A+

Source: Fitch Ratings

Berlin Hyp's long-term senior preferred debt and deposit ratings are rated one notch above its Long-Term IDR to reflect the protection that could accrue to these creditors from the build-up of junior resolution debt and equity buffers. This is because we expect Berlin Hyp to meet its resolution buffer requirement with senior non-preferred and more junior instruments only. Berlin Hyp's senior non-preferred debt rating is aligned with its Long-Term IDR. Berlin Hyp's short-term senior preferred debt and deposits are rated in line with LBBW's short-term senior preferred debt and deposits.

Significant Changes from Last Review

Strengthened IPS

In January 2024, SFG implemented a reform of its IPS. In Fitch's view, the amendments to the statutes of the IPS have substantially strengthened its governance, risk monitoring and funds. As a result, the probability of timely support for LBBW from its owners has increased. Berlin Hyp's IDRs are equalised with those of its parent.

The reformed IPS clearly defines the responsibilities and timelines in a potential support scenario. The role and powers of the IPS's central body were also strengthened. The central body has decision-making power over recovery and support measures, including the raising of the required funds from the IPS's members, with a simple majority within two weeks of the receipt of the request for intervention. We therefore believe that the IPS would provide support to a member in need in a timelier manner compared to the past.

The risk-monitoring system was also strengthened with quantitative triggers, allowing for an early identification of member with deteriorating financial profile and enabling early intervention measures. This is also supported by a newly created internal audit unit within the IPS. In our view, this reduces the probability of a member requiring support.

The creation of an additional support fund as part of the reform, which we estimate will reach EUR5 billion–EUR6 billion by 2033, also improves the IPS's ability to support a larger number of members that may require capital support at the same time. This is in addition to SFG's sound pre-impairment operating profitability and strong capitalisation, which already provide it with sufficient financial flexibility to support also large members.

Resilient Profit Despite Asset Quality Deterioration

Berlin Hyp's new business volumes halved to EUR2.9 billion in 2023 (2022: EUR5.8 billion), broadly in line with the sharp fall of CRE transactions in Germany. We expect new business volumes to have remained subdued also in 1H24. Prolongations doubled to EUR2.2 billion in 2023 (2022: EUR1.1 billion), driving total new lending volume to EUR5.1 billion in 2023. Close to three quarters of the new lending volume in 2023 was domestic, with a focus on large and medium cities. New business focused on residential property (44%) followed by offices (32%), logistic premises (13%) and retail (7%). However, at 41% of total mortgage loans, offices still accounted for Berlin Hyp's largest CRE exposure at end-2023, followed by residential property (29%).

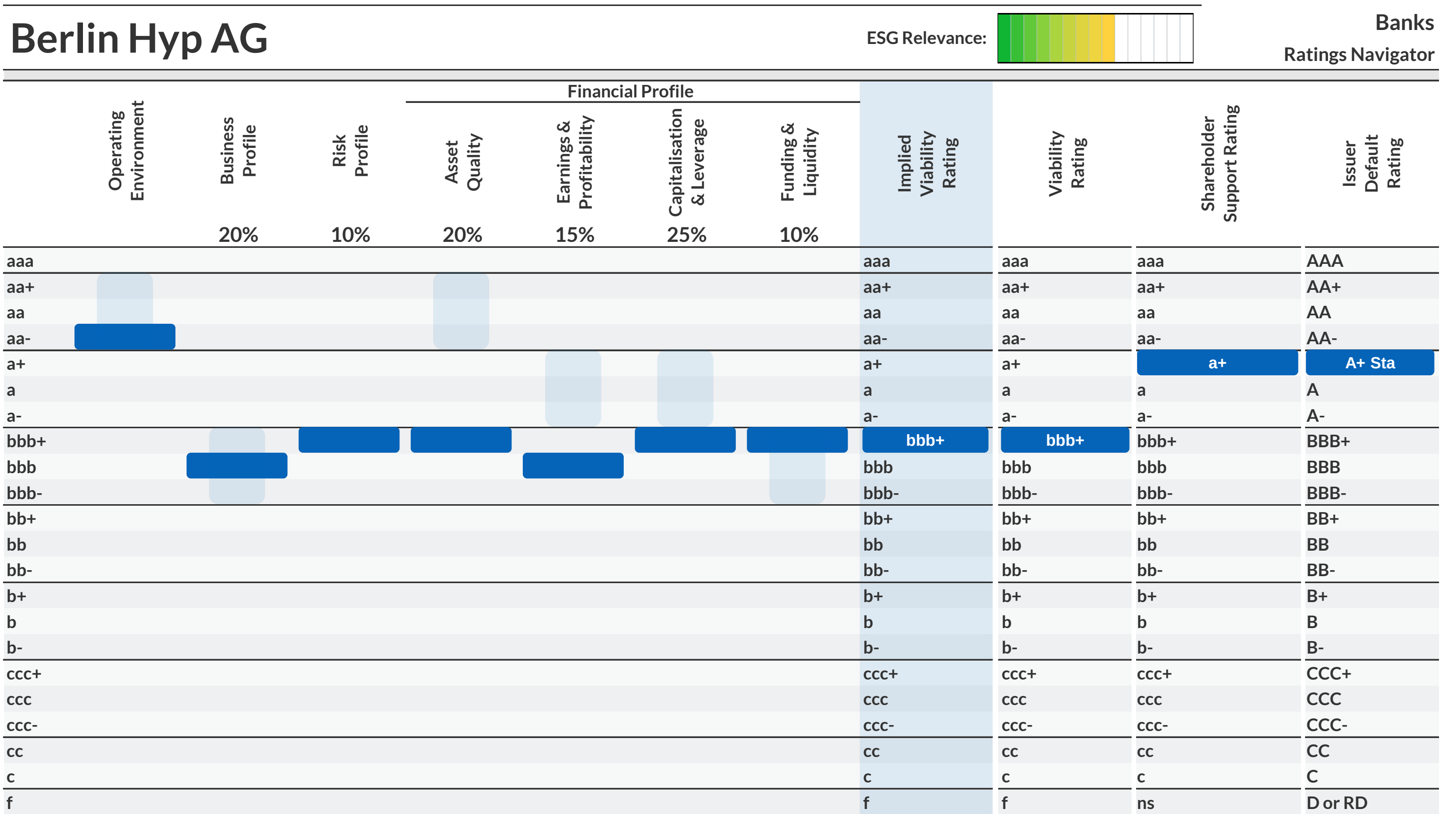
Loan-to-value ratios in the portfolio were resilient in 2023, and valuation declines are mitigated by the higher proportion of new buildings in Berlin Hyp's mortgage book compared to peers (one third of the mortgage book was classified as green at end-2023). At the same time, we expect inflows into impaired loans to continue in 2024, when about 18% of the mortgage book is due for refinancing.

Impaired loans increased to EUR492 million at end-2023 (1.7% of gross loans; end-2022: EUR127 million, 0.5%). We expect some of the inflows in 2023 to reverse in 2024 as developments are finalised and the properties are sold. The rise in impaired loans drove most of the increase in LICs to EUR152 million in 2023 (53bp of average gross loans) from EUR13 million in 2022. The remaining LICs were precautionary provisions, which resulted from the increase in a post-model adjustment for the CRE portfolio to EUR127 million at end-2023 (end-2022: EUR48 million). We expect precautionary provisions to cover a material share of credit losses in 2024, but for LICs to remain high compared to the historical average.

Net interest income increased in 2023 on the back of an increase in average loan volumes and higher income from the closing of derivatives to hedge against early termination rights, which will not recur in 2024. At the same time, the 2022 valuation losses in the bond portfolio, driven by the sudden increase in interest rates, did not recur in 2023, and bank levies were substantially lower, in line with those of European peers. Altogether, this compensated for the surge in LICs, resulting in a stable operating profit in 2023. Berlin Hyp also expects operating profit in 2024 to remain broadly in line with the 2023 level.

Capitalisation, funding and liquidity metrics all improved in 2023 compared to 2022, and we expect them to remain stable in 2024.

Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The asset quality score of 'bbb+' has been assigned below the 'aa' category implied score due to the following adjustment reason(s): concentrations (negative).

The earnings & profitability score of 'bbb' has been assigned below the 'a' category implied score due to the following adjustment reason(s): revenue diversification (negative).

The capitalisation & leverage score of 'bbb+' has been assigned below the 'a' category implied score due to the following adjustment reason(s): risk profile and business model (negative).

Financials

Financial Statements

	31 Dec 23		31 Dec 22[a]	31 Dec 21	31 Dec 20
	12 months (USDm)	12 months (EURm)	6 months (EURm)	12 months (EURm)	12 months (EURm)
Summary income statement					
Net interest and dividend income	546	498	197	407	313
Net fees and commissions	20	18	13	25	20
Other operating income	7	6	3	2	5
Total operating income	573	523	213	433	339
Operating costs	232	212	93	194	183
Pre-impairment operating profit	341	311	120	239	155
Loan and other impairment charges	150	137	25	2	62
Operating profit	191	174	95	238	94
Other non-operating items (net)[b]	-55	-50	-25	-187	-70
Tax	54	49	29	1	0
Net income	82	75	41	50	23
Summary balance sheet					
Assets					
Gross loans	32,489	29,655	28,036	26,240	24,452
– Of which impaired	539	492	127	146	141
Loan loss allowances	477	436	33	49	69
Net loans	32,012	29,219	28,003	26,191	24,383
Interbank	313	285	211	152	112
Other securities and earning assets	5,836	5,327	5,559	6,799	6,226
Total earning assets	38,161	34,831	33,773	33,141	30,721
Cash and due from banks	42	39	27	2,654	1,895
Other assets	644	588	612	415	808
Total assets	38,847	35,457	34,412	36,210	33,423
Liabilities					
Customer deposits	4,848	4,425	3,103	2,394	2,732
Interbank and other short-term funding	2,718	2,481	4,565	8,809	9,324
Other long-term funding	28,228	25,765	24,168	22,637	19,192
Total funding and derivatives	35,794	32,671	31,836	33,841	31,248
Other liabilities	1,068	975	849	759	751
Total equity	1,984	1,811	1,727	1,611	1,424
Total liabilities and equity	38,847	35,457	34,412	36,210	33,423
Exchange rate		USD1 = EUR0.912742	USD1 = EUR0.937559	USD1 = EUR0.884173	USD1 = EUR0.821963

[a] With transfer of ownership to LBBW, Berlin Hyp disclosed annual accounts as at 30 June 2022 and 31 December 2022 each as a Short Financial Year. The Income Statement as of 31 December refers to a six-month period.
[b] Refers to contributions to the fund for general banking risks, as per Article340g German GAAP
Source: Fitch Ratings, Fitch Solutions, Berlin Hyp AG

Key Ratios

	31 Dec 23	31 Dec 22	31 Dec 21	31 Dec 20
Ratios (%; annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.6	1.6	2.2	0.9
Net interest income/average earning assets	1.5	1.2	1.3	1.1
Non-interest expense/gross revenue	40.6	43.7	44.8	53.7
Net income/average equity	4.2	4.9	3.3	1.7
Asset quality				
Impaired loans ratio	1.7	0.5	0.6	0.6
Growth in gross loans	5.8	3.9	7.3	8.7
Loan loss allowances/impaired loans	88.5	26.2	33.7	49.2
Loan impairment charges/average gross loans	0.5	-0.2	0.1	0.4
Capitalisation				
Common equity Tier 1 ratio	15.4	13.7	14.3	13.4
Tangible common equity/tangible assets	4.9	4.9	4.3	4.2
Basel leverage ratio	4.5	4.5	4.2	4.1
Net impaired loans/common equity Tier 1	3.4	5.8	6.2	5.2
Funding and liquidity				
Gross loans/customer deposits	670.2	903.5	1,096.0	894.9
Gross loans/customer deposits + covered bonds	132.9	144.4	153.2	162.1
Liquidity coverage ratio	149.8	124.5	128.4	140.7
Customer deposits/total non-equity funding	13.5	9.8	7.1	8.7
Net stable funding ratio	111.3	105.8	—	—

Source: Fitch Ratings, Fitch Solutions, Berlin Hyp AG

Support Assessment

Shareholder Support	
Shareholder IDR	A+
Total Adjustments (notches)	0
Shareholder Support Rating	a+
Shareholder ability to support	
Shareholder Rating	A+/ Stable
Shareholder regulation	Equalised
Relative size	1 Notch
Country risks	Equalised
Shareholder propensity to support	
Role in group	1 Notch
Reputational risk	Equalised
Integration	1 Notch
Support record	1 Notch
Subsidiary performance and prospects	Equalised
Legal commitments	1 Notch

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

Berlin Hyp's SSR reflects our view of LBBW's very high propensity of support. This is because LBBW's reputation would be greatly damaged if, as Berlin Hyp's owner, it failed to provide support, should this ever be needed.

Environmental, Social and Governance Considerations

FitchRatings **Berlin Hyp AG**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Berlin Hyp AG has 5 ESG potential rating drivers

- Berlin Hyp AG has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

SOLICITATION & PARTICIPATION STATUS

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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