FitchRatings

Banks
Wholesale Commercial Banks
Germany

Berlin Hyp AG

Update

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

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 its owner, Landesbank Baden-Wuerttemberg (LBBW; A-/Stable/F1) to reflect Fitch Ratings' view that LBBW would have the ability and a very high propensity to support Berlin Hyp if needed. We believe LBBW's reputation would be greatly damaged if, as Berlin Hyp's owner, it failed to provide support. The Stable Outlook on Berlin Hyp's Long-Term IDR mirrors that on its parent.

LBBW acquired 100% of Berlin Hyp in July 2022 and considers the bank as a central pillar of its commercial real estate (CRE) strategy. We expect integration to intensify over time, although Berlin Hyp currently retains some management independence.

Specialist CRE Lender: Berlin Hyp's Viability Rating (VR) reflects its business model specialisation on CRE lending, conservative risk profile, good asset quality, as well as adequate profitability and capitalisation. The VR also factors in Berlin Hyp's integration into the savings banks organisation (Sparkassen-Finanzgruppe; SFG; A+/Stable/F1+), which enhances its loan origination potential and supports its liquidity and funding profile.

Focus on Core Domestic CRE: Berlin Hyp's lending mix is focused on investment and development financings – mainly in German metropolitan areas and larger cities, where it has expertise. The risk/return profile of the loans originated in recent years appears reasonable and consistent over time, despite the intense competition.

Robust Asset Quality: Berlin Hyp's focus on CRE lending with inherently high single-borrower concentration constrains our asset quality assessment. We expect Berlin Hyp's gross impaired loans ratio to increase to up to 2% in the medium term (2022: 0.5%) due to increased refinancing risks and falling market valuations.

Resilient Profitability: 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. Profitability could temporarily fall below this level in the coming quarters as rising interest rates weaken loan demand and loan impairment charges (LICs) are likely to increase, which might be only partially offset by higher net interest margins.

Adequate Capital: Berlin Hyp's common equity Tier 1 (CET1) ratio (end-2022: 13.7%) is adequate for the bank's risk profile and provides a reasonable buffer over regulatory requirements. Berlin Hyp is likely to continue to retain parts of its profits to match RWA inflation from the implementation of the Basel III output floor.

Sound Funding and Liquidity Profile: Berlin Hyp is wholesale-funded, mostly through mortgage Pfandbriefe and unsecured debt. Due to Berlin Hyp's membership in SFG's institutional protection scheme, investments by SFG's members in the bank's unsecured debt benefit from a 0% regulatory risk weight. This ensures privileged access to SFG's large pool of excess liquidity.

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Fitch Affirms Berlin Hyp's Long-Term IDR at 'A-'/Stable; VR at 'bbb+' (November 2022)

Fitch Upgrades LBBW's Viability Rating to 'bbb+'; Affirms IDR at 'A-'/Stable (March 2023)

Fitch Affirms Sparkassen-Finanzgruppe at 'A+'; Outlook Stable (April 2023)

Analysts

Marco Diamantini
+49 69 768076 114
marco.diamantini@fitchratings.com

Justus Roppertz
+49 69 768076 232
justus.roppertz@fitchratings.com

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 in the event of downside risks to our 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. Fitch would limit the upgrade of the VR of Berlin Hyp to one notch above its parent's VR, because we view both banks' credit profiles as highly correlated.

Other Debt and Issuer Ratings

Rating level	Rating
Long-term deposits	A
Short-term deposits	F1
Long-term senior preferred debt	A
Short-term senior preferred debt	F1
Senior non-preferred: long term	A-

Source: Fitch Ratings

Berlin Hyp's long-term senior preferred debt and deposit ratings are one notch above its Long-Term IDR due to its large buffer of senior non-preferred (SNP) debt, equivalent to about 35% of the bank's RWAs at end-2022. We expect Berlin Hyp to become part of LBBW's single-point-of-entry resolution perimeter.

Berlin Hyp's short-term senior preferred debt and deposit ratings are the baseline options that map to the 'A' Long-Term ratings and are in line with LBBW's ratings.

Significant Changes from Last Review

Falling Market Valuations and Higher Interest Rates Increase Refinancing Risks

Although German real estate valuations have steadily increased since 2010, market values started declining in 2022 following the ECB's interest rate increases. Residential CRE and office values declined by 4% in 2H22, and retail property values fell by 8%, according to the Association of German Pfandbrief Banks. Fitch believes prices could fall significantly further given the increase in interest rates, in particular for older properties. At the same time, refinancing risks are increasing. However, this should not result in outsized credit losses for German banks, at least in the near term, due to adequate collateralisation, long average maturities and predominantly fixed-rate loans in domestic CRE portfolios.

Most German banks, unlike those in many other jurisdictions, adjust valuations downward to the 'mortgage lending value' at origination so as to strip out cyclical valuation swings for assets to be eligible for covered bond financing. The adjustments can be material and a reason why German banks often report higher loan-to-value (LTV) ratios.

Remote working could also pressure to the valuations and rents of office properties, but vacancy rates in this segment remained relatively low in 2022 (less than 5% according to Bundesbank data).

Resilient Performance in 2022

New business volumes in 2022 remained stable yoy at EUR6.9 billion (2021: EUR7.1 billion) despite a sharp drop in German CRE transaction volumes to EUR65 billion in 2022 (2021: EUR112 billion). The financing of office properties, mainly in Germany, accounted for over half of new business. We expect new business to decline significantly in 2023 and 2024.

Gross loans increased by about 7% in 2022. In combination with a higher interest margin, this led to the aggregated net interest income for 2022 increasing by 12% to EUR456 million, including EUR70 million interest income from central bank tenders (TLTRO, 2021: EUR89 million), which will not recur in 2023.

Operating expenses also increased 12% to EUR207 million in 2022, mainly driven by higher bank levies, as well as by costs for integrating Berlin Hyp into LBBW and for digitalising the lending process.

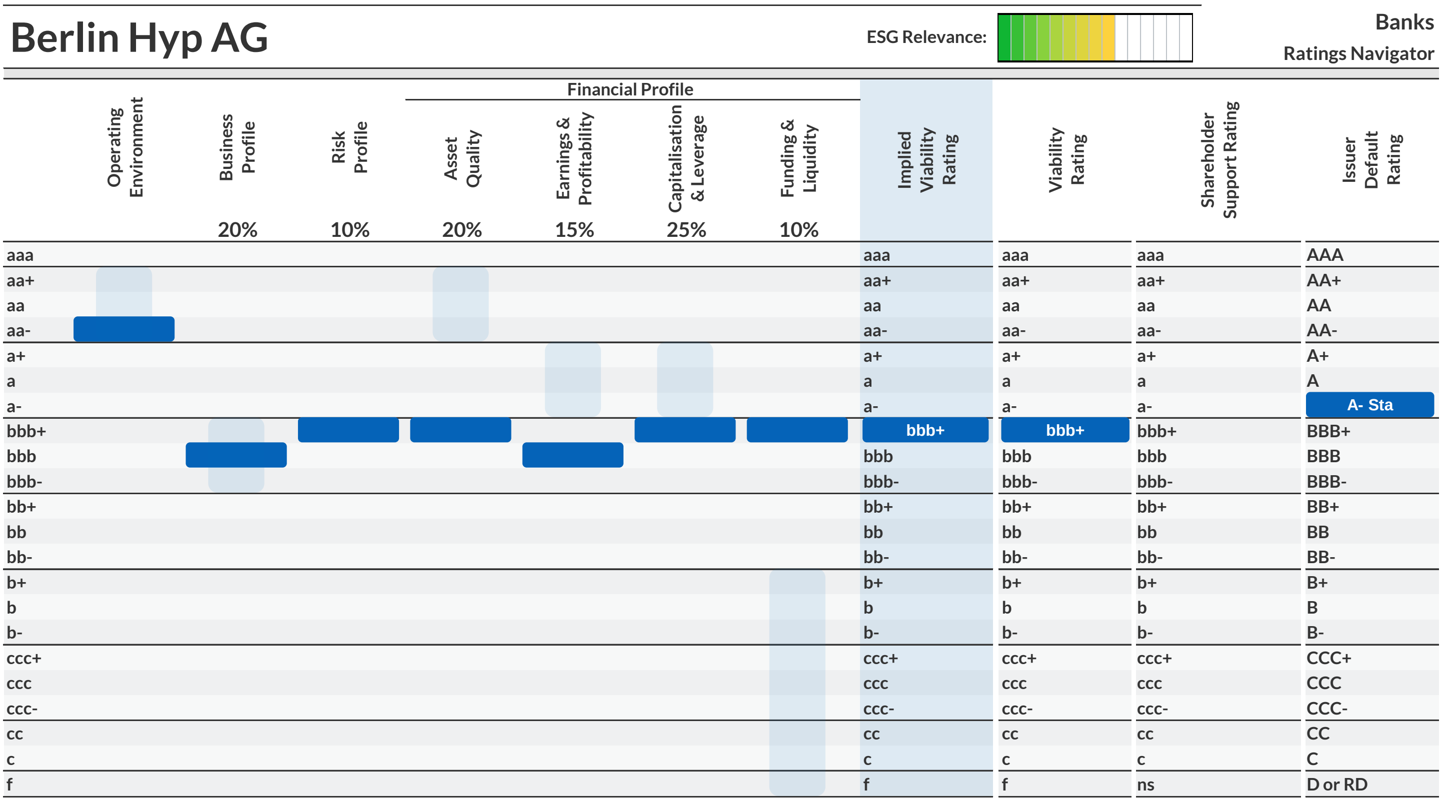
While LICs remained low in 2022 on the back of a broadly stable impaired loans ratio, the bank booked EUR100 million valuation losses on its liquidity portfolio due to higher interest rates. As a result, Berlin Hyp's operating profit declined 25% to EUR175 million in 2022.

Berlin Hyp's capital ratios slightly declined at end-2022 due to an 8% increase in risk-weighted assets.

Berlin Hyp's EUR18.4 billion outstanding covered bonds covered 65% of its external funding needs at end-2022. They are issued to a diversified investor base and are maturity-matched to the mortgage loans. The remaining funding was mostly covered with senior unsecured bonds with a comfortable maturity profile.

Berlin Hyp repaid EUR6 billion TLTRO at end-2022, which temporarily wiped out nearly its entire cash pool. However, the liquidity coverage ratio remained sound at 125%, underpinned by the bank's high-quality bond portfolio of EUR5.6 billion. The latter covers more than half of Berlin Hyp's liabilities due in 2023 and consists predominantly of covered bonds (44%) and government bonds (29%). Senior unsecured bonds (including corporates) account for a moderate 9% of the liquidity portfolio.

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 appetite and business model (negative).

The funding & liquidity score of 'bbb+' has been assigned above the 'b and below' category implied score due to the following adjustment reason(s): liquidity support and ordinary support (positive).

Financials

Financial Statements

	31 Dec 22[b]		30 Jun 22	31 Dec 21	31 Dec 20
	Year end (USDm)	Year end (EURm)	Year end[a] (EURm)	Year end (EURm)	Year end (EURm)
Summary income statement					
Net interest and dividend income	211	197	259	407	313
Net fees and commissions	13	13	11	25	20
Other operating income	3	3	1	2	5
Total operating income	227	213	271	433	339
Operating costs	99	93	130	194	183
Pre-impairment operating profit	128	120	142	239	155
Loan and other impairment charges	27	25	61	2	62
Operating profit	101	95	80	238	94
Other non-operating items (net)[a]	-27	-25	-50	-187	-70
Tax	31	29	0	1	0
Net income	44	41	30	50	23
Summary balance sheet					
Assets					
Gross loans	29,903	28,036	26,983	26,240	24,452
- Of which impaired	135	127	141	146	141
Loan loss allowances	36	33	42	49	69
Net loans	29,868	28,003	26,941	26,191	24,383
Interbank	225	211	785	152	112
Other securities and earning assets	5,929	5,559	5,833	6,799	6,226
Total earning assets	36,022	33,773	33,559	33,141	30,721
Cash and due from banks	28	27	4,057	2,654	1,895
Other assets	653	612	495	415	808
Total assets	36,704	34,412	38,111	36,210	33,423
Liabilities					
Customer deposits	3,310	3,103	3,316	2,394	2,732
Interbank and other short-term funding	4,869	4,565	8,923	8,809	9,324
Other long-term funding	25,777	24,168	23,482	22,637	19,192
Total funding and derivatives	33,956	31,836	35,721	33,841	31,248
Other liabilities	905	849	730	759	751
Total equity	1,842	1,727	1,661	1,611	1,424
Total liabilities and equity	36,704	34,412	38,111	36,210	33,423
Exchange rate		USD1 = EUR0.93756	USD1 = EUR0.96274	USD1 = EUR0.884173	USD1 = EUR0.821963

[a] Refers to contributions to the fund for general banking risks, as per Article340g German GAAP
[b] 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.
Source: Fitch Ratings, Fitch Solutions, Berlin Hyp AG

Key Ratios

	31 Dec 22	30 Jun 22	31 Dec 21	31 Dec 20
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	1.6	1.4	2.2	0.9
Net interest income/average earning assets	1.2	1.6	1.3	1.1
Non-interest expense/gross revenue	43.7	47.9	44.8	53.7
Net income/average equity	4.9	3.7	3.3	1.7
Asset quality				
Impaired loans ratio	0.5	0.5	0.6	0.6
Growth in gross loans	3.9	2.8	7.3	8.7
Loan loss allowances/impaired loans	26.2	29.9	33.7	49.2
Loan impairment charges/average gross loans	-0.2	0.1	0.1	0.4
Capitalisation				
Common equity Tier 1 ratio	13.7	14.0	14.3	13.4
Tangible common equity/tangible assets	4.9	4.2	4.3	4.2
Basel leverage ratio	4.5	4.1	4.2	4.1
Net impaired loans/common equity Tier 1	5.8	6.2	6.2	5.2
Funding and liquidity				
Gross loans/customer deposits	903.5	813.8	1,096.0	894.9
Liquidity coverage ratio	124.5	142.6	128.4	140.7
Customer deposits/total non-equity funding	9.8	9.3	7.1	8.7

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 Shareholder Support Rating 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

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

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.

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.

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.