FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Berlin Hyp's Long-Term IDR at 'A+'/Stable; Upgrades VR to 'bbb+'

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Fitch Ratings - Frankfurt am Main - 17 Nov 2021: Fitch Ratings has affirmed Berlin Hyp AG's Long-Term Issuer Default Rating (IDR) at 'A+' with a Stable Outlook. The bank's Viability Rating (VR) has been upgraded to 'bbb+' from 'bbb'.

A full list of rating actions is detailed below.

The upgrade of the VR to 'bbb+', in line with its implied VR, reflects Berlin Hyp's improved risk profile, which we have upgraded to 'bbb+' from 'bbb' amid easing pandemic-induced risks and reflecting continued strengthening of the bank' risk profile, pre-pandemic. We have also revised the outlook on Berlin Hyp's asset quality (bbb+) and earnings & profitability (bbb) to stable from negative to reflect its strong loan quality and more resilient profitability than initially expected through the pandemic.

Following the update of Fitch's Bank Rating Criteria on 12 November 2021, Fitch has withdrawn the bank's Support Rating of '1' as it is no longer considered by Fitch to be relevant to the agency's coverage. In line with the updated Criteria, we have assigned Berlin Hyp a Shareholder Support Rating (SSR) of 'a+'.

KEY RATING DRIVERS

IDRs, SSR AND SENIOR NON-PREFERRED (SNP) DEBT RATINGS

Berlin Hyp's IDRs, SSR and SNP debt ratings are underpinned by support from the bank's ultimate parent, Sparkassen-Finanzgruppe (SFG, A+/Stable/F1+), the German savings banks group, which collectively owns Berlin Hyp's immediate parent, Landesbank Berlin Holding AG (LBBH). In Fitch's view, Berlin Hyp benefits from an extremely high probability of support from the savings banks, if required. Therefore, Berlin Hyp's IDRs are aligned with those of SFG.

SFG is not a legal entity but a banking network, whose cohesion is ensured by an institutional support scheme (IPS), of which Berlin Hyp is a member. The bank's SSR of 'a+' reflects our view that the savings banks' reputation and their IPS's credibility would be greatly damaged if SFG fails to support Berlin Hyp when the need arises. Therefore, we believe SFG has a very high propensity to support Berlin Hyp. Given Berlin Hyp's small size relative to SFG's as well as SFG's strong financial profile, any required support would likely be manageable for SFG.

VR

Berlin Hyp's risk profile benefits from conservative underwriting standards, good collateralisation levels and the savings banks' monitoring to ensure stable, quality investments in domestic core commercial real-estate (CRE) assets. The bank's strong asset quality through the pandemic is reflected in a low non-performing loan (NPL) ratio of 0.3% at end-1H21, which was significantly stronger than most peers' and the German banking-sector average. The stable outlook on the bank's asset quality reflects our expectation that the NPL ratio will remain below 1% in the medium term. However, the bank's specialisation on lending to the cyclical CRE sector with inherently high loan concentration constrains our assessment of its asset quality.

Berlin Hyp's profitability recovered strongly in 1H21, helped by favourable funding conditions, including large drawings on the ECB's TLTRO, in combination with higher loan volumes. Its operating profit/risk-weighted assets (RWAs) increased to an unsustainable high 2.7% in 1H21 from 0.9% in 2020, when pandemic-driven loan impairment charges (LICs) of EUR81 million (EUR8 million in 2019) weighed on profits. The stable outlook on the bank's profitability reflects our expectation that operating profit/RWA will gradually revert to its long-term average of about 1.5% over the next 24 months.

Berlin Hyp's common equity Tier 1 (CET1) ratio, which improved to 13.9% at end-1H21, is adequate for the bank's risk profile and provides a reasonable buffer over regulatory requirements. Berlin Hyp is likely to continue to retain large parts of its profits to match long-term RWA inflation that will result from the implementation of the Basel IV output floor.

Funding and liquidity are sound. Berlin Hyp is wholesale-funded, mostly through mortgage Pfandbriefe and unsecured debt. Due to Berlin Hyp's membership in SFG's IPS, 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 vast excess liquidity. The issuance of green bonds and sustainability-linked bonds further diversifies its institutional investor base, including SFG's members.

SENIOR PREFERRED (SP) DEBT AND DEPOSIT RATINGS

Berlin Hyp's long-term SP debt and deposit ratings are one notch above the bank's Long-Term IDR, due to a large buffer of SNP debt equivalent to 43% of the bank's RWAs at end-1H21. This buffer provides the bank's preferred creditors with considerable additional protection compared with non-preferred creditors in a resolution.

The short-term SP debt and deposit ratings of 'F1+' are the only options mapping to the respective long-term ratings.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A downgrade of SFG's ratings would trigger a downgrade of Berlin Hyp's IDRs and debt ratings, which are also sensitive to a weakening of the bank's owners' propensity to support. This could result from changes in Berlin Hyp's ownership or contractual relationships with the savings bank, in particular the bank's membership in SFG's IPS.

SFG is considering several options to restructure Berlin Hyp's ownership. While the bank's current ultimate ownership structure may remain unchanged, the bank could also be sold to a member of SFG's IPS, either DekaBank Deutsche Girozentrale or a Landesbank. If Berlin Hyp is sold to a new majority owner, we could notch its SSR from the Long-Term IDR of the new owner. If the latter is lower than SFG's Long-Term IDR, this could result in a downgrade of Berlin Hyp's SSR, IDRs and debt ratings.

Berlin Hyp's long-term SP debt and deposit ratings would be downgraded if the Long-Term IDR is downgraded, or if the bank uses SP debt to fulfil its minimum resolution buffer requirements and its SNP and more junior debt buffers fall below 10% of RWAs.

Berlin Hyp's VR offers moderate headroom in downside scenarios to our baseline forecast. We could downgrade the VR if we expect severe and sustained pressure on the performance of CRE market to durably weaken the bank's four year-average NPL and operating profit/RWA ratios above 3% and below 0.8%, respectively.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade of Berlin Hyp's IDRs and SNP debt ratings would require an upgrade of SFG's ratings. The bank's long-term SP debt and deposit ratings would be upgraded if the Long-Term IDR is upgraded, unless the bank's uses SP debt to fulfil its minimum resolution buffer requirements and its SNP and more junior debt buffers fall below 10% of RWA.

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 independent from CRE lending.

VR ADJUSTMENTS

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

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

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

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

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Berlin Hyp's ratings are driven by potential support from SFG.

ESG CONSIDERATIONS

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

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Berlin Hyp AG	LT IDR	A+ Rating Outlook Stable	Affirmed	A+ Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	Viability	bbb+	Upgrade	bbb
	Support	WD	Withdrawn	1
	Shareholder Support	a+	New Rating	
Senior non-preferred	LT	A+	Affirmed	A+

long-term deposits	LT	AA-	Affirmed	AA-
Senior preferred	LT	AA-	Affirmed	AA-
short-term deposits	ST	F1+	Affirmed	F1+
Senior preferred	ST	F1+	Affirmed	F1+

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 12 Nov 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Berlin Hyp AG	EU Issued, UK Endorsed

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