FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - Frankfurt am Main - 25 Oct 2023: Fitch Ratings has affirmed Berlin Hyp AG's Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook and Viability Rating (VR) at 'bbb+'. A full list of rating actions is below.

KEY RATING DRIVERS

Support Drives Ratings: Berlin Hyp AG's IDRs are driven by its Shareholder Support Rating (SSR), which is aligned with the Long-Term IDR of Landesbank Baden-Wuerttemberg (LBBW; A-/Stable/F1), Berlin Hyp's owner. This reflects 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 LongTerm 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+/F1+) and its strong ties to a large number of savings banks, resulting in enhanced loan origination and cheaper funding than independent peers.

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

Concentrated Loan Book: We expect Berlin Hyp's impaired loan ratio to increase in 2023 and 2024 from its exceptionally low level, as higher interest rates and structural changes impact valuations in the bank's office and retail investment and development portfolios. However, we maintain the asset quality score's stable outlook because our assessment of the bank's asset quality is already adjusted down 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) to remain at 1.0%-1.5% through the cycle, but profitability could fall below this level in the next years due to weaker loan demand and higher loan impairment charges. 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 ratio of 14.4% and Basel leverage ratio of 4.4% at end-1H23 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 consistent 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. 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.

We expect limited external issuance of unsecured debt in the next quarters due to the bank's inclusion in LBBW's resolution perimeter, low upcoming redemptions and declining new business. Liquidity metrics are adequate and the over-collateralisation of its mortgage pool can be tapped to generate additional liquidity in case of need.

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 the 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.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Berlin Hyp's long-term senior preferred debt and deposit ratings are rated one notch above its Long-Term IDR due to its large buffer of senior non-preferred (SNP) and subordinated debt equivalent to about 35% of the bank's RWAs at end-1H23. Berlin Hyp's short-term senior preferred debt and deposits are rated in line with LBBW's short-term senior preferred debt and deposits.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Berlin Hyp's senior debt and deposit ratings are sensitive to a change in its IDRs. We could also downgrade the senior debt and deposit ratings if the sum of SNP and more junior debt falls below 10% of RWAs.

VR ADJUSTMENTS

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).

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 shareholder support from LBBW.

ESG CONSIDERATIONS

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.

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+	Affirmed	bbb+
	Shareholder Support	a-	Affirmed	a-
Senior preferred	LT	A	Affirmed	A
long-term deposits	LT	A	Affirmed	A
Senior non-preferred	LT	A-	Affirmed	A-

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. 01 Sep 2023) (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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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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