FitchRatings

Banks
Wholesale Commercial Banks
Germany

Berlin Hyp AG

Key Rating Drivers

Savings Banks' Support Drives Ratings: Berlin Hyp's ratings are underpinned by Fitch Ratings' view of the extremely high probability of support, if needed, from the bank's ultimate parent, Sparkassen-Finanzgruppe (SFG, A+/Stable/F1+). SFG, the German savings banks group, collectively owns Berlin Hyp's immediate parent, Landesbank Berlin Holding AG (LBBH).

Improved Risk Profile: The upgrade of Berlin Hyp's Viability Rating (VR) to 'bbb+' from 'bbb' mirrors the upgrade of its risk profile, which reflects continued strengthening before the pandemic and easing pandemic-induced risks. We have also revised the outlook on the bank's asset quality and profitability to stable from negative to reflect its strong loan quality and more resilient profitability than initially expected through the pandemic.

Strong Asset Quality: Berlin Hyp's low non-performing loan (NPL) ratio of 0.3% at end-1H21 is significantly stronger than most peers' and the German banking sector average. We expect the ratio to stay below 1% in the medium term, but the bank's focus on commercial real-estate (CRE) lending with inherently high loan concentrations constrains our assessment of its asset quality.

Profitability Recovering: Berlin Hyp's operating profit/risk weighted assets (RWA) rose to an unsustainably high 2.7% in 1H21 from 0.9% in 2020 amid benign funding conditions including large drawings on the ECB's TLTRO and the absence of loan impairment charges. We expect operating profit/RWA to revert toward its long-term average of 1.5% over the next two years.

Stable, Adequate Capitalisation: We expect Berlin Hyp's common equity Tier 1 (CET1) ratio (slightly down to 13.3% at end-3Q21 due to loan growth) to stay close to 13%, which is adequate for the bank's risk profile and well above its regulatory requirement of 8.1%. We adjust the implied capital score negatively to reflect the concentration on relatively large CRE loans. The bank is likely to continue to retain most of its profits to match the long-term RWA inflation driven by the future implementation of the Basel III output floor.

Sound Funding and Liquidity: Berlin Hyp is wholesale funded, mostly through Pfandbriefe and unsecured debt. Thanks to Berlin Hyp's membership in SFG's institutional protection scheme (IPS), investments by SFG's members in the bank's unsecured debt benefit from a 0% regulatory risk weight. This ensures Berlin Hyp privileged access to SFG's vast excess liquidity.

Rating Sensitivities

New Owner: Berlin Hyp's Issuer Default Ratings (IDRs) are primarily sensitive to changes in SFG's IDRs or a weakening of SFG's propensity to provide support. This could result from changes to Berlin Hyp's ownership or to its membership in the IPS.

Asset Quality, Profitability Pressure: Berlin Hyp's VR offers moderate headroom under downside scenarios to our baseline forecast. We could downgrade the VR if we expect severe and sustained pressure on the performance of CRE markets to durably weaken the bank's four-year-average NPL and operating profit/RWA ratios to above 3% and below 0.8%, respectively. The bank's focus on CRE lending makes an upgrade of the VR unlikely in the foreseeable future.

Ratings

Foreign Currency	
Long-Term IDR	A+
Short-Term IDR	F1+
Viability Rating	bbb+
Shareholder Support Rating	a+
Sovereign Risk	
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 (November 2021)

Related Research

Fitch Revises Sparkassen-Finanzgruppe's Outlook to Stable from Negative; Affirms at 'A+' (June 2021)

Fitch Affirms Germany at 'AAA'; Outlook Stable (October 2021)

Fitch Affirms Berlin Hyp's Long-Term IDR at 'A+'/Stable; Upgrades VR to 'bbb+' (November 2021)

Analysts

Markus Glabach
+49 69 768076 195
markus.glabach@fitchratings.com

Roger Schneider, CIIA
+49 69 768076 242
roger.schneider@fitchratings.com

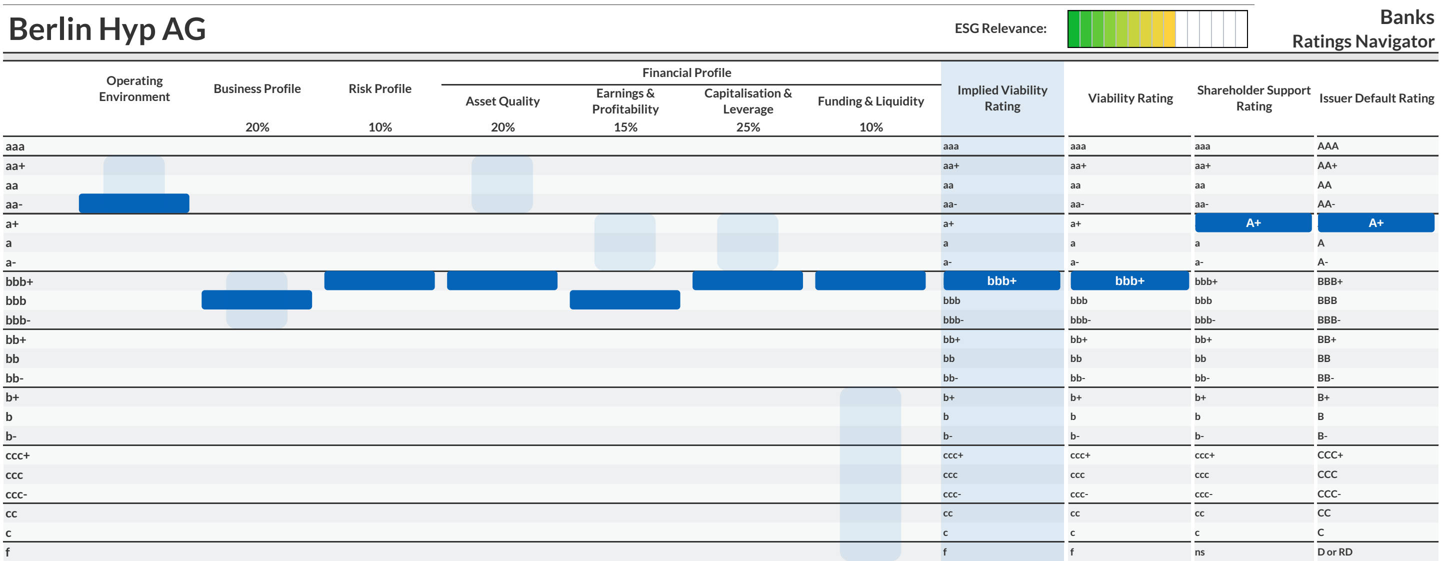
Debt Rating Classes

Rating level	Rating
Deposit rating	AA-/F1+
Senior preferred (SP) debt	AA-/F1+
Senior non-preferred (SNP) debt	A+

Source: Fitch Ratings

Berlin Hyp's SNP debt rating is aligned with its Long-Term IDR, and its long-term SP debt and deposit ratings are one notch above its Long-Term IDR. This reflects its large buffer of SNP debt equivalent to 43% of its RWA at end-1H21, which protects preferred creditors relative to 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.

Ratings Navigator



Adjustments to Implied VR Scores

The asset quality score of 'bbb+' has been assigned below the 'aa' category implied score, to reflect Berlin Hyp's high risk concentration resulting from its monoline, domestic CRE focused business model, with high sector property type exposures and some large individual loans.

The earnings and profitability score of 'bbb' has been assigned below the 'a' category implied score, to reflect the bank's low revenue diversification, resulting from high reliance on a single business line and its relatively low fee income. The capitalisation and leverage score of 'bbb+' has been notched down from the 'a' category implied score, reflecting the cyclicality of the CRE asset class, typical for the risk profile and business model of a monoline lender. The funding and liquidity score of 'bbb+' is substantially above the 'b & below' category implied score, to reflect Berlin Hyp's access to liquidity and ordinary support resulting from its integration into SFG.

Significant Changes

Improved Economic Prospects

Near-term pandemic-related risk has receded thanks to the extensive state support to the economy. CRE markets recovered globally in 1H21 as investments rebounded in most regions. Transaction volumes are close to pre-crisis levels and yields should stabilise after a compression in 2020. In Germany, CRE investments of EUR34 billion in 1H21 (-20% yoy) still lag behind the high pre-pandemic levels. Thirty-five percent of domestic investments are from foreign buyers, whose demand remains strong thanks to the perception of the German economy as a relatively safe haven with sound market fundamentals for long-term investments. The strong demand also reflects moderate property valuation by international comparison despite rapid price increases.

Ownership Under Review

SFG is considering several options to restructure Berlin Hyp's ownership. The bank could be sold to a member of SFG's IPS, or its ultimate ownership structure could remain unchanged. SFG's IPS members Landesbank Baden-Wuerttemberg (A-/Stable/F1), Landesbank Hessen-Thueringen Girozentrale (A+/Stable/F1+) and DekaBank Deutsche Girozentrale have expressed their interest. We could notch Berlin Hyp's Shareholder Support Rating (SSR) from its new owner's Long-Term IDR. 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. Diverging interests within SFG could delay the decision into 2022.

Robust Performance through Pandemic Supported by Strengthened Risk Profile

Berlin Hyp's conservative risk appetite rests on an established risk management framework and prudent underwriting standards including stricter requirements for foreign exposure. The savings banks' focus on stability, quality investments in core assets in domestic prime locations and moderate loan-to-value ratios have largely prevented negative rating migrations. Prudent asset selection in recent years has led to smaller exposure than peers to retail properties (15% of total loans at end-1H21) and hotels (below 5%), which are the most vulnerable to the pandemic.

Management Team Partially Renewed

The management team was partially renewed over the last 18 months, with the hiring of a chief marketing officer completing the executive board in May 2021.

Brief Company Summary and Key Qualitative Assessments

CRE Lender Integrated into the Savings Banks Organisation

Berlin Hyp is SFG's specialised, though not exclusive, CRE lender, and operates predominantly in Germany. It accounts for less than 3 % of SFG's total assets, but its product range allows the savings banks to participate in collateralised lending outside their regions without violating the savings banks laws that restrict their operations to their local areas. Berlin Hyp's established and intensifying cooperation with savings banks supports its cohesion with SFG and enhances its loan origination potential.

Moderate Exposure to CRE Markets in the EU

Berlin Hyp primarily focuses on lending to core domestic CRE types, with a stable strategic mix of investment and development financing in more resilient regions (including larger cities). The risk/return profile of the loans originated in recent years appears reasonable and consistent over time, despite the intense competition. The bank avoids asset classes not identified as core areas of expertise. Its risk appetite also benefits from conservative eligibility criteria for German covered bonds, which are its primary funding source.

Berlin Hyp's foreign lending focuses on lower-risk properties in capital regions in the EU, with reasonably prudent underwriting standards and stricter requirements than for domestic loans. Its asset quality has benefitted from a low exposure to the UK (less than 3% of total loans at end-1H21), which proved more volatile during the pandemic and in the context of Brexit.

Berlin Hyp is significantly more exposed than domestic peers to development loans (15% of new lending in 1H21), which we generally consider higher risk and more cyclical than cash flow-producing investment properties. However, the share of development loans has gradually declined from 23% at end-2016, and the book has performed well through the pandemic so far.

We expect SFG's risk-averse culture to ensure that Berlin Hyp will maintain its prudent risk appetite. We notably believe that the savings banks, whose operations are purely domestic, are particularly conservative when approving Berlin Hyp's foreign strategy. An independent advisory council that includes savings banks' board members monitor the bank's operations. Material changes to Berlin Hyp's risk standards or strategic priorities require SFG's approval.

Dedicated Sustainability Targets

Berlin Hyp has developed its sustainability framework in recent years and targets a third of its loan portfolio qualifying as 'green' (i.e. buildings compliant with energy-efficiency criteria such as energy consumption thresholds) by end-2025 (20% at end-2020). In April 2021, it became the first bank globally to issue a EUR500 million sustainability-linked bond. Failing to cut the carbon intensity of the bank's loan portfolio by 40% from 2020 to 2030 would trigger a step up on the final coupon. The issuance of green and sustainability-linked bonds under its respective frameworks helps Berlin Hyp expand its already diversified investor base outside SFG.

Summary Financials and Key Ratios

	30 Jun 21		31 Dec 20	31 Dec 19	31 Dec 18
	6 months - interim	6 months - interim	Year end	Year end	Year end
	(USDm)	(EURm)	(EURm)	(EURm)	(EURm)
Summary income statement					
Net interest and dividend income	262	221	313	310	316
Net fees and commissions	15	13	20	18	23
Other operating income	4	3	5	5	14
Total operating income	282	237	339	332	352
Operating costs	116	97	183	183	168
Pre-impairment operating profit	166	140	155	150	184
Loan and other impairment charges	-3	-3	62	-2	-37
Operating profit	169	142	94	152	222
Other non-operating items (net)	-133	-112	-70	-90	-105
Tax	0	0	0	1	0
Net income	36	30	23	61	116
Summary balance sheet					
Assets					
Gross loans	30,852	25,961	24,452	22,487	20,955
- Of which impaired	88	74	141	181	183
Loan loss allowances	n.a.	n.a.	69	84	90
Net loans	30,852	25,961	24,383	22,403	20,865
Interbank	106	89	112	262	1,011
Other securities and earning assets	7,760	6,530	6,226	3,704	3,073
Total earning assets	38,718	32,580	30,721	26,370	24,949
Cash and due from banks	2,750	2,314	1,895	26	1,815
Other assets	591	497	808	626	415
Total assets	42,059	35,391	33,423	27,021	27,178
Liabilities					
Customer deposits	3,276	2,757	2,732	2,303	2,476
Interbank and other short-term funding	10,643	8,956	9,324	3,803	3,719
Other long-term funding	25,495	21,453	19,192	18,738	18,880
Total funding and derivatives	39,414	33,166	31,248	24,843	25,075
Other liabilities	819	689	751	824	839
Total equity	1,825	1,536	1,424	1,354	1,264
Total liabilities and equity	42,059	35,391	33,423	27,021	27,178
Exchange rate		USD1 = EUR0.841468	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings

Summary Financials and Key Ratios

	30 Jun 21	31 Dec 20	31 Dec 19	31 Dec 18
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.7	0.9	1.5	2.4
Net interest income/average earning assets	1.4	1.1	1.2	1.2
Non-interest expense/gross revenue	41.6	53.7	54.3	47.9
Net income/average equity	4.1	1.7	4.6	9.5
Asset quality				
Impaired loans ratio	0.3	0.6	0.8	0.9
Growth in gross loans	6.2	8.7	7.3	-0.6
Loan loss allowances/impaired loans	n.a.	49.2	46.1	49.1
Loan impairment charges/average gross loans	0.1	0.4	0.0	-0.1
Capitalisation				
Common equity Tier 1 ratio	13.9	13.4	13.3	13.5
Tangible common equity/tangible assets	4.2	4.2	4.9	4.6
Basel leverage ratio	4.3	4.1	4.6	4.3
Net impaired loans/common equity Tier 1	n.a.	5.2	7.4	7.5
Funding and liquidity				
Gross loans/customer deposits	941.6	894.9	976.5	846.4
Liquidity coverage ratio	171.8	140.7	158.8	160.2
Customer deposits / total non-equity funding	8.3	8.7	9.3	9.9

Source: Fitch Ratings

Key Financial Metrics – Latest Developments

NPLs Could Rise Moderately in 2022

We believe the low NPL ratio is not sustainable in the longer term. We expect a moderate rise in 2022 due to lagging effects of the pandemic as state support is being phased out, and because the loan book is exposed to tail risks in the CRE market. The current resurgence of the pandemic is adding to the short-term uncertainty. In addition, the pandemic accelerates structural trends, including lower office demand due to the progression of agile working, and the secular shift to online shopping, which could weigh on the quality of CRE asset in the longer term.

Net Interest Income Dominates Revenue; Low Funding Costs Support Profitability

Berlin Hyp's low funding costs benefit from its membership in SFG's IPS and mitigate the low lending margins that result from the competitive pressure in the German CRE market. Low margins are likely to weigh on revenues beyond the pandemic, because new business is likely to remain predominantly domestic. Berlin Hyp's cost efficiency is reasonable. The gradual rise in costs in 1H21 relates mainly to investment in IT, but also to higher staff and regulatory costs.

CRE Focus Exposes Bank to RWA Inflation from Basel IV

We believe the Basel IV output floor that will be phased in by 2029 could inflate Berlin Hyp's RWA by up to 20%. This is significantly above the average expected for the banking sector, due to the bank's focus on income-producing CRE lending and use of internal rating models, which drive its relatively low RWA density of 30% at end-1H21. Berlin Hyp will continue to build up its capital by allocating a significant portion of its operating profits to its reserves for general banking risks (EUR157 million in 9M21) to match the regulatory RWA inflation ('Other non-operating items' in the income statement overleaf). We believe SFG would inject capital if a prolonged and severe downturn prevented sufficient profit retention.

Opportunistic Use of ECB Facilities Enhances Funding and Liquidity Profile

Berlin Hyp's extensive use of the ECB's TLTRO amounted to about a quarter of its total funding at end-1H21 and temporarily inflates its liquidity buffer and Liquidity Coverage Ratio (LCR). We expect the LCR to decline gradually as the bank deploys some excess liquidity for new lending and liability management. Besides cash, Berlin Hyp's liquidity reserve included EUR6.6 billion of high-quality securities at end-3Q21, predominantly government (46%) and covered (37%) bonds. Senior unsecured bonds (including corporates) account for 11% of the portfolio. Germany (52%), France (16%) and Scandinavia (10%) are the main regions.

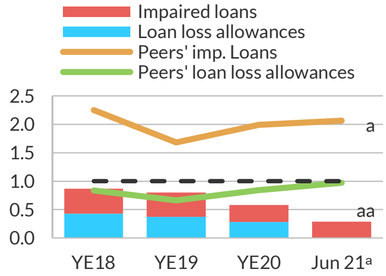
Note on Charts

Dashed lines represent indicative ranges and implied scores for Fitch's core financial metrics for banks operating in environments that Fitch scores in the 'aa' category like Germany.

Peer averages include Berlin Hyp, Aareal Bank AG (VR: bbb+), Landesbank Saar (bb+), NIBC Bank N.V. (bbb) and de Volksbank N.V. (a-).

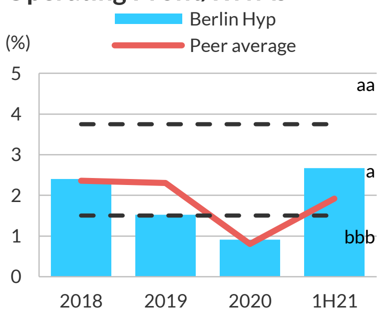
Asset Quality

(% gross loans)



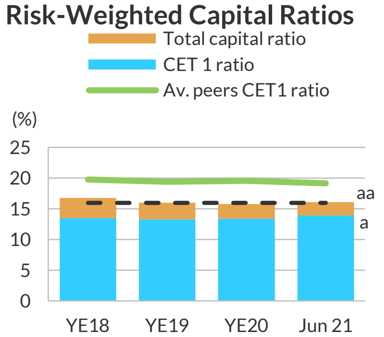
[a]Loan Loss Allowances not disclosed
Source: Fitch Ratings, banks

Operating Profit/RWAs



Source: Fitch Ratings, banks

Risk-Weighted Capital Ratios



Source: Fitch Ratings, banks

Shareholder Support Rating

Berlin Hyp's SSR reflects our view of SFG's very high propensity of support, because the savings banks' reputation and the IPS's credibility would be greatly damaged if SFG failed to support the bank. Given the bank's small size relative to SFG, and SFG's strong financial profile, any required support would most likely be immaterial for SFG.

SSR Key Rating Drivers

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

Source: Fitch Ratings

Key Rating Drivers' influence on SSR
Higher
Moderate
Lower

Environmental, Social and Governance Considerations

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	Company Profile; Management & Strategy; Risk Appetite; 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	Company Profile; Management & Strategy; Risk Appetite	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; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	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	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	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	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	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 left-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 the [number of] general 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 and sub-sector ratings criteria and the General Issues and the Sector-Specific Issues have been informed with SASB's Materiality Map.

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.

Berlin Hyp's 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, either due to their nature or the way in which they are being managed by the bank. For more information on our 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.

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