MOODY'S
INVESTORS SERVICE

Rating Action: Moody's downgrades Berlin Hyp AG's long-term deposit and senior unsecured debt ratings to Aa3

07 Jul 2022

Frankfurt am Main, July 07, 2022 -- Moody's Investors Service (Moody's) has today downgraded Berlin Hyp AG's (Berlin Hyp) long-term deposit, issuer and senior unsecured debt ratings to Aa3 from Aa2. Further, the rating agency downgraded the bank's Adjusted Baseline Credit Assessment (BCA) to baa1 from a3 and affirmed Berlin Hyp's ba1 BCA. The outlook on the long-term deposit, issuer and senior unsecured debt ratings has been changed to stable from ratings under review.

Today's rating actions were triggered by the closure of Berlin Hyp's acquisition by Landesbank Baden-Wuerttemberg (LBBW, deposits Aa3 stable/senior unsecured Aa3 stable, BCA baa2)[1] and conclude the rating review opened on 3 February 2022.

A full list of affected ratings can be found at the end of the press release.

RATINGS RATIONALE

DOWNGRADE OF ADJUSTED BCA DUE TO ASSUMPTION OF JOINT RESOLUTION PERIMETER

The downgrade of Berlin Hyp's Adjusted BCA reflects the rating agency's expectation that Berlin Hyp will be included in the resolution perimeter of its parent, in particular because they are subject to the same jurisdiction and insolvency legislation. Forming a joint resolution implies that the two issuer's probability of default is the same, resulting in an alignment of risks for investors and an alignment of the Adjusted BCA at the group level of baa1, three notches above Berlin Hyp's ba1 BCA.

While both Berlin Hyp and its new parent LBBW are members of Sparkassen-Finanzgruppe (S-Finanzgruppe, Corporate Family Rating Aa2 stable, BCA a2) and its institutional protection scheme, the rating agency generally applies a higher support assumption for members that are fully owned by S-Finanzgruppe. The sale of Berlin Hyp from Erwerbsgesellschaft der S-Finanzgruppe mbH (S-Erwerbsgesellschaft), an entity fully-owned by the group of savings banks, to LBBW, an entity only co-owned by the group of savings banks in Baden-Wuerttemberg, resulted in a reduced support assumption by the sector and fewer notches of affiliate support uplift.

IMPLICATIONS OF JOINT RESOLUTION ASSUMPTION ON RATINGS FROM ADVANCED LOSS GIVEN FAILURE ANALYSIS

Moody's expects Berlin Hyp to be resolved together with its new parent LBBW. The rating agency therefore applies the same Advanced Loss Given Failure (LGF) analysis for both entities, now including Berlin Hyp's assets and liabilities in the group's resolution balance sheet. Previously, Berlin Hyp formed a joint resolution group within S-Erwerbsgesellschaft. The outcome of the new resolution group is similar on the more senior liability classes and subordinated debt while it is more favorable at the level of junior senior unsecured debt. Both, LBBW and Berlin Hyp are primarily market funded institutions and have substantial volumes of bail-inable liabilities outstanding, a key driver for the unchanged uplift for deposits and senior unsecured debt. However, LBBW has higher volumes of subordinated liabilities outstanding and also a moderate amount of Additional Tier 1 (AT1) capital instruments in issuance, that together with the significant volumes of outstanding junior senior debt lead to a higher uplift for Berlin Hyp's junior senior liabilities. For subordinated debt, however, these volumes remain insufficient to indicated a lower loss given failure.

The downgrade of Berlin Hyp's long-term deposit, issuer and senior unsecured debt ratings therefore follows the downgrade of the bank's Adjusted BCA and the application of the new group's LGF analysis to Berlin Hyp's rated instruments, considering the risks faced by the different debt and deposit classes across the liability structure at failure, which however, is unchanged for these instrument classes. Moody's Advanced LGF analysis continues to result in three notches of uplift for deposits and senior unsecured debt for Berlin Hyp, based on an extremely low loss given failure at group level.

The unchanged assumption of a moderate likelihood of government support for deposits and senior unsecured debt instruments continues to provide one notch of rating uplift for these liabilities.

For junior senior unsecured debt instruments, the downgrade of Berlin Hyp's Adjusted BCA is balanced by increased rating uplift available from the Advanced LGF analysis at group level, now providing two notches ratings uplift from the baa1 Adjusted BCA instead of one notch before. The key driver for the very low loss given failure results for Berlin Hyp stems from LBBW's liability structure, which provides stronger investor protection at the more junior instrument level, because of higher volumes of subordinated debt and AT1 capital instruments being in issuance combined with the significant volumes of outstanding junior senior debt. As a result, Moody's affirmed the junior unsecured debt ratings.

The downgrade of Berlin Hyp's subordinated programme rating follows the downgrade of the Adjusted BCA as the Advanced LGF analysis at group level indicates an unchanged high loss given failure, leading us to position the subordinated programme one notch below the Adjusted BCA, as volumes and subordination on the group level indicate no change from the liability analysis, even if LBBW issued more of these liabilities.

BERLIN HYP's BCA AFFIRMATION REFLECTS AN UNCHANGED CREDIT PROFILE

The affirmation of Berlin Hyp's ba1 standalone BCA reflects Moody's expectation that it will continue to operate as a standalone entity and subsidiary of LBBW, under its existing brand and with an unchanged strategy. Berlin Hyp's ba1 BCA continues to reflect its very high concentration risks in cyclical commercial real estate (CRE) lending, resulting from its highly focused business model. This implies a larger tail risk, particularly in a more challenging operational environment and despite the overall good asset quality evidenced through a low share of non-performing loans.

Key risk mitigants are Berlin Hyp's good and improved capitalisation and a profitability that exceeds the level of domestic peers. Though the weaker economic environment will likely lead to higher risk costs, balancing the positive impact of a steeper yield curve on revenues in 2022, profitability should continue to provide a sufficient buffer to absorb a more elevated level of provisioning needs.

The bank's sound solvency is somewhat offset by the bank's weaker liquidity, due to a high reliance on confidence-sensitive market funding and substantial asset encumbrance. However, Berlin Hyp has good access to stable funding sources within S-Finanzgruppe.

OUTLOOK

The outlook on Berlin Hyp's long-term deposit, issuer and senior unsecured debt ratings is stable and aligned with the outlook of LBBW's ratings.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Upwards pressure on Berlin Hyp's ratings could develop if LBBW's fundamental credit profile improves or higher sector support becomes available.

Upward pressure on Berlin Hyp's ba1 BCA could develop as a combination of an improvement in the bank's leverage ratio, particularly through higher capitalisation levels generated via a further reserve buildup; substantially improving earnings; or in case the bank substantially reduces its market funding dependence, for instance via intra-group funding. However, an upgrade of the bank's BCA would not result in an upgrade of its Adjusted BCA or its long-term issuer rating because the impact of such an upgrade would be offset by lower affiliate support uplift as its baa1 Adjusted BCA is already aligned with its parent.

Berlin Hyp's long-term deposit, issuer and senior unsecured debt ratings could be downgraded in case of downwards pressure for LBBW's ratings, available parent support declines, or if our assumption of group resolution will not be implemented. Further, a change in the joint liability structure with LBBW, resulting in higher loss given failure in resolution and, therefore, fewer notches of rating uplift derived from our Advanced LGF analysis could exert downwards rating pressure.

Berlin Hyp's BCA could be downgraded if capital ratios weaken in case of a sustained and significant deterioration in asset quality, or if profitability declines sustainably from historical levels.

LIST OF AFFECTED RATINGS

Issuer: Berlin Hyp AG

..Downgrades:

....Long-term Counterparty Risk Ratings, downgraded to Aa3 from Aa2

....Long-term Bank Deposits, downgraded to Aa3 from Aa2, outlook changed to Stable from Ratings under Review

....Long-term Counterparty Risk Assessment, downgraded to Aa3(cr) from Aa2(cr)

....Long-term Issuer Ratings, downgraded to Aa3 from Aa2, outlook changed to Stable from Ratings under Review

....Adjusted Baseline Credit Assessment, downgraded to baa1 from a3

....Senior Unsecured Regular Bond/Debenture, downgraded to Aa3 from Aa2, outlook changed to Stable from Ratings under Review

....Senior Unsecured Medium-Term Note Program, downgraded to (P)Aa3 from (P)Aa2

....Subordinate Medium-Term Note Program, downgraded to (P)Baa2 from (P)Baa1

..Affirmations:

....Short-term Counterparty Risk Ratings, affirmed P-1

....Short-term Bank Deposits, affirmed P-1

....Short-term Counterparty Risk Assessment, affirmed P-1(cr)

....Short-term Issuer Ratings, affirmed P-1

....Baseline Credit Assessment, affirmed ba1

....Junior Senior Unsecured Regular Bond/Debenture, affirmed A2

....Junior Senior Unsecured Medium-Term Note Program, affirmed (P)A2

....Commercial Paper, affirmed P-1

..Outlook Action:

....Outlook changed to Stable from Ratings Under Review

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at https://ratings.moodys.com/api/rmc-documents/71997 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the UK and is endorsed by Moody's Investors Service Limited, One Canada Square, Canary Wharf, London E14 5FA under the law applicable to credit rating agencies in the UK. Further information on the UK endorsement status and on the Moody's office that issued the credit rating is available on https://ratings.moodys.com.

REFERENCES/CITATIONS

[1] Landesbank Baden-Württemberg press release 30 June 2022

Please see https://ratings.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

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