



## Fitch Affirms Berlin Hyp's Long-Term IDR at 'A+' & VR at 'bbb'

Fitch Ratings-Frankfurt/London-21 January 2019: 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 at the end of this commentary.

### KEY RATING DRIVERS

**IDRs, SUPPORT RATING (SR) AND SENIOR NON-PREFERRED UNSECURED DEBT RATINGS**  
Berlin Hyp's IDRs, SR and senior non-preferred unsecured debt ratings are based on support from the bank's ultimate parent, Sparkassen-Finanzgruppe (Sparkassen) (SFG, A+/Stable/F1+), the German savings banks group, which collectively owns Berlin Hyp's immediate parent, Landesbank Berlin Holding AG. The equalisation of Berlin Hyp's IDRs with those of SFG reflects Fitch's view that Berlin Hyp benefits from an extremely high probability of support from the savings banks, if needed.

We believe SFG has a very high propensity to support Berlin Hyp, primarily because failing to do so would greatly damage the savings banks' reputation and their mutual support scheme's credibility. SFG is not a legal entity but a banking network, whose cohesion is ensured by its mutual support scheme. Therefore, Berlin Hyp's ultimate support provider is not a single legal entity. While this could increase the complexity of devising extraordinary support measures, we expect the savings banks to coordinate adequate and timely support, if ever needed. Given Berlin Hyp's small size relative to SFG, any required support would be immaterial to SFG.

Berlin Hyp's privileged access to the savings banks' strong excess liquidity drives the bank's 'F1+' Short-Term IDR, which is equalised with SFG's Short-Term IDR and corresponds to the higher of two possible Short-Term IDRs for a 'A+' Long-Term IDR.

### VR

Berlin Hyp's VR reflects its strong asset quality despite its concentrated loan book inherent in its business model as a monoline commercial real estate (CRE) lender, as well as its adequate and improved risk-adjusted profitability. The bank's capitalisation is moderate in absolute terms but provides a sufficient buffer over its regulatory requirements and is adequate in light of its sound asset quality. Its funding and liquidity are sound despite its wholesale funded profile.

Berlin Hyp's sound and improved asset quality indicators are stronger than those of its CRE peers and of the broader German banking sector. This reflects the bank's prudent underwriting standards, both domestically and abroad, and the decline in non-performing loans (NPLs) resulting from the wind-down of its legacy portfolio in recent years. However, similar to other CRE lenders, Berlin Hyp's structurally high concentration on single borrowers constrains our assessment of the bank's asset quality.

We expect SFG to ensure that Berlin Hyp will maintain its prudent risk appetite despite the considerable margin pressure that has affected the German CRE lending market in recent years. We expect this margin pressure to limit future improvements of Berlin Hyp's performance because its domestic business is likely to continue to account for 70%-75% of the bank's new business in the medium term, as the bank intensifies its cooperation with the domestically-focused savings banks. In

addition, Berlin Hyp is exposed to significant interest rate risk in its banking book, which results in significant vulnerability to rising rates.

Berlin Hyp's profitability is commensurate with its risk profile. Despite the challenging low margin and interest rate environment, its operating performance was exceptionally strong in 2017 and particularly in 9M18, notably thanks to net releases of loan impairment charges (LICs). In addition, Berlin Hyp's earnings currently benefit from stringent cost management and high volumes of new business generation as demand remains strong in Germany. We expect profitability to remain adequate, although LIC releases cannot continue at the current pace for much longer in light of the bank's low remaining stock of loan loss allowances. We view Berlin Hyp's current cost/income ratio of around 40% as appropriate for a lean monoline CRE lender, although it will be challenging to maintain through the cycle.

Berlin Hyp's Common Equity Tier 1 (CET1) ratio decreased to 11.8% at end-3Q18 from 12.5% at end-2017 as its risk-weighted assets (RWA) continued to grow significantly. However, the CET1 ratio including the provisions for general banking risk was stable at 12.6%, as the bank continued to allocate a sizeable share of its solid operating profits to these provisions. Berlin Hyp's leverage ratio was a quite tight 4.0% at end-3Q18 but we expect it to maintain sufficient internal capital generation, and for SFG to inject capital if necessary to accompany the growth of the bank's operations and in the longer term, mitigate the RWA inflation that will arise from the output floor to be implemented with the revised Basel III regime.

Berlin Hyp's funding and liquidity are adequate. The bank is wholesale-funded and has a diversified base of domestic and foreign institutional investors, both for mortgage Pfandbrief issuance (its largest funding source) and unsecured funding. Through its privileged access to SFG's members that results from its membership in the group's mutual support scheme (0% intragroup regulatory risk weighting), Berlin Hyp's funding profile also benefits from the savings banks' vast structural excess liquidity.

#### SENIOR PREFERRED DEBT AND DEPOSIT RATINGS

Berlin Hyp's senior preferred debt ratings and Deposit Ratings are aligned with the bank's IDRs. We have not given any uplift to the senior preferred debt ratings and Deposit Ratings, as in Fitch's opinion, the bank's debt buffers do not afford any incremental probability of default benefit over and above the support benefit already factored into Berlin Hyp's Long-Term IDR, which is rated four notches above its VR. We have also not assigned any uplift for above-average recovery prospects in the event of default because of the limited visibility into recovery levels in such circumstances.

#### RATING SENSITIVITIES

##### IDRs, SR AND SENIOR NON-PREFERRED UNSECURED DEBT RATINGS

Berlin Hyp's IDRs, SR and senior debt ratings are primarily sensitive to changes in the bank's ownership structure or contractual relationship with the savings banks, in particular its membership in SFG's mutual support scheme. Any perceived weakening in the owners' propensity to provide support would put pressure on the ratings. The ratings are also sensitive to changes in SFG's ratings, as Berlin Hyp's IDRs are equalised with those of the group.

#### VR

We currently view limited upside for Berlin Hyp's VR given the dominance of net interest income from the CRE sector in the bank's revenue mix. Downside pressure on the VR is most likely to arise from severe stress in the property markets (particularly in Germany) that would significantly affect the bank's profitability and ultimately its capitalisation, although we would expect SFG to provide precautionary recapitalisations in a timely manner if necessary.

#### SENIOR PREFERRED DEBT AND DEPOSIT RATINGS

Berlin Hyp's senior preferred debt ratings and Deposit Ratings are primarily sensitive to changes in the bank's IDRs.

The rating actions are as follows:

Berlin Hyp AG:

Long-Term IDR: affirmed at 'A+', Outlook Stable

Short-Term IDR: affirmed at 'F1+'

Support Rating: affirmed at '1'

Viability Rating: affirmed at 'bbb'

Deposit Ratings: affirmed at 'A+/'F1+'

Senior non-preferred unsecured notes and debt issuance programme rating: affirmed at 'A+'

Senior preferred notes and debt issuance programme ratings: affirmed at 'A+/'F1+'

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Bank Rating Criteria (pub. 12 Oct 2018) (<https://www.fitchratings.com/site/re/10044408>)

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