FitchRatings

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+'

Contact:
Primary Analyst
Roger Schneider, CIIA
Director
+49 69 768076 242
Fitch Deutschland GmbH
Neue Mainzer Strasse 46-50
D-60325 Frankfurt am Main

Secondary Analyst
Patrick Rioual
Senior Director
+49 69 768076 123

Committee Chairperson
Eric Dupont
Senior Director
+33 1 44 29 91 31

Media Relations: Louisa Williams, London, Tel: +44 20 3530 2452, Email:
louisa.williams@fitchratings.com

Additional information is available on www.fitchratings.com

Applicable Criteria

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

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form (https://www.fitchratings.com/site/dodd-frank-disclosure/10060028)
Solicitation Status (https://www.fitchratings.com/site/pr/10060028#solicitation)
Endorsement Policy (https://www.fitchratings.com/regulatory)

DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.
For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

SOLICITATION STATUS

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.

Endorsement Policy

Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures (https://www.fitchratings.com/regulatory) page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Fitch Updates Terms of Use & Privacy Policy

We have updated our Terms of Use (https://www.thefitchgroup.com/site/termsofuse) and Privacy Policies (https://www.thefitchgroup.com/site/privacy) which cover all of Fitch Group's websites. Learn more. (https://www.thefitchgroup.com/site/policies)