



RATING ACTION COMMENTARY

Fitch Affirms Aareal at 'BBB+'; Outlook Negative

Wed 17 Nov, 2021 - 10:26 AM ET

Fitch Ratings - Frankfurt am Main - 17 Nov 2021: Fitch Ratings has affirmed Aareal Bank AG's Long-Term Issuer Default Rating (IDR) at 'BBB+' with Negative Outlook and Viability Rating (VR) at 'bbb+'. A full list of rating actions is below.

The Negative Outlook on the Long-Term IDR reflects remaining risks from the pandemic, which could result in greater-than-anticipated asset-quality pressures and profitability challenges.

Aareal's VR is constrained by the bank's focus on lending to the cyclical commercial real-estate (CRE) sector and exposure to risks associated with this market. These risks include the immediate pressure from the pandemic, as the bank's asset quality is exposed to weaker borrowers' performance in the hotel and retail segments. Risks also stem from structural trends that are being accelerated by the pandemic and could affect parts of the CRE sector in the long term.

The VR is supported by, the bank's good geographical diversification relative to peers', diversified funding mix and sound capitalisation. However, Aareal's profitability, which has been recovering in 9M21, remains vulnerable to the pandemic, in particular if asset quality does not recover as swiftly as currently expected.

Following the update of Fitch's Bank Rating Criteria on 12 November 2021, we have withdrawn Aareal's Support Rating of '5' and Support Rating Floor of 'No Floor' as they are no longer considered by Fitch to be relevant to the agency's coverage. In line with the updated Criteria, we have assigned Aareal a Government Support Rating (GSR) of 'No Support'.

KEY RATING DRIVERS

IDRs, VR AND SENIOR NON-PREFERRED (SNP) DEBT RATING

Aareal's reported non-performing loan (NPL) ratio (which includes off-balance sheet, fair-value NPLs and IFRS Stage 3 loans) rose to 6% at end-1H21 from 4.1% at end-2019. The large NPL inflow was mainly driven by UK retail properties and, to a smaller extent, hotels, to which Aareal has a large exposure (hotel and retail properties represented 32% and 20% of total loans at end-3Q21). Both segments have been most affected by the pandemic so far, and our negative outlook on the bank's asset-quality score reflects the risk of further NPL inflows in the short term as state support (e.g. furlough schemes) is being phased out.

We expect the four-year average Stage 3 ratio (5.4% at end-1H21) to reduce to about 4% by end-2022. The bank should be able to reduce NPLs in the foreseeable future, as recovering consumer spending and business travel should support the performance and valuation of retail and hotel properties. Additionally, Aareal is likely to consider de-risking measures similar to 2019, amid a recovering operating environment in 2021 that is supported by the vaccine rollout. Aareal's reported NPL ratio stood at 4.9% at end-3Q21.

We maintain a negative outlook on Aareal's earnings and profitability score, as a slow recovery of the hotel and retail sectors could temper the stabilisation of the bank's results. The bank's operating profit/risk-weighted assets (RWA) rebounded to 1.5% in 9M21 from -0.6% in 2020, when high pandemic-driven loan impairment charges (LICs) of EUR344 million (EUR90 million in 2019) triggered an annual loss of EUR69 million, despite only a slight decrease in net interest income.

The bank's long-term profitability record is better than German peers', as its international focus results in above-average margins, with a four-year average operating profit/RWA above 2% before the pandemic. We expect profitability to recover toward the long-term average over the next 24 months, supported by profitable loan growth, normalisation of LICs and steadily rising income at the bank's service and consulting subsidiary Aareon.

Aareal's capitalisation remains a rating strength, despite the 2020 annual loss and RWA inflation from recent asset-quality deterioration. Its sound common equity Tier 1 (CET1) ratio of 21.5% at end-3Q21 is well above the SREP CET1 requirement of 8.28% in 2021 (accounting for Pillar 2 requirements relief). The bank is not constrained by its regulatory leverage ratio, which at 5.7% at end-3Q21 compares well with other specialised CRE lenders' and the overall banking sector's. The bank is well-positioned to

absorb the finalisation of the Basel III framework, including the output floor, given its pro-forma Basel IV (fully phased-in) CET1 ratio of 12.5% at end-3Q21.

Beside Pfandbriefe, Aareal's diversified funding mix consists primarily of resilient and stable deposits from the institutional housing sector. This limits the bank's reliance on unsecured market funding, which mostly consists of private placements from an established investor base.

Aareal's Short-Term IDR of 'F2' is the baseline option mapping to the 'BBB+' Long-Term IDR, because the bank's funding & liquidity score of 'bbb+' does not allow for a higher option.

DERIVATIVE COUNTERPARTY RATING (DCR), DEPOSIT AND SENIOR PREFERRED (SP) DEBT RATINGS

Aareal's DCR, long-term deposit and SP debt ratings are one-notch above the bank's Long-Term IDR to reflect the large buffer of SNP and junior debt of 41% of RWAs at end-2Q21, which provides the bank's preferred creditors and counterparties with additional protection compared with SNP creditors in a resolution. The short-term deposit and SP debt ratings of 'F2' are the baseline option mapping to the long-term preferred ratings 'A-', because the bank's funding & liquidity score of 'bbb+' does not allow for a higher option.

GSR

We have assigned a GSR of 'No Support'. This reflects Fitch's view that due to the EU's Bank Recovery and Resolution Directive (BRRD) senior creditors of the bank can no longer rely on full extraordinary support from the sovereign if the bank becomes non-viable.

TIER 2 SUBORDINATED DEBT AND HYBRID SECURITIES

Aareal's Tier 2 notes are notched down twice from the VR, which is the baseline notching for this type of debt under Fitch's criteria, to reflect their poor recovery prospects. The additional Tier 1 (AT1) notes are rated four notches below the VR: twice for loss severity, due to their deep subordination and write-down on a breach of the 7% CET1 trigger, and twice for incremental non-performance risk relative to the VR to reflect fully discretionary coupon payments.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

We could downgrade the VR (and, thus the Long-Term IDR) if the Stage 3 ratio exceeds 5% for an extended period with no credible reduction plan, combined with an operating profit/RWA ratio durably below 1.5%. This could result from stress in the property market leading to unexpectedly high asset-quality pressure. Should the emergence of a majority shareholder drive aggressive loan growth or profit distribution to the point that it would significantly deplete Aareal's capital ratios, this could also weigh on the VR.

A downgrade of the Long-Term IDR would trigger a downgrade of the DCR, long-term SP and SNP debt and deposit ratings. We could also downgrade the long-term SP and SNP debt ratings if the bank no longer retains an SNP and junior debt buffer that is large enough to cover its total resolution buffer requirement, and if at the same time the SNP and junior debt buffer declines below 10% of RWA.

A downgrade of the VR would lead to a downgrade of the Tier 2 and AT1 notes. The ratings of AT1 notes could also be downgraded if we perceive a heightened risk that capital cushions above maximum distributable amount trigger points could fall below 100bp.

Aareal's GSR is at the bottom of Fitch's rating scale and therefore cannot be downgraded.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlook on the Long-Term IDR could be revised to Stable if the bank weathers the challenges arising from the pandemic, limiting risks to its asset quality and profitability, while maintaining broadly stable capitalisation.

An upgrade of the VR (and, thus, of the Long-Term IDR) is unlikely in the near term given the risks posed by the pandemic. In the longer term, an upgrade would require significant diversification of its business model into revenue sources that are not directly dependent on large-ticket CRE lending, as well as strengthened asset quality. An operating profit/RWA sustainably above 2% combined with a Stage 3 ratio sustainably below 3% could result in an upgrade.

An upgrade of Aareal's IDRs would trigger an upgrade of the DCR, SP and SNP debt and deposit ratings, unless the buffer of junior and SNP debt decreases below the level required to maintain the SP ratings' one-notch uplift above and the SNP debt' alignment with the Long-Term IDR. An upgrade of Aareal's VR would lead to an upgrade of the Tier 2 and AT1 notes.

An upgrade of the GSR would require a higher propensity of sovereign support. While not impossible, the Banking Recovery and Resolution Directive makes this highly unlikely.

VR ADJUSTMENTS

The earnings and profitability score of 'bbb+' has been assigned below the 'a' category implied score, due the following adjustment reason: revenue diversification (negative).

The capitalisation and leverage score of 'a-' has been assigned below the 'aa' category implied score, due to the following adjustment reason: risk profile and business model (negative).

The funding and liquidity score of 'bbb+' has been assigned above the 'bb' category implied score, due to the following adjustment reasons: liquidity coverage (positive); deposit structure (positive).

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

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.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the 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 on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Aareal Bank AG	LT IDR	BBB+ Rating Outlook Negative		BBB+ Rating Outlook Negative
	Affirmed			
	ST IDR	F2	Affirmed	F2
	Viability	bbb+	Affirmed	bbb+
	Support	WD	Withdrawn	5
	Support Floor	WD	Withdrawn	NF
	DCR	A-(dcr)	Affirmed	A-(dcr)
	Government Support	ns	New Rating	
Senior preferred	LT	A-	Affirmed	A-
subordinated	LT	BBB-	Affirmed	BBB-
subordinated	LT	BB	Affirmed	BB
long-term deposits	LT	A-	Affirmed	A-
Senior preferred	LT	A-	Affirmed	A-

Senior non-preferred	LT	BBB+	Affirmed	BBB+
short-term deposits	ST	F2	Affirmed	F2
Senior preferred	ST	F2	Affirmed	F2

[VIEW ADDITIONAL RATING DETAILS](#)

FITCH RATINGS ANALYSTS

Markus Glabach

Director

Primary Rating Analyst

+49 69 768076 195

markus.glabach@fitchratings.com

Fitch Ratings – a branch of Fitch Ratings Ireland Limited

Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Roger Schneider

Director

Secondary Rating Analyst

+49 69 768076 242

roger.schneider@fitchratings.com

Konstantin Yakimovich

Senior Director

Committee Chairperson

+44 20 3530 1789

konstantin.yakimovich@fitchratings.com

MEDIA CONTACTS

Louisa Williams

London

+44 20 3530 2452

louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 12 Nov 2021\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

Aareal Bank AG

EU Issued, UK Endorsed

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK:

[HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, THE FOLLOWING [HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT](https://www.fitchratings.com/rating-definitions-document) DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE OR ANCILLARY SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF PERMISSIBLE SERVICE(S) FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA- REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) OR ANCILLARY SERVICE(S) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk,

unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and 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.

[READ LESS](#)

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be.

Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

Banks Europe Germany
