

Research Update:

# Hypo Vorarlberg Ratings Affirmed At 'A+/A-1'; Outlook Still Negative After Outlook Revision On State Of Vorarlberg

March 23, 2021

## Overview

- We revised our outlook on the Austrian State of Vorarlberg to negative from stable on March 19, 2021.
- The ratings on Hypo Vorarlberg benefit from the bank's very strong link and important role to its majority owner the State of Vorarlberg.
- We affirmed our long- and short-term ratings on Hypo Vorarlberg at 'A+/A-1'.
- The negative outlook now reflects a potential downgrade of the State of Vorarlberg as well as our view that economic risk for the Austrian banking system could increase over the medium term as a result of the economic slowdown related to the pandemic. This could hamper the bank's capitalization and asset quality.

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## Rating Action

On March 23, 2021, S&P Global Ratings affirmed its 'A+/A-1' long- and short-term issuer credit ratings on Hypo Vorarlberg Bank AG. The outlook remains negative.

## Rationale

**The affirmation follows our rating action on the State of Vorarlberg.** The outlook revision on Vorarlberg reflected our view of heightened risk that COVID-19 fallout could stress Vorarlberg's budget more and for longer than we previously anticipated. We expect that the state's fiscal performance will improve markedly from 2022, on account of better tax revenue and a focus on consolidation efforts once the pandemic subsides. This should allow the state to stabilize its debt burden and gradually return toward an almost-fully balanced budget after capital expenditure by about 2024. However, these developments will depend on the state implementing a yet-to-be defined financial policy response that is well synchronized with economic conditions. For details

on Vorarlberg, see "Austrian State Of Vorarlberg Outlook Revised To Negative From Stable; 'AA+/A-1+' Ratings Affirmed," published March 19, 2020, on RatingsDirect.

**The bank's strong link to and important role for the State of Vorarlberg are unchanged.** We continue to regard Hypo Vorarlberg as a government-related entity (GRE) with a high likelihood of extraordinary government support from its owner, the State of Vorarlberg. We therefore apply three notches of uplift from the stand-alone credit profile, leading to a long-term issuer credit rating of 'A+'. As a result, our ratings on the bank also depend on our view of the state's creditworthiness. A downgrade of the State of Vorarlberg would very likely be followed by a downgrade of the bank.

**We expect Vorarlberg will remain supportive of Hypo Vorarlberg and a long-term shareholder of the bank.** The bank exclusively executes Vorarlberg's developmental mortgage lending program. Our assessment is reinforced by the bank's high share of lending to local small and midsize enterprises. Our view of a high likelihood of extraordinary government support for Hypo Vorarlberg is based on our assessment of the bank's:

- Very strong and durable link with the government of Vorarlberg and its policies, supported by the government's track record of providing very strong and timely support in most circumstances; and
- Important role for the government of Vorarlberg. Even though the bank operates as a profit-seeking enterprise in a competitive environment, its credit standing is important for the government because credit stress would lead to a disruption of its activities and could have an important impact on a sector of the economy.

**Hypo Vorarlberg has a leading franchise in Vorarlberg, but the pandemic could worsen its performance in 2021.** Hypo Vorarlberg has a cost-efficient leading franchise in corporate and retail banking in Vorarlberg, which we consider the bank's key rating strength in comparison with the Austrian Hypo banks operating in the other regions. That said, its geographical concentration makes the bank vulnerable to a further downturn of the regional economy if the COVID-19-related stress continues longer than we currently expect.

**We project strong capitalization but elevated loan-loss provisions and nonperforming assets in 2021.** We forecast the bank's risk-adjusted capital (RAC) ratio will remain beyond 10% over the coming 12-24 months. However, we expect loan-loss provisions and nonperforming assets will remain elevated in 2021. The bank's pre-tax profits will therefore remain lower than in pre-pandemic years over the next 12 months, in our view. We expect this will also reduce capital ratios in the short term. That said, the bank's sound cost efficiency (cost-to-income ratio for 2019: 53%) and earnings generation ability point to a recovery for the bank after 2021. Management's consistent strategy execution and rich regional expertise is also a positive factor for our assessment.

## Outlook

The negative outlook reflects our view of downside risks that the bank faces in the coming 12-24 months. This includes our opinion that economic risk for the Austrian banking system could increase over the medium term as a result of the economic slowdown related to the pandemic. We believe this could weaken the bank's revenue base, and that asset quality could come under greater strain than we currently anticipate through 2021-2022 if economic recovery is significantly

delayed.

### Downside scenario

We could lower the long-term issuer credit rating on the bank in the next two years if:

- We lowered our ratings on the State of Vorarlberg; or
- We saw further deterioration in the operating environment, leading to a more material setback to profitability and asset quality, particularly if the bank were to become loss-making or we observed a substantial increase in nonperforming assets; or
- The bank deviated from its current business strategy of focusing on key markets and low-risk products; or
- Hypo Vorarlberg's RAC ratio dropped sustainably below 10%, contrary to our expectations.

### Upside scenario

We could revise the outlook to stable if we saw sustainable improvements in global economic conditions, including stable economic and industry risk trends for the Austrian banking industry and the main markets where Hypo Vorarlberg operates. We see an upgrade as remote, mainly because of the bank's regional and business-line concentration, which is greater than that of some of the market-dominating banks in Austria. A precondition for a positive rating action on the bank would be unchanged ratings on the State of Vorarlberg and a revision of our outlook on the state to at least stable.

### Ratings Score Snapshot

Issuer Credit Rating	A+/Negative/A-1
SACP	bbb+
Anchor	a-
Business Position	Moderate (-1)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and	Average and (0)
Liquidity	Adequate
Support	3
ALAC Support	0
GRE Support	3
Group Support	0
Sovereign Support	0
Additional Factors	0

## Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Austrian State Of Vorarlberg Outlook Revised To Negative From Stable; 'AA+/A-1+' Ratings Affirmed, March 19, 2021
- Full Analysis: Hypo Vorarlberg Bank AG, Feb. 18, 2021
- Banking Industry Country Risk Assessment: Austria, June 17, 2020
- Outlook Revisions On Several Austrian Banks On Deepening COVID-19 Downside Risks, April 29, 2020

## Ratings List

### Ratings Affirmed

#### Hypo Vorarlberg Bank AG

Issuer Credit Rating	A+/Negative/A-1
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Senior Unsecured	A+
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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support

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