

Research Update:

# Austria-Based Hypo Vorarlberg Bank AG Affirmed At 'A+/A-1'; Outlook Remains Negative On Asset Quality Risk

October 22, 2024

## Overview

- Austria's real estate market remains under stress, which implies persisting asset quality risks for development companies, which could lead to higher-than-expected credit losses for Hypo Vorarlberg Bank AG (Hypo Vorarlberg).
- The bank's risk-adjusted capital (RAC) remains strong, but we see a risk of higher nonperforming assets in the next 12 months, due to its sizable exposures to the construction and real estate development sector.
- We therefore affirmed our 'A+/A-1' long-term and short-term issuer credit ratings on the bank and maintained our negative outlook.
- The negative outlook reflects our view of ongoing downside risks over the next 12 months if stressed real estate markets lead to a material asset quality deterioration, resulting in materially weaker capitalization, or if Hypo Vorarlberg's profitability and cost efficiency metrics continue to underperform other rated peers.

## Rating Action

On Oct. 22, 2024, S&P Global Ratings affirmed its 'A+' long-term and 'A-1' short-term issuer credit ratings on Hypo Vorarlberg. The outlook remains negative.

## Rationale

**Persisting challenges in the Austrian real estate sector could be exacerbated by the bank's concentration risk.** Construction and real estate development lending makes up a considerable part of Hypo Vorarlberg's portfolio, at about 12%. The bank is therefore significantly exposed to risks in the stressed real estate market in Austria. We see no signs of increased risk-taking and anticipate no changes in this regard. That said, credit losses have been material in 2023. The bank

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booked significant financial losses of €79.5 million in 2023 because of loan loss provisions in its corporate portfolio. While we think that some risk parameters will be reviewed in lending and underwriting standards, Hypo Vorarlberg's business model is unlikely to change considering the good track record of the bank before 2023.

**Ongoing pressure on profits could become a structural weakness when benchmarked against other Austria-based Hypo-type mortgage banks (Hypo banks).** We forecast elevated loan loss provisions to weigh on after-tax earnings in 2024-2026, the latter ranging at €50 million-€70 million annually between 2024 and 2026. This translates into a return on equity ratio of only 3.0%-4.5%, comparatively weaker than our forecasts of other Hypo bank peers. We expect Hypo Vorarlberg's earnings buffer to remain in the range of 0.2%-0.3% between 2024 and 2026. This is markedly below our estimated median of 1.5% for Austrian and European banks in 2024, which indicates Hypo Vorarlberg's weaker capacity to absorb normalized credit losses with operating income through a full economic cycle. We see greater uncertainty as to whether Hypo Vorarlberg can restore its leading position in terms of profitability and efficiency among Hypo banks.

**Elevated loan loss provisions could undermine earnings and capital accretion.** In our base case, we expect the asset quality to marginally deteriorate in the next 12 months. Elevated loan loss provisioning could put further pressure on earnings and, ultimately, on the bank's capitalization, particularly if European real estate markets remain under stress in the next 12 months. That said, we anticipate Hypo Vorarlberg's RAC ratio will slightly improve by about 70 basis points to about 11.5% in the next 12-24 months.

## Outlook

The negative outlook reflects our view that Hypo Vorarlberg continues to face heightened asset quality risk, which could translate to higher credit losses and put pressure on its after-tax earnings over the next 12 months.

We consider Hypo Vorarlberg to be a government-related entity (GRE) and our rating on the bank is supported by our credit view of the owner. As such, a downgrade of the State of Vorarlberg by one notch would lead us to downgrade the bank. A change in Hypo Vorarlberg's role or link with the state could also lead us to reassess the bank's status as a GRE and result in a lower rating, although this is a remote scenario.

## Downside scenario

We could also lower our rating on Hypo Vorarlberg over the next 12 months if real estate markets remain challenging, leading to further material asset-quality deterioration and higher credit losses.

Additionally, we could lower the rating if the bank's RAC ratio drops sustainably below 10%. We could also lower the rating if Hypo Vorarlberg sustainably underperforms other rated Austrian Hypo-type mortgage banks, in terms of profitability and cost efficiency.

## Upside scenario

We could revise our outlook to stable over the next 12 months if Hypo Vorarlberg maintains a resilient balance sheet and sound asset quality amid a challenging real estate sector. A

precondition for an outlook revision hinges on the bank's ability to sustain a robust financial performance, including profitability and efficiency metrics in line with those of other rated Austrian Hypo-type mortgage banks.

## 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 liquidity	Adequate and adequate (0)
Comparable ratings analysis	0
Support	3
ALAC support	0
GRE support	3
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

## Related Criteria

- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Credit Conditions Europe Q4 2024: Turn In Credit Cycle Won't Be Plain Sailing, Sept. 25, 2024
- Banking Industry Country Risk Assessment: Austria, Aug. 27, 2024
- Hypo Vorarlberg Bank AG, Feb. 21, 2024
- Austria-Based Hypo Vorarlberg Bank Outlook Revised To Negative On Rising Asset Quality Risk; Affirmed At 'A+/A-1', Dec. 12, 2023

## Ratings List

### Ratings Affirmed

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#### Hypo Vorarlberg Bank AG

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Issuer Credit Rating A+/Negative/A-1

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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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceld/504352>. Complete ratings information is available to RatingsDirect subscribers 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.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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