PRESS RELEASE APRIL 19, 2023

DBRS Morningstar Confirms Landesbank Baden-Württemberg LT Issuer Rating at A (high), Trend Remains Stable

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the ratings on Landesbank Baden-Württemberg (LBBW or the Bank), including Issuer Ratings at A (high) / R-1 (middle). DBRS Morningstar also confirmed the Senior Non-Preferred Debt rating at 'A', the Subordinated Debt Rating at A (low) and the Critical Obligations Ratings (COR) at AA / R-1 (high). The trend on all ratings remains Stable. The ratings and the trend are all in line with the broader Sparkassen-Finanzgruppe (SFG). LBBW's Intrinsic Assessment (IA) is 'A' and its Support Assessment is SA1. For a complete list of ratings, please see the table at the end of this press release.

KEY RATING CONSIDERATIONS

LBBW's ratings reflect its membership in the Sparkassen-Finanzgruppe (SFG) and in the Institutional Protection Scheme (IPS) of the SFG. Each member of the IPS, including LBBW, is generally rated at the floor level, which is currently A (high) with a Stable trend.

The 'A' Intrinsic Assessment (IA) takes into account LBBW's well established universal banking franchise with a regional focus on Southern Germany. Given its history, the Bank's clients are predominantly commercial clients and LBBW also acts as a central institution and clearing bank for the savings banks in its designated regions of Baden-Württemberg, Rhineland-Palatinate and Saxony. The franchise also includes a savings bank in Stuttgart, and a growing asset and wealth management business. LBBW's liquidity position is solid and funding is diversified, supported by its well-established covered bond franchise and its membership in the SFG, offsetting the lack of a large retail deposit base. LBBW has solid capital ratios with cushions well above minimum requirements, which we expect to be maintained over the medium-term. The IA also reflects that earnings power is still somewhat moderate, partly mitigated by resilient revenue generation. Asset quality metrics are strong, supported by the relatively benign German economic environment, prudent underwriting and pro-active portfolio management. However, with the acquisition of Berlin Hyp, concentration risk has increased in commercial real estate (CRE), at a time when the CRE cycle is turning.

The Stable trend reflects DBRS Morningstar's expectations that tailwinds from higher interest rates, the Bank's growth strategy, and ongoing cost control measures are likely to be offset by factors such as a weakening economic environment, inflationary pressures, and higher cost of funding.

RATING DRIVERS

LBBW's Issuer Ratings benefit from the SFG's IPS, and therefore a change in SFG's ratings would lead to a change in LBBW's ratings.

The Bank's Intrinsic Assessment (IA) would be upgraded if the Bank improves its profitability metrics, while maintaining solid asset quality. A significant deterioration in asset quality or a material and sustained decline in profitability would lead to a downgrade of the IA.

RATING RATIONALE

Franchise Combined Building Block (BB) Assessment: Strong / Good

With total assets of EUR 324 billion at end-2022, LBBW is a medium-sized commercial bank providing universal banking services to corporate clients, and, to a lesser extent, to retail clients in its core regions of Baden-Württemberg, Rhineland-Palatinate and Saxony. The Bank also performs central banking and clearing functions for the savings bank associations in these regions. LBBW is an institution incorporated under German public law with legal capacity (rechtsfähige Anstalt des öffentlichen Rechts, AöR) and is a member of the Sparkassen Finanzgruppe which benefits from a joint liability scheme. The Bank holds a strong market share in its core regions and has market leading positions in a number of products, including commercial real estate (CRE) finance in Germany. LBBW is designated as an 'other systemically important institution' within Germany, given its position as a major counterparty in the German capital markets.

Earnings Combined Building Block (BB) Assessment: Moderate

LBBW profitability metrics are weaker when compared to European peers, partly mitigated by relative stable revenues. The Bank has been pursuing a strategy to improve efficiency through revenue growth while keeping costs relatively stable in order to create positive operating leverage. This has led to a gradual decline in its cost/income ratio and an improved return on equity (ROE), albeit from low levels. In 2022, LBBW reported a profit before tax of EUR 1,873 million up from EUR 817 million a year earlier mainly driven by the badwill of EUR 972 million generated from the acquisition of Berlin Hyp. On an operating basis, the Bank's net profit before tax increased by 10% (YoY) to EUR 901 million in 2022 underpinned by a 13% increase in net interest income (NII) and fee growth of 5%, while administrative expenses increased by 10% and loan loss provisions remained largely flat. Results reflect the first-time inclusion of Berlin Hyp. Despite tailwinds from higher interest rates and ongoing cost control measures combined with a medium-term growth strategy, DBRS Morningstar also sees challenges given the weakening economic environment, inflationary pressures, and higher cost of funding. While we expect a positive revenue contribution from Berlin Hyp given its good income generation capacity, we also note that its historically low credit losses may not be sustainable.

Risk Combined Building Block (BB) Assessment: Strong / Good

In DBRS Morningstar's view, LBBW's asset quality metrics are strong, backed by prudent underwriting and a benign credit environment. The NPL ratio as calculated by DBRS Morningstar was 0.9% in 2022 compared to 1.0% in 2021. Cost of risk was 21 basis points (bps) in 2022 compared to 23 bps in 2021. LBBW's corporate loan book shows a well-balanced sector mix, as the traditionally high exposure to the automobile industry has been reduced in recent years to reflect structural changes in the industry. However, DBRS Morningstar notes that with the acquisition of Berlin Hyp, CRE concentration has increased. Geographically, LBBW mainly operates in stable, mature economies. Most of LBBW's loan exposure is to Germany and Western Europe, followed by North America. While asset quality has been improving in recent years, risks for 2023 are rising due to a challenging operating environment characterised by weak economic growth, rising interest rates and high inflation. In DBRS Morningstar's view, potential asset quality deterioration is likely to remain manageable given LBBW's strong underwriting standards, and solid buffers stemming from good provisioning level and loan collateralisation.

Funding and Liquidity Combined Building Block (BB) Assessment: Strong / Good

DBRS Morningstar views LBBW's funding and liquidity profile as sound. The high reliance on wholesale funding increased further with acquisition of Berlin Hyp and the loan-to-deposit ratio as calculated by DBRS Morningstar climbed to 137% from 126% a year earlier, with a relatively limited retail deposit base, which could leave the Bank vulnerable. However, DBRS Morningstar sees this as mitigated by (i) a well matched asset/liability profile; (ii) well-established access to the covered bond market, which DBRS Morningstar considers a stable source of funding; (iii) a solid liquidity position with liquid assets (cash, deposits with central banks, and securities) accounting for 26% of total assets; and (iv) the Bank's access to the savings banks liquidity pool and the confidence derived from its membership in the Sparkassen-Finanzgruppe. At end-2022, the Liquidity Coverage Ratio (LCR) was 144.2% and the Net Stable Funding Ratio (NSFR) was 111.3%, well above minimum requirements.

Capitalisation Combined Building Block (BB) Assessment: Good

In 2022, capital ratios experienced a modest decline due to a combination of the integration of Berlin Hyp, business growth and market volatility, all of which contributed to an increase in risk weighted assets. However, with a fully loaded CET1 ratio of 14.1% at end-2022 and a total capital ratio of 20.0%, LBBW maintained cushions well over minimum requirements. LBBW's SREP requirement for CET1 slightly declined by 3 bps to 8.78% as of March-2023. In addition, since February 1, 2023, the Bank has to fully comply with an additional countercyclical buffer of 0.75% of risk-weighted German receivables and the sectoral systemic risk buffer of 2.0% of risk-weighted German receivables backed by residential real estate. The Bank's healthy capital cushions should provide management flexibility in response to the new requirements. In DBRS Morningstar's view, solid capital cushions are important due to the somewhat modest capital generation capacity through retained earnings and the Bank's limited access to capital markets due to its ownership structure.

Further details on the Scorecard Indicators and Building Block Assessments can be found at https://www.dbrsmorningstar.com/research/412843.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Credit rating actions on Sparkassen-Finanzgruppe are likely to have an impact on this credit rating.
Governance (G) Factors

The subfactor Corporate Governance is relevant to the rating of Sparkassen-Finanzgruppe, and this is reflected in the franchise grid grades for the group.
DBRS Morningstar views certain weaknesses in the group structure as relevant from a corporate government perspective. Notably, the Landesbanken are majority or part-owned by German Federal States. State governments, in our view, have limited capabilities to effectively supervise the banks' activities. In the past, Landesbanken have taken outsized risks, resulting in high costs to tax payers and the Sparkassen. Sparkassen associations, while part-owners of some Landesbanken have had only limited influence over the risk taking by the Landesbanken. The ownership mix and the parliamentary process involved in decision making, have also made it difficult at times to swiftly react to challenges. In 2020, the ECB requested better pre-emptive risk controls within the IPS and more transparent processes in case of a recapitalisation, which was addressed in 2021. In addition, aggregate financial information for the Group is limited.
There were no Environmental or Social factors that had a significant or relevant effect on the credit analysis.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings (17 May 2022)

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations https://www.dbrsmorningstar.com/research/398692 (23 June 2022). In addition DBRS Morningstar uses the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings https://www.dbrsmorningstar.com/research/

396929/ in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: https://www.dbrsmorningstar.com/about/methodologies

The sources of information used for this rating include Morningstar Inc. and Company Documents, LBBW 2017-2022 Annual Reports, LBBW H1 2022 & 2022 Results Presentations, LBBW H1 2022 Disclosure Reports, and Berlin Hyp H1 2022 Interim Report. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. For further information on DBRS Morningstar historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see https://data.fca.org.uk/#/ceres/craStats.

The sensitivity analysis of the relevant key rating assumptions can be found at: https://www.dbrsmorningstar.com/research/412842.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Last Rating Date: June 21, 2022.

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

Landesbank Baden-Wuerttemberg

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
19-Apr-23	Long-Term Issuer Rating	Confirmed	A (high)	Stb	EU U

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
19-Apr-23	Short-Term Debt	Confirmed	R-1 (middle)	Stb	EU U
19-Apr-23	Short-Term Deposits	Confirmed	R-1 (middle)	Stb	EU U
19-Apr-23	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	EU U
19-Apr-23	Long-Term Critical Obligations Rating	Confirmed	AA	Stb	EU U
19-Apr-23	Short-Term Critical Obligations Rating	Confirmed	R-1 (high)	Stb	EU U
19-Apr-23	Senior Non-Preferred Debt	Confirmed	A	Stb	EU U
19-Apr-23	Long-Term Deposits	Confirmed	A (high)	Stb	EU U
19-Apr-23	Long-Term Senior Debt	Confirmed	A (high)	Stb	EU U
19-Apr-23	Subordinated Debt	Confirmed	A (low)	Stb	EU U
19-Apr-23	LBBW EUR 10,000,000,000 Commercial Paper Programme 2019	Confirmed	R-1 (middle)	Stb	EU U
19-Apr-23	LBBW EUR 5,000,000,000 Negotiable European Commercial Paper Programme 2022	Confirmed	R-1 (middle)	Stb	EU U

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