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Ratings

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Oberoesterreichische Landesbank AG

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Oberoesterreichische Landesbank AG

SACP	bbb+	+	Support	+3	+	Additional Factors	0

Anchor	a-	
Business Position	Weak	-2
Capital and Earnings	Strong	+1
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

ALAC Support	0
GRE Support	+3
Group Support	0
Sovereign Support	0

Issuer Credit Rating
A+/Negative/A-1

Major Rating Factors

Strengths:	Weaknesses:
• Important role for, and very strong link with, the State of Upper Austria, the bank's 51% owner. • Low-risk business model and strong capitalization.	• Very low operating profitability that is further strained by challenging operating conditions because of COVID-19. • Concentration in the loan portfolio on one region, with a focus on public-sector-related lending and the promotion of subsidized housing.

Outlook: Negative

S&P Global Ratings' negative outlook on Austria-based Oberoesterreichische Landesbank AG (Hypo OÖ) reflects our view of potential increasing pressure on the group's profitability and asset quality due to the economic and credit distress stemming from the pandemic.

Downside scenario

We could lower our ratings within the next 12-24 months if we saw the risks to the Austrian banking sector significantly increasing or if we expected our risk-adjusted capital (RAC) ratio for Hypo OÖ to deteriorate toward or below 10% due to, for example, increased credit losses and even lower profitability. We could also take a negative rating action on Hypo OÖ if we downgraded Upper Austria or if we observed weakening in Hypo OÖ's role for, or link with, Upper Austria.

Upside scenario

We could revise the outlook to stable within the next 12-24 months if the operating conditions recover or Hypo OÖ demonstrates superior resilience to the pandemic, as shown, for example, by a sustainably low cost of risk and stable profitability.

Rationale

We base our ratings on Hypo OÖ on the bank's concentrated business model, which has a regional focus on low-margin lending that results in low operating profitability. This is partly mitigated by sound capitalization, as underlined by our projected RAC ratio of 11.0%-11.5% over the next 12-24 months, and a conservative business approach targeting low-risk sectors, including the promotion of subsidized housing and public-sector-related lending. We also have a favorable view of Hypo OÖ's matched funding profile, which benefits from the bank's links with its majority owner, Upper Austria.

We continue to consider Hypo OÖ a government-related entity (GRE) with a high likelihood of receiving timely and sufficient extraordinary government support from the state of Upper Austria if needed. We base this opinion on Hypo OÖ's important role for, and very important link with, the local government.

We revised the outlook to negative in April 2020 due to the economic and market stress triggered by the COVID-19 pandemic (see "Outlook Revisions On Several Austrian Banks On Deepening COVID-19 Downside Risks," published on April 29, 2020, on RatingsDirect). Although Hypo OÖ has notably lower exposure to the market segments most severely impacted by the current downturn, namely consumer credit and corporate lending, the negative macroeconomic trajectory will increase the bank's strain on profitability.

We note significant uncertainty in assessing the severity of the impact of COVID-19-related economic stress, material fiscal and monetary support measures, and their potential unwinding (including debt moratoria and temporary insolvency exceptions) and their impact on the labor markets. That said, materially increasing unemployment could represent a material risk for Hypo OÖ.

Anchor:'a-' for banks operating only in Austria

Our 'bbb+' stand-alone credit profile (SACP) on Hypo OÖ is based on its 'a-' anchor, the starting point for our ratings on banks operating exclusively in Austria.

Our economic risk assessment is based on Austria's highly competitive and diverse economy, with strong economic fundamentals, high integration in Western European economies, and strong ties to Eastern and Southeastern Europe. In our base case, we expect a sharp recession due to the pandemic this year, but we anticipate a relatively strong rebound in 2021. However, we view the economic risk trend as negative, reflecting the significant downside risk to our current baseline scenario due to the economic effects of COVID-19, which could result in a deterioration of household and corporate sector health, particularly given Austria's economy is focused on service industries, with some additional sensitivity due to large tourism sector exposure.

With regard to industry risk, Austrian banks face similar challenges as their global peers, including business model optimization, ensuring sufficient and sustainable profitability, leveraging the benefits of the digital era, and introducing measures to avoid disruption and franchise damage from cyberattacks and customer-data mismanagement. We view the trend on banking industry risk in Austria as stable. We expect that overall COVID-19-related damage to the banking system will remain contained. Despite the one-off deterioration of the sector's performance, overall sector stability is unlikely to deteriorate, given banks comfortable capital and provisions, as well as massive government programs, large-scale short-term work contracts, and the social benefit system, which are likely to absorb or prevent material adverse effects on the banking system. Looking beyond the pandemic, we believe enhanced focus on efficiency and profitability and recent derisking will contribute to system stability over the cycle.

Table 1

Oberoesterreichische Landesbank AG--Key Figures						
	--Fiscal year end Dec. 31--					
(Mil. €)	**June 2020**	**2019**	**2018**	**2017**	**2016**	**2015**
Adjusted assets	7,689.9	7,767.4	7,769.4	7,755.2	8,755.5	8,931.6
Customer loans (gross)	5,364.9	5,444.1	5,561.8	5,666.7	5,594.2	5,924.8
Adjusted common equity	452.3	449.1	383.8	365.6	396.7	345.7
Operating revenue	32.6	75.0	76.1	73.9	107.9	109.6
Noninterest expenses	31.4	59.7	59.0	57.8	60.1	55.4
Core earnings	(3.3)	13.0	16.3	12.5	32.8	33.3

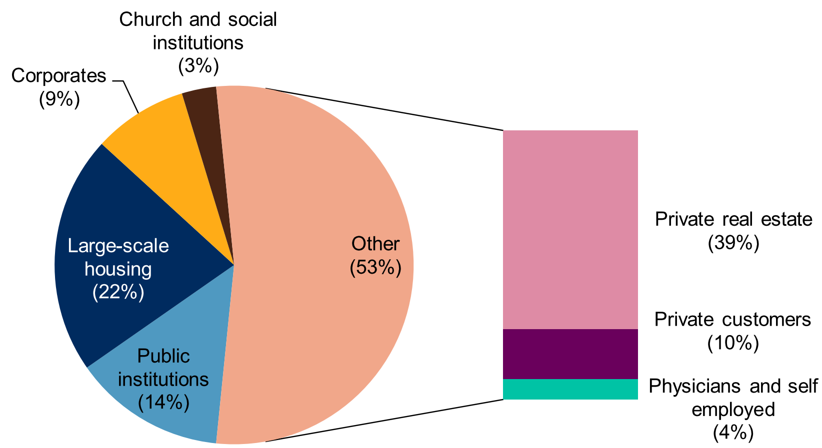
Business position: A concentrated business model with low operating efficiency

We think Hypo OÖ's business model with its regional concentration on low-margin subsidized housing and public-sector lending, accompanied by one of the lowest efficiencies amongst its peer, makes the bank more sensitive to downside scenarios than more diversified, stronger performing peers.

The bank is characterized by a clear focus on real estate, which accounts for 73% of its €7.7 billion balance sheet. It executes subsidized housing programs on behalf of its home state Upper Austria, and has a strong position in the local public housing niche (see chart 1). We do not expect this will change over the next few years, because this focus is intrinsic to the business profile of this GRE.

Chart 1

73% Of Hypo OÖ's Loan Volume Relates To The Housing Sector
Breakdown of customer loans

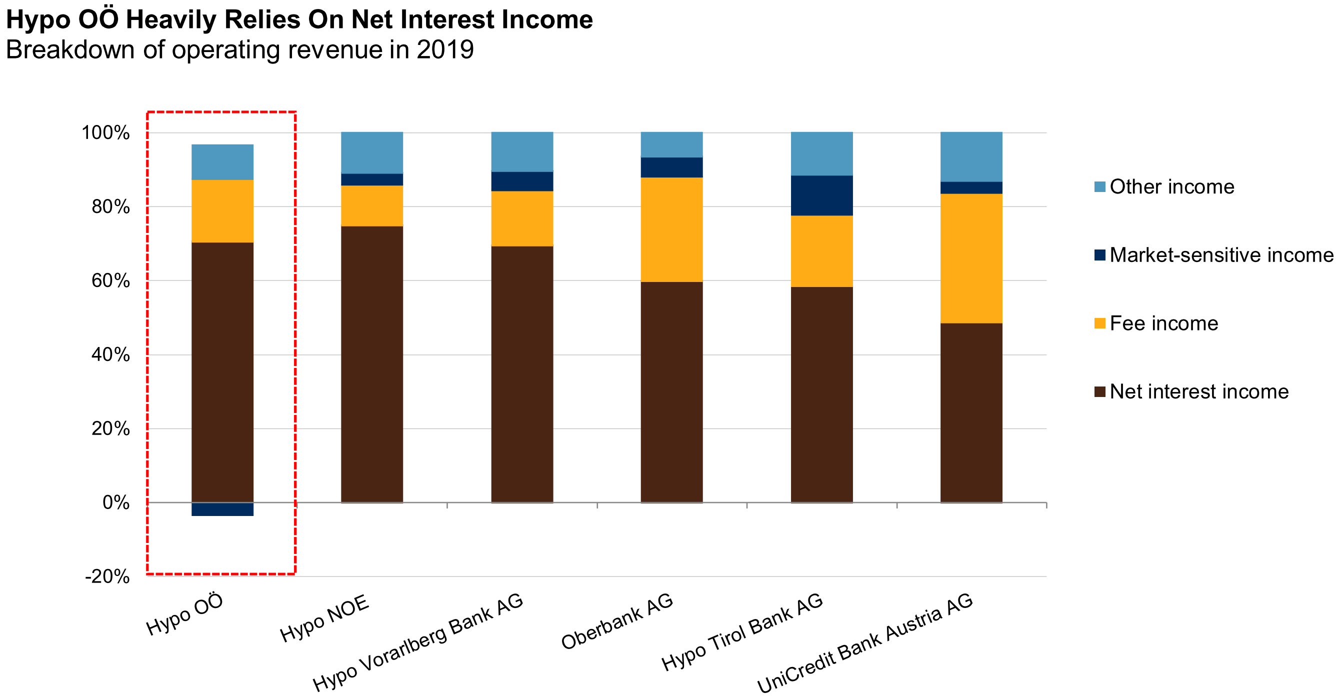


Data as of December 2019. Source: Hypo OÖ, S&P Global Ratings.

We also see some benefits from having Upper Austria and Raiffeisenlandesbank Oberösterreich (RLB OÖ) as shareholders (51% and 41%, respectively), since this helps the bank maintain a relatively stable, local customer base. Furthermore, RLB OÖ provides Hypo OÖ with additional information technology infrastructure.

Given Hypo OÖ's reliance on interest income, we see the bank as more sensitive to prolonged low interest rates than peers with higher revenue diversification (see chart 2).

Chart 2



TThe selected peer group only includes rated Austrian banks which are focussed predominantely on the Austrian market.

Hypo NOE--Hypo NOE Landesbank fur Niederosterreich und Wien AG. Data as of Dec. 31, 2019.

Source: S&P Global Ratings.

Additionally, we expect the bank's operational efficiency will remain under pressure as we see limited progress in addressing the underlying causes. Over the medium term, we expect cost-to-income ratios will hover at about 80%, after the temporary spike we expect this year.

Table 2

Oberoesterreichische Landesbank AG--Business Position						
		--Fiscal year end Dec. 31--				
(%)	**June 2020**	**2019**	**2018**	**2017**	**2016**	**2015**
Total revenues from business line (mil. €)	32.6	75.0	76.1	73.9	107.9	109.6
Commercial & retail banking/total revenue from business line	100.0	100.0	100.0	100.0	100.0	100.0
Return on average common equity	(1.5)	2.8	3.5	2.6	7.6	8.3

Capital and earnings: Low dividends support strong capitalization

We view Hypo OÖ's capital and earnings as strong because we expect that the bank's RAC ratio will remain comfortably above our 10% threshold over our 24-month outlook horizon. The RAC ratio was 11.7% at year-end 2019 (see table 3), and we project it at 11.0%-11.5% through end-2021.

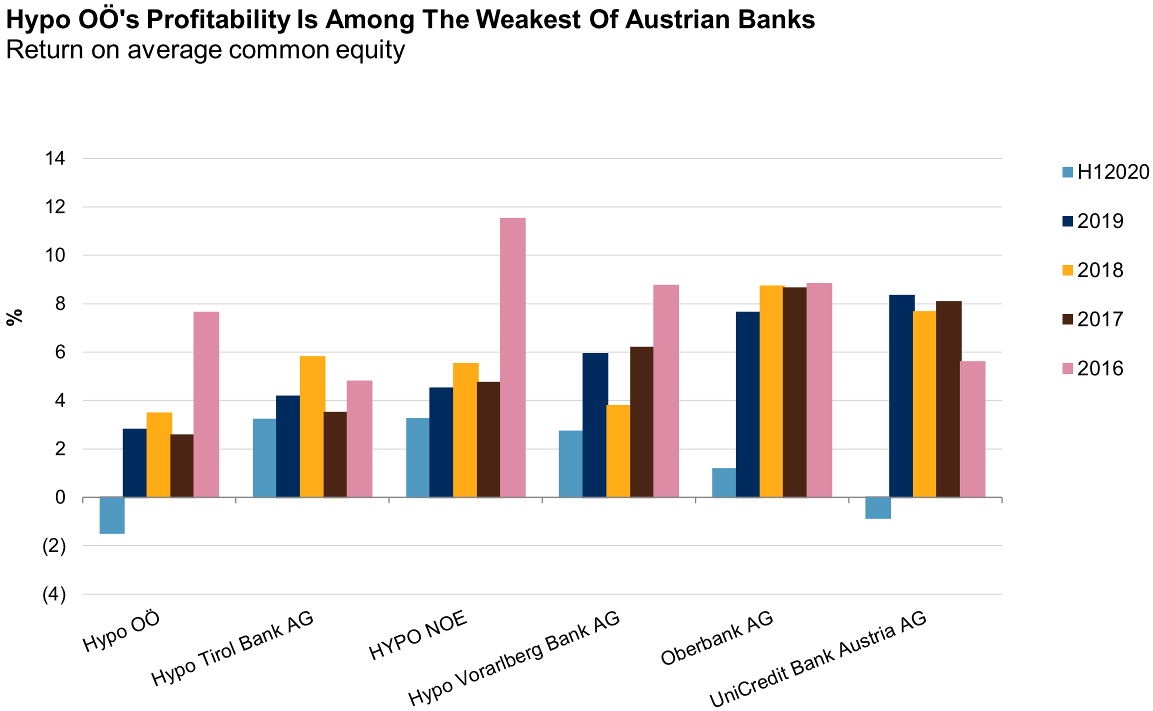
Hypo OÖ operates on tight margins and reports only low returns (see chart 3), and the negative effects from the recession in Austria will further strain bottom-line profitability. We expect the bank's low-risk business profile will help support relatively stable core operating performance, and cushion the spike in risk costs—both factors that we deem critical for the rating at the current level. Additionally, we view Hypo OÖ's moderate dividend policy, with payouts of about €3 million per year, as favorable to support gradual but sustainable internal capital accumulation.

For 2020, we expect a very low but positive net income, after a €3 million loss in the first half of the year, with a rebound in 2021. Specifically, our forecast assumptions for 2020-2021 include:

- Revenue of about 5% lower in 2020 due to weaker trading results but otherwise stable interest and fee income, followed by a rebound in 2021;
- Pre-provision operating income of €10 million-€12 million in 2020, down from about €15 million in 2019;
- Increased but still-low credit losses at 10-15 basis points (bps) in 2020 and 2021;
- Growth of S&P Global Ratings' risk-weighted assets of about 3%-4% in 2020, underpinned by a broadly stable loan book, but some adverse developments with regards to market risk;
- After Hypo OÖ paid no dividends on 2019 earnings, we expect the bank to resume distributions at a moderate level of about €3 million per year.

We continue to view Hypo OÖ as having good quality of capital because our total adjusted capital (TAC) comprises solely common equity.

Chart 3



Hypo OÖ--Oberoesterreichische Landesbank AG. Hypo NOE--Hypo NOE Landesbank fur Niederosterreich und Wien AG. Source: S&P Global Ratings.

Table 3

Oberoesterreichische Landesbank AG--Capital And Earnings

	--Fiscal year end Dec. 31--					
(%)	**June 2020**	**2019**	**2018**	**2017**	**2016**	**2015**
Tier 1 capital ratio	13.9	14.0	14.3	14.7	12.5	11.0
S&P Global Ratings' RAC ratio before diversification	N/A	11.7	13.0	12.0	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	7.3	7.3	6.6	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	84.1	75.7	60.0	68.0	53.8	52.4
Fee income/operating revenues	21.5	18.1	18.7	19.8	12.9	12.8
Market-sensitive income/operating revenues	(24.7)	(3.6)	0.9	(8.9)	3.9	22.7
Cost to income ratio	96.1	79.6	77.6	78.2	55.7	50.5
Preprovision operating income/average assets	0.0	0.2	0.2	0.2	0.5	0.6
Core earnings/average managed assets	(0.1)	0.2	0.2	0.2	0.4	0.4

N/A--Not applicable. RAC--Risk-adjusted capital.

Table 4

Oberoesterreichische Landesbank AG--Risk-Adjusted Capital Framework Data

(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings' RWA	Average S&P Global Ratings' RW (%)
Credit risk					
Government & central banks	1,667.0	13.0	1.0	45.0	3.0
Of which regional governments and local authorities	970.0	0.0	0.0	35.0	4.0
Institutions and CCPs	739.0	125.0	17.0	126.0	17.0
Corporate	1,166.0	1,163.0	100.0	894.0	77.0
Retail	3,800.0	1,463.0	38.0	1,083.0	29.0
Of which mortgage	3,327.0	1,150.0	35.0	772.0	23.0
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	104.0	88.0	84.0	103.0	99.0
Total credit risk	7,476.0	2,850.0	38.0	2,251.0	30.0
Credit valuation adjustment					
Total credit valuation adjustment	--	50.0	--	172.0	--
Market Risk					
Equity in the banking book	132.0	137.0	104.0	1,248.0	948.0
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	137.0	--	1,248.0	--
Operational risk					
Total operational risk	--	138.0	--	161.0	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification	--	3,175.0	--	3,832.0	100.0
Total Diversification/ Concentration Adjustments	--	--	--	2,359.0	62.0
RWA after diversification	--	3,175.0	--	6,192.0	162.0
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings' RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		445.0	14.0	449.0	11.7
Capital ratio after adjustments‡		445.0	14.0	449.0	7.3

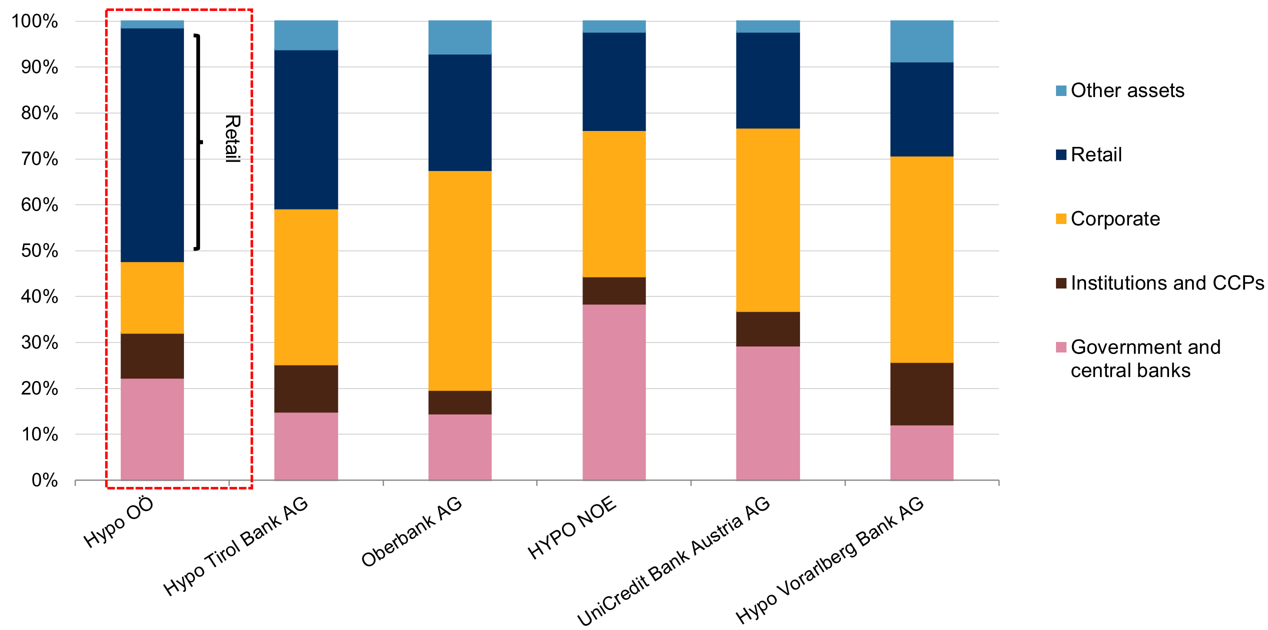
*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2019, S&P Global Ratings.

Risk position: The business strategy is risk averse, but some concentrations remain

Hypo OÖ's risk position is a neutral factor to our rating, and on par with that of banks with similar business models operating in Austria or in other countries with a similar economic risk environment. Our view balances the bank's geographic concentration with our expectation that Hypo OÖ will continue to focus on low-risk products, such as small secured homeowner loans, mortgage loans to public-benefit housing associations with historically very low default risk, and public-sector loans (see chart 4). We expect new lending will be only in core business areas and with clearly defined, low-risk products. In our view, the RAC ratio adequately reflects Hypo OÖ's main risks.

Chart 4

Hypo OÖ's Large Retail Portfolio Reflects Its Subsidized Mortgage Lending Activities
Credit risk exposure of rated Austrian banks



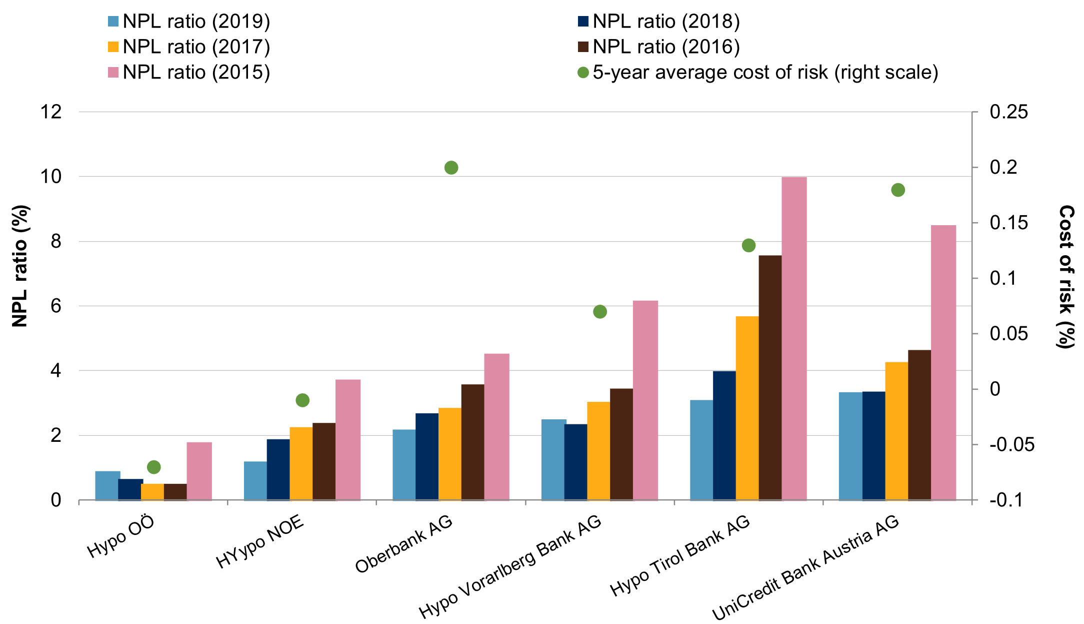
Others includes securitization and other assets. Exposure referes to exposure at default. The selected peer group only includes rated Austrian banks which are focussed predominantely on the Austrian market. Data as of Dec. 31, 2019. Source: S&P Global Ratings.

We expect Hypo OÖ's asset quality metrics will deteriorate over our two-year projection period as a result of the COVID-19 pandemic, but we still believe the bank will continue to exhibit better risk metrics than the Austrian market average. The bank entered the recession with one of the strongest loan qualities in Austria, with gross nonperforming assets accounting for 0.8% of the bank's gross customer loans as of Dec. 31, 2019 (table 5).

We also regard the composition of Hypo OÖ's loan book as favorable in the current economic downturn. Low exposures to corporate and small and midsized enterprises in general, and heavily affected industries in particular, leave the bank less vulnerable than many of its domestic peers, which are often more exposed to corporate borrowers. Additionally, we anticipate that fiscal mitigation measures and Austria's effective social security system will partially shield retail clients from the negative economic impacts.

Chart 5

Hypo OÖ's Low-Risk Business Model Supports Asset Quality
NPL ratio and cost of risk



NPL--Nonperforming loans. NPL ratio is defined as gross nonperforming assets divided by customer loans. Cost of risk is defined as new loan loss privisions as % of average customer loans. The selected peer group only includes rated Austrian banks which are focussed predominantely on the Austrian market. Hypo NOE--Hypo NOE Landesbank fur Niederosterreich und Wien AG. Source: S&P Global Ratings.

Table 5

Oberoesterreichische Landesbank AG--Risk Position						
	--Fiscal year end Dec. 31--					
(%)	**June 2020**	**2019**	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	(2.9)	(2.1)	(1.9)	1.3	(5.6)	0.6
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	61.6	76.5	80.7	62.7	61.8
Total managed assets/adjusted common equity (x)	17.0	17.3	20.2	21.2	22.1	25.8
New loan loss provisions/average customer loans	0.2	(0.0)	(0.1)	0.0	(0.5)	0.2
Net charge-offs/average customer loans	N.M.	0.0	0.0	0.0	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	0.9	0.8	0.6	0.5	0.5	1.7
Loan loss reserves/gross nonperforming assets	23.5	17.1	27.7	44.1	40.5	29.7

N/A--Not applicable.

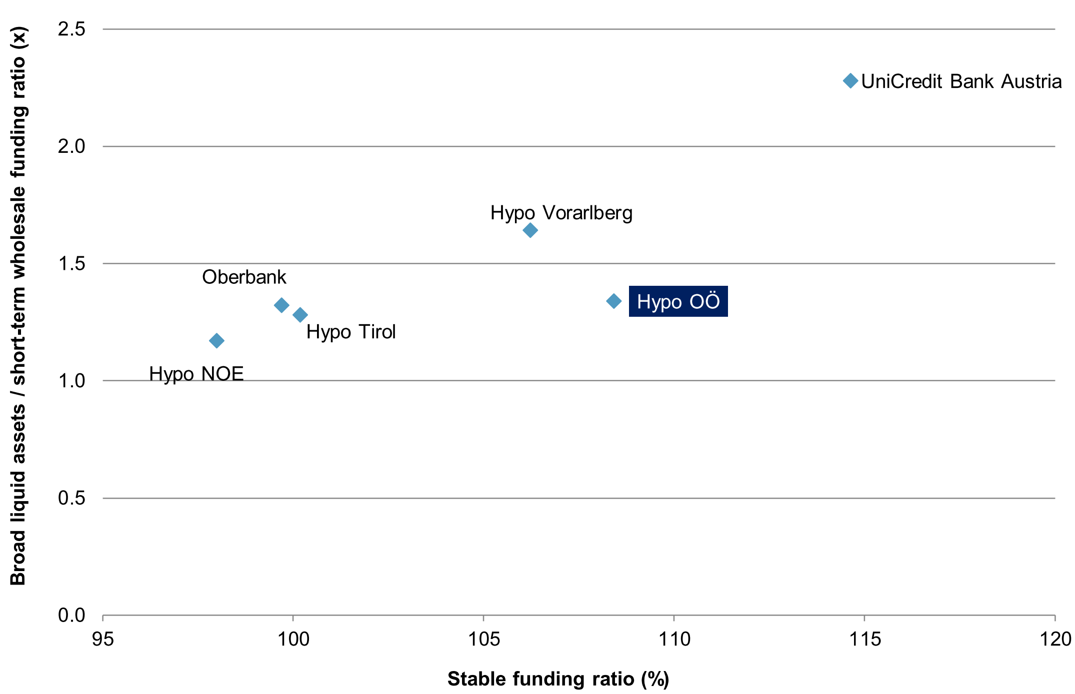
Funding and liquidity: Matched funding and a conservative liquidity policy are reinforced by strong customer confidence

We expect Hypo OÖ's link with the state and its matched asset-liability profile will continue to support its sound funding profile. We believe the bank's ownership by Upper Austria materially reduces its sensitivity to market confidence. We saw this, for example, with COVID-19, which had no significant impact on the group's funding and liquidity situation. In addition, we view Hypo OÖ's main wholesale funding tool--covered bonds--as a stable source of funding.

At year-end 2019, our stable funding ratio for Hypo OÖ was 108% and our liquidity ratio, as measured by broad liquid asset to short-term wholesale funding (BLAST), at 1.34x. The regulatory liquidity coverage ratio of 139.5% at year-end 2019 remains comfortably above the 100% minimum. While the bank's solid BLAST ratio indicates a strong liquidity buffer, we consider it to be in line with the system average and think that it could operate for more than six months without access to market funding in an adverse scenario.

Chart 6

Hypo OÖ's Funding And Liquidity Profile Is In Line With Domestic Peer's
Key funding and liquidity metrics



The selected peer group only includes rated Austrian banks which are focussed predominantely on the Austrian market. Data as of Dec. 31, 2019. Source: S&P Global Ratings.

We believe Hypo OÖ will remain primarily wholesale funded and reliant on the capital market. Core customer deposits, which we consider the most stable funding source, covered only about one-third of the loan portfolio on Dec. 31, 2019. Market issuances made up about 76% of the funding base. Since most of the wholesale funding is long term and relates to covered bond placements, which we regard as a stable and reliable source of funding in Austria, we view Hypo OÖ's overall funding structure to be in line with that of more retail-oriented domestic peers.

Table 6

Oberoesterreichische Landesbank AG--Funding And Liquidity						
	--Fiscal year end Dec. 31--					
(%)	**June 2020**	**2019**	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	24.6	24.5	24.5	24.5	20.9	18.1
Customer loans (net)/customer deposits	309.0	311.7	316.6	324.1	328.3	388.5
Long-term funding ratio	89.6	89.8	91.2	91.2	81.3	81.6
Stable funding ratio	107.3	108.4	108.9	106.7	107.9	100.6
Short-term wholesale funding/funding base	11.0	10.8	9.3	9.4	19.6	19.3
Broad liquid assets/short-term wholesale funding (x)	1.3	1.3	1.5	1.3	1.0	0.7
Net broad liquid assets/short-term customer deposits	13.5	16.2	20.5	10.9	2.4	(51.2)
Short-term wholesale funding/total wholesale funding	14.6	14.3	12.3	12.4	24.8	23.5
Narrow liquid assets/3-month wholesale funding (x)	1.5	1.6	1.7	1.5	1.3	0.8

Support: A high likelihood of extraordinary support from Upper Austria

Our long-term issuer credit rating on Hypo OÖ is three notches higher than the SACP, since we see a high likelihood of the bank receiving timely and sufficient extraordinary support from the government of Upper Austria (AA+/Stable/A-1+) if needed. Our assessment is based on Hypo OÖ's:

- Important role as one of Upper Austria's largest GREs, implying that a default of Hypo OÖ could tarnish the state's reputation in the capital markets; and
- Very strong link with the government of Upper Austria. We do not expect changes to the bank's prominent role in the state-supported real estate promotion business or to the state's majority stake in Hypo OÖ over the next two years.

The bank's other major strategic shareholder, RLB OÖ, also demonstrates support. However, we think the uplift from the GRE status will remain the strongest rating factor in the foreseeable future.

We believe that the prospect of extraordinary government support for Austrian banks is uncertain, following the full implementation of the EU Bank Recovery and Resolution Directive, including bail-in powers, in January 2015. However, we generally believe that resolution frameworks are less likely to impede the state owners' willingness to provide extraordinary support to banks we consider GREs, including Hypo OÖ.

Issue ratings

We rate Hypo OÖ's nondeferrable senior subordinated debt 'BBB-', two notches downward from our assessment of the bank's SACP. The SACP indicates our view of a bank's credit risk without extraordinary support from the government. We believe that by notching from the SACP assessment, instead of from the long-term counterparty credit rating, we better capture the risk of increased uncertainty of government support for subordinated debt issues.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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: Banks: Rating Methodology And Assumptions, Nov.09, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011

Related Research

- Banking Industry Country Risk Assessment: Austria, June 17, 2020
- Upper Austria (State of), May 22, 2020
- Transaction Update: Oberoesterreichische Landesbank AG Mortgage Covered Bond Program, Nov. 18, 2019
- Outlook Revisions On Several Austrian Banks On Deepening COVID-19 Downside Risks, April 29, 2020
- How COVID-19 Risks Prompted European Bank Rating Actions, April 29, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020

Anchor Matrix

Industry Risk	Economic Risk									
	1	**2**	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	**a-**	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of October 6, 2020)*	
Oberoesterreichische Landesbank AG	
Issuer Credit Rating	A+/Negative/A-1
Senior Secured	AA+/Stable
Subordinated	BBB-
Issuer Credit Ratings History	
29-Apr-2020	A+/Negative/A-1
11-Jun-2018	A+/Stable/A-1
13-Jun-2017	A+/Negative/A-1
16-Dec-2016	A/Stable/A-1
16-Jun-2016	A/Positive/A-1
Sovereign Rating	
Austria	AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.