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Ratings

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Oberoesterreichische Landesbank AG

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Oberoesterreichische Landesbank AG

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

\+

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

\+

Additional Factors	0

Issuer Credit Rating
A+/Stable/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 compared with peers'. • Concentration in the loan portfolio on one region, with a focus on public-sector-related lending and the promotion of subsidized housing.

Outlook : Stable

S&P Global Ratings' stable outlook on Oberoesterreichische Landesbank AG (HYPO OÖ) takes into account the stable outlook on Upper Austria and our expectation that the likelihood of support from the state will remain high over the next two years.

Downside scenario

The ratings are sensitive to HYPO OÖ's owner's ability and willingness to support the bank. We would lower the ratings on HYPO OÖ in the event of downgrade of Upper Austria or if we observed weakening in HYPO OÖ's role for, or link with, Upper Austria. However, we currently consider this scenario as remote.

We could also lower the ratings if the bank embarked on riskier lending, leading our risk-adjusted capital (RAC) ratio to drop below 10%.

Upside scenario

A positive rating action would require an upgrade of Upper Austria, accompanied by an increase in HYPO OÖ's RAC ratio sustainably above 15%, a scenario we see as highly unlikely over the next two years.

Rationale

We base our ratings on HYPO OÖ's domicile and main lending focus, Austria, which provides the bank with a strong economic environment and very benign credit conditions. At the same time, the bank's business model is very concentrated, with a regional focus on low-margin lending, which results in low operating profitability. This is partly mitigated by strong capitalization, as underlined by our projected RAC ratio of 13%-14% over the next 24 months, and a conservative new business approach targeting low-risk, public-sector-related lending, and the promotion of social housing.

HYPO OÖ's funding and liquidity illustrate its predominantly matched-funding profile with conservative liquidity management. We also see implicit 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.

Anchor: 'a-' for banks operating only 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. Economic growth is aiding the banking sector's performance. We believe that the Austrian economy will remain in an expansionary phase, but don't expect an accumulation of imbalances due to further increases in real estate prices.

Credit risk in the economy is likely to remain low, reflecting a healthy private sector, low lending growth, and prudent lending standards, which we expect will persist.

With regards to industry risk, Austrian banks face similar challenges as their global peers regarding 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 cyber-attacks and customer data mismanagement. We believe that most Austrian banks still have much work to do to improve profitability, since we continue to see moderate overcapacity in their domestic operations and low prices for core banking products, resulting in lower domestic margins than those of many peers in other countries. In our view, banks' enhanced focus on efficiency and profitability and recent derisking contribute to stability of the system over the cycle.

Table 1

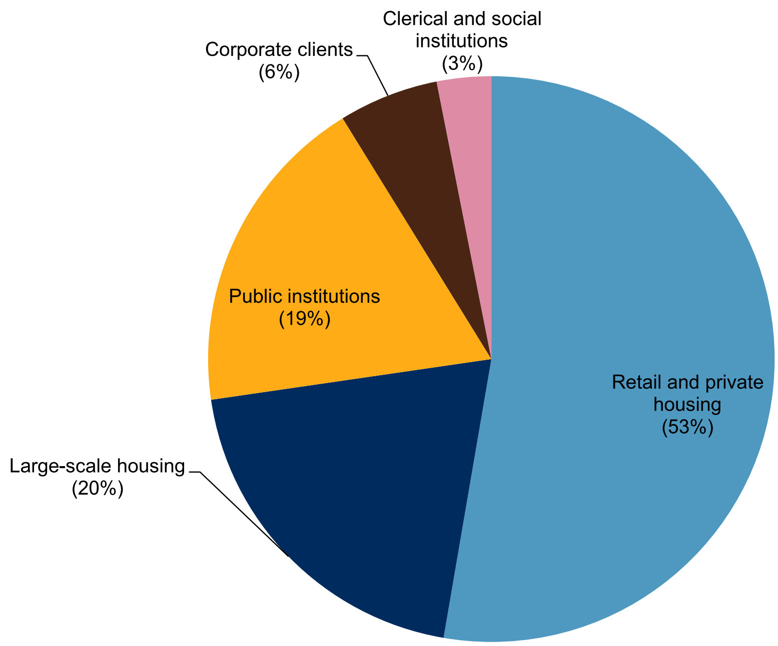
Oberoesterreichische Landesbank AG--Key Figures					
	--Year ended Dec. 31--				
(Mil. €)	**2018**	**2017**	**2016**	**2015**	**2014**
Adjusted assets	7,769.4	7,755.2	8,755.5	8,931.6	9,395.5
Customer loans (gross)	5,561.8	5,666.7	5,594.2	5,924.8	5,887.6
Adjusted common equity	383.8	365.6	396.7	345.7	343.9
Operating revenues	76.1	73.9	107.9	109.6	80.7
Noninterest expenses	59.0	57.8	60.1	55.4	50.2
Core earnings	16.3	12.5	32.8	33.3	9.0

Business position: A concentrated business model with low operating efficiency

We think HYPO OÖ's business model's main weakness is its regional concentration on low-margin public-sector lending, including public-sector-related real estate, and subsidized housing. We do not expect this to change over the next few years because this focus is intrinsic to the business profile of this government-related entity.

Chart 1

70% Of HYPO OÖ's Loan Volume Relates To The Housing Sector
Breakdown of lending as of 2018



Data as of Dec. 31, 2018. Source: Company reports and S&P Global Ratings.

Given HYPO OÖ's reliance on interest income and its tight margins, we see the bank as particularly sensitive to adverse scenarios compared with more diversified peers, since its sensitivity to interest rates remains high.

Following the 2018 Austrian Supreme Court ruling on negative interest rate recognition in private customer margins, which resulted in reimbursements made to borrowers, the judicial proceedings for corporate and public customers are still ongoing. To account for the possible outcome, HYPO OÖ created a €10 million provision in 2018 that contributed to the drop of its net interest income by 9% year on year.

Noninterest expenses relating to operating revenues (our measure of the bank's cost-to-income ratio) remained elevated in 2018, at 78%, similar to the 2017 level. We expect the bank's operational efficiency to remain under pressure over the next 24 months.

At the same time, we see some benefits from having Upper Austria and Raiffeisenlandesbank Oberösterreich (RLB OÖ) as shareholders (51% and 49%, respectively), since this helps the bank maintain a relatively stable, local customer base. Furthermore, RLB OÖ provides HYPO OÖ with additional information technology infrastructure.

Table 2

Oberoesterreichische Landesbank AG--Business Position

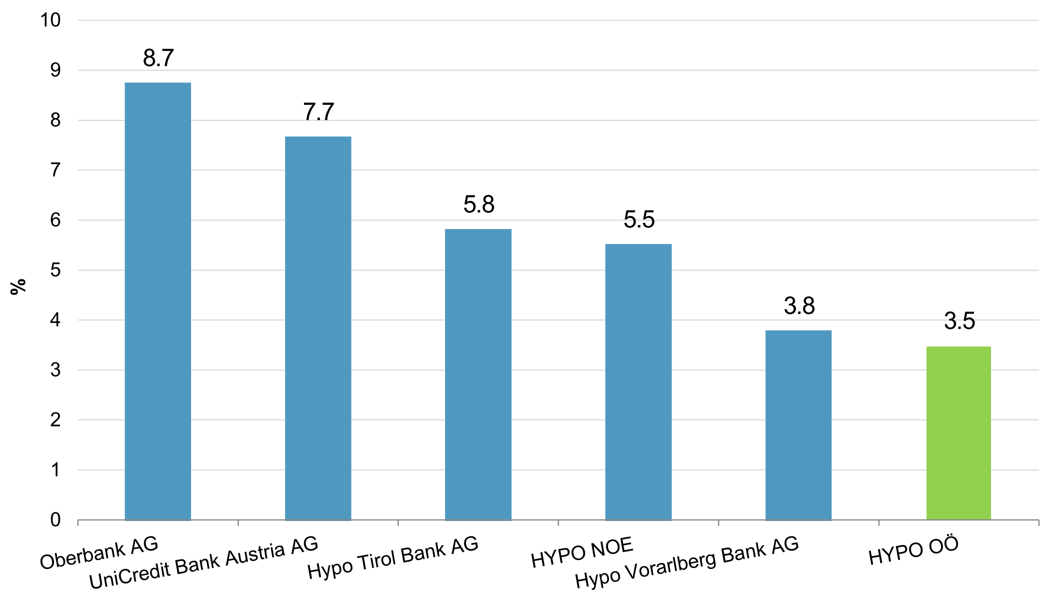
	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Total revenues from business line (currency in millions)	76.1	73.9	107.9	109.6	80.7
Commercial & retail banking/total revenues from business line	100.0	100.0	100.0	100.0	100.0
Return on average common equity	3.5	2.6	7.6	8.3	1.7

Capital and earnings: Low dividend payouts support strong capitalization

We expect that the bank's RAC ratio will strengthen toward 13.5% over the next two years from 13.0% as of Dec. 31, 2018. HYPO OÖ operates with tight margins and reports only low returns (see chart 2). However, its core operating performance has been relatively stable, supported by its low-risk business profile, leading to gradual but sustainable internal capital generation.

Chart 2

HYPO OÖ's Profitability Is Among The Weakest Of Austrian Banks
Return on average common equity in 2018



Data as of Dec. 31, 2018. Source: S&P Global Ratings.

For our capital and earnings projections over the next two years, we assume:

- Marginal shrinkage of the loan portfolio in 2019 due to early redemptions of promotional lending and low growth in subsequent years.

- Marginally increasing revenues, with a net interest margin of only about 0.7%.
- Very low credit losses of €3 million-€5 million per year.
- Dividend payouts of around €3 million per year.

We expect our earnings buffer will be only marginally above zero over the next two years, signaling HYPO OÖ's limited ability to cover its normalized credit losses. However, in our view, the bank's low internal capital generation is not a major rating consideration. This is because HYPO OÖ's management is not targeting aggressive growth and the bank's risk costs are likely to stay below normalized costs in the coming two years.

Table 3

Oberoesterreichische Landesbank AG--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	14.3	14.7	12.5	11.0	10.9
S&P Global Ratings' RAC ratio before diversification	13.0	12.0	11.0	8.6	7.8
S&P Global Ratings' RAC ratio after diversification	7.3	6.6	6.8	5.3	5.1
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	95.7
Net interest income/operating revenues	60.0	68.0	53.8	52.4	73.5
Fee income/operating revenues	18.7	19.8	12.9	12.8	16.9
Market-sensitive income/operating revenues	0.9	(8.9)	3.9	22.7	1.2
Noninterest expenses/operating revenues	77.6	78.2	55.7	50.5	62.2
Preprovision operating income/average assets	0.2	0.2	0.5	0.6	0.3
Core earnings/average managed assets	0.2	0.2	0.4	0.4	0.1

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	1,942.0	12.5	0.6	58.0	3.0
Of which regional governments and local authorities	1,308.0	0.0	0.0	47.1	3.6
Institutions and CCPs	680.0	125.0	18.4	135.9	20.0
Corporate	953.0	937.5	98.4	628.2	65.9
Retail	3,795.0	1,446.3	38.1	1,054.3	27.8
Of which mortgage	3,387.0	1,171.3	34.6	785.4	23.2
Securitization§	0.0	0.0	0.0	0.0	0.0
Other assets†	156.0	150.0	96.2	154.3	98.9
Total credit risk	7,526.0	2,671.3	35.5	2,030.7	27.0
Credit valuation adjustment					
Total credit valuation adjustment	--	53.3	--	69.3	--
Market Risk					
Equity in the banking book	71.0	125.0	176.1	702.5	989.4

Table 4

Oberoesterreichische Landesbank AG--Risk-Adjusted Capital Framework Data (cont.)					
Trading book market risk	--	0.0	--	0.0	--
Total market risk	--	125.0	--	702.5	--
Operational risk					
Total operational risk	--	143.3	--	161.3	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	2,992.8	--	2,963.7	100.0
Total Diversification/ Concentration Adjustments	--	--	--	2,267.9	76.5
RWA after diversification	--	2,992.8	--	5,231.6	176.5
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		427.4	14.3	383.8	13.0
Capital ratio after adjustments‡		427.4	14.3	383.8	7.3

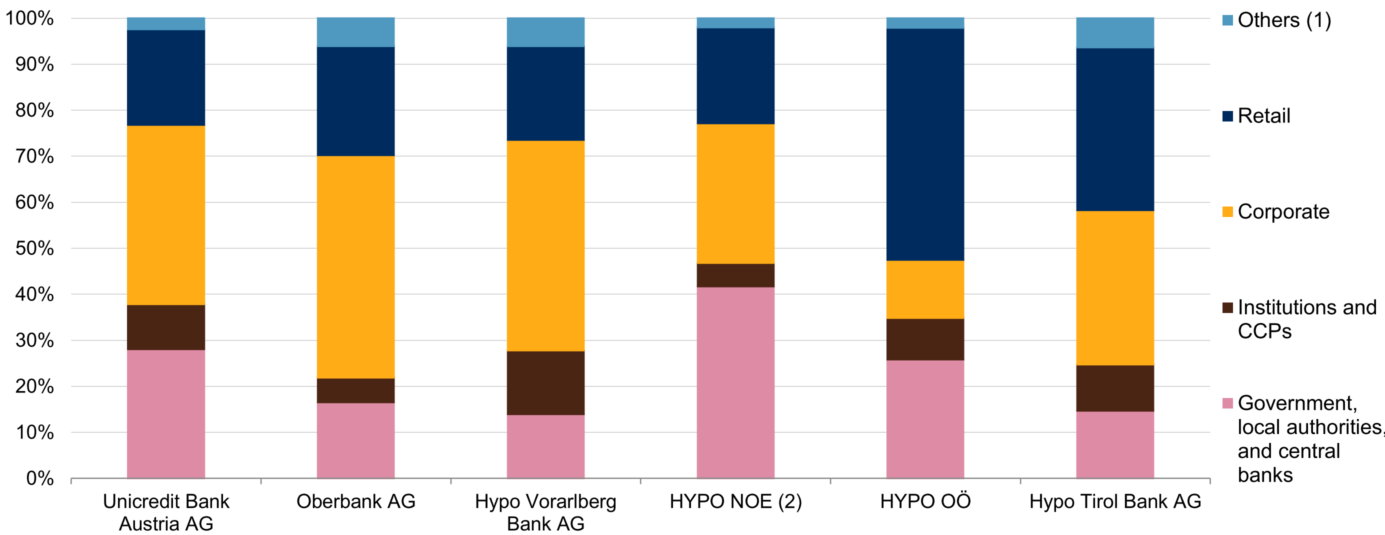
*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). CCP--Central counterparty. RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2018', S&P Global Ratings.

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

HYPO OÖ's risk position is a neutral factor to our rating, on a par with that of banks with similar business models operating in Austria or in 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 3). 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. We regard loan quality at HYPO OÖ as among the highest in Austria. The nonperforming loan ratio remains low, at 0.6% of total loans (see chart 4), and we expect the bank will preserve its favorable risk metrics.

Chart 3

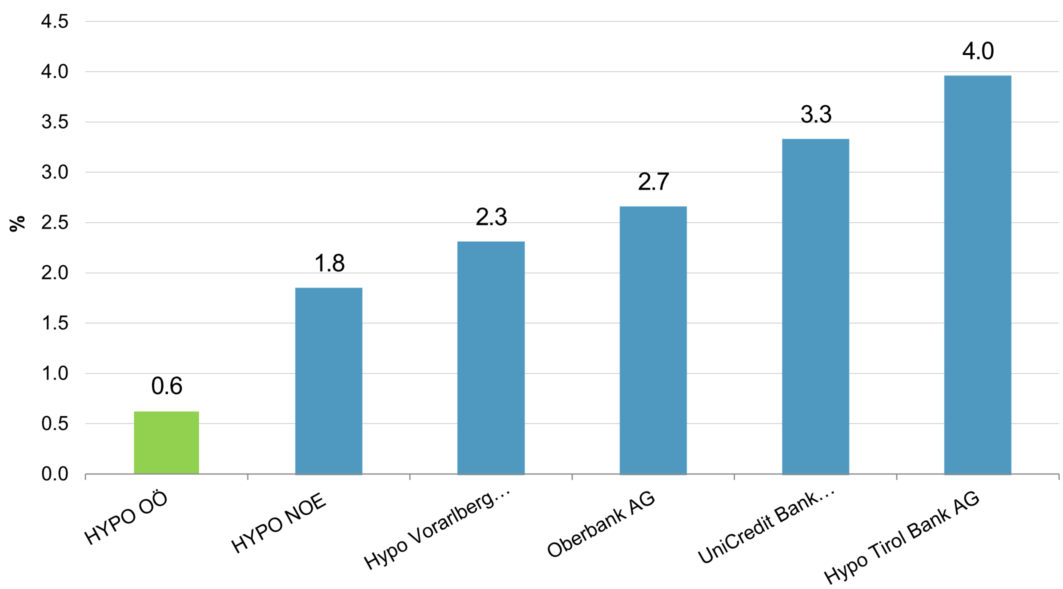
HYPO OÖ's Retail Portfolio Is Larger Than Peers'
Credit risk exposure of rated Austrian banks as of 2018



(1) 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. (2) Over half of HYPO NOE exposure reported as Corporate carry a sovereign guarantee. Data as of Dec. 31, 2018. Source: S&P Global Ratings.

Chart 4

HYPO OÖ Has Strong Asset Quality, Thanks To Its Low-Risk Business Model
Nonperforming loan ratios versus peers'



NPL-ratio is defined as gross nonperforming assets divided by customer loans. Data as of Dec.31, 2018.
Source: S&P Global Ratings.

Table 5

Oberoesterreichische Landesbank AG--Risk Position					
	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	(1.9)	1.3	(5.6)	0.6	3.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	76.5	80.7	62.7	61.8	53.4
Total managed assets/adjusted common equity (x)	20.2	21.2	22.1	25.8	27.3
New loan loss provisions/average customer loans	(0.1)	0.0	(0.5)	0.2	0.2
Net charge-offs/average customer loans	0.0	0.0	0.1	0.1	0.3
Gross nonperforming assets/customer loans + other real estate owned	0.6	0.5	0.5	1.7	0.4
Loan loss reserves/gross nonperforming assets	27.7	44.1	40.5	29.7	122.1

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. In addition, we view HYPO OÖ's main wholesale funding tool--covered bonds--as a stable source of funding.

At year-end 2018, our stable funding ratio for HYPO OÖ was 109% and the liquidity ratio 1.50x. The regulatory liquidity coverage ratio of 147.9% at year-end 2018 remains comfortably above the 2019 minimum of 100%.

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, 2018. Market issuances made up around 75% 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					
	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	24.5	24.5	20.9	18.1	17.5
Customer loans (net)/customer deposits	316.6	324.1	328.3	388.5	378.0
Long-term funding ratio	91.2	91.2	81.3	81.6	88.3
Stable funding ratio	108.9	106.7	107.9	100.6	113.0
Short-term wholesale funding/funding base	9.3	9.4	19.6	19.3	12.2
Broad liquid assets/short-term wholesale funding (x)	1.5	1.3	1.0	0.7	1.2
Net broad liquid assets/short-term customer deposits	20.5	10.9	2.4	(51.2)	26.6
Short-term wholesale funding/total wholesale funding	12.3	12.4	24.8	23.5	14.8
Narrow liquid assets/3-month wholesale funding (x)	1.7	1.5	1.3	0.8	1.1

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 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: 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
- Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Austria, Sept. 13, 2019
- Banking Industry Country Risk Assessment: Austria, June 19, 2019
- Upper Austria (State of), June 7, 2019
- Ratings Affirmed On Oberoesterreichische Landesbank's Mortgage Covered Bonds Following Review; Outlook Stable, Oct. 31, 2017

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 September 27, 2019)*

Oberoesterreichische Landesbank AG	
Issuer Credit Rating	A+/Stable/A-1
Senior Secured	AA+/Stable
Subordinated	BBB-
Issuer Credit Ratings History	
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
09-Jun-2015	A/Stable/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.