

MOODY'S

RATINGS

Rating Action: Moody's Ratings affirms Aareal Bank AG's Baa1 long-term issuer ratings, changes outlook to stable from negative

26 Jun 2024

Frankfurt am Main, June 26, 2024 -- Moody's Ratings (Moody's) has today affirmed Aareal Bank AG's (Aareal) Baa1 long-term deposit, senior unsecured and issuer ratings and changed the outlook on these ratings to stable from negative. Concurrently, Moody's affirmed Aareal's (P)Baa1 senior unsecured MTN program ratings, its (P)Baa3/Baa3 junior senior unsecured MTN program/junior senior unsecured debt ratings as well as the bank's P-2 short-term deposit, issuer and commercial paper ratings.

Further, Moody's affirmed Aareal's Baa1/P-2 long- and short-term Counterparty Risk Ratings (CRR), its Baa1(cr)/P-2(cr) long- and short-term Counterparty Risk Assessment (CR Assessment) as well as the bank's ba1 Baseline Credit Assessment (BCA) and Adjusted BCA.

The rating action was triggered by Aareal's announcement to sell its stake in Aareon, its software subsidiary [1]. The transaction is expected to close in the second half of 2024 and is subject to regulatory approval.

RATINGS RATIONALE

-- AFFIRMATION OF AAREAL'S BASELINE CREDIT ASSESSMENT

The affirmation of Aareal's BCA at ba1 reflects our assessment of the bank's stable combined solvency and liquidity profiles, despite the ongoing challenges for commercial real estate (CRE) exposures, including US office, which continues to provide headwinds for the bank.

The sale of Aareon has a significant positive effect on Aareal's ability to withstand asset quality shocks in the near-term because of a material capital gain the bank will realize as a result of the sale, likely taking the pro-forma Tangible Common Equity (TCE) ratio to around 30% according to our estimates. The ultimate effect on Aareal's capitalization will depend on the use of the sale proceeds. We expect that at least the

majority of freshly generated capital will be distributed to its owners, which is, however, subject to supervisory approval.

Aareal will continue to benefit from diversified funding, including access to sizeable and growing deposits, mostly from its corporate clients, which complements its covered bond franchise with proven ability to withstand some market dislocation in more confidence-sensitive capital-market funding.

The affirmation also takes into account that Aareal has made sound progress in its operating performance due to robust pre-provision profits and improved asset quality following the successful reduction of non-performing loans during the first quarter of this year.

Being an internationally active CRE lending specialist, Aareal is exposed to severe concentration risks in highly cyclical CRE lending. The announced sale of its software service activities housed in Aareon further cement Aareal's limited earnings diversification. We therefore continue to consider Aareal to operate a monoline business model.

-- AFFIRMATION OF LONG-TERM RATINGS

The affirmation of Aareal's long-term ratings reflects the affirmation of its BCA and Adjusted BCA, as well as unchanged results from our Advanced Loss Given Failure (LGF) analysis and low government support assumption.

Because of significant volumes of subordinated and junior senior unsecured debt outstanding, our Advanced LGF analysis results in three notches of rating uplift for deposit, senior unsecured and issuer ratings for Aareal. For Aareal's junior senior unsecured program rating, the LGF analysis results in one notch of rating uplift from the bank's ba1 Adjusted BCA.

-- OUTLOOK CHANGE TO STABLE FROM NEGATIVE

The stable outlook on the long-term deposit, issuer and senior unsecured ratings reflects our expectation of Aareal's stable financial profile, balancing asset quality challenges for CRE exposures and solid operating performance and the benefit of increased risk protection resulting from the realization of capital gains due to the Aareon sale. The stable outlook further incorporates our expectation of a broadly unchanged liability structure over the 12-18 months outlook horizon.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Aareal's ratings could be upgraded in case of an upgrade of its BCA and Adjusted BCA. In addition, the bank's junior senior unsecured program rating may be upgraded following a significant increase in the volume of lower-ranking bail-in-able liabilities, relative to its tangible banking assets.

Aareal's BCA could be upgraded if it maintains a materially higher capitalization following a moderate distribution of the sale proceeds to its owners, while not experiencing an unexpected deterioration of asset quality and evidencing funding stability.

Aareal's ratings could be downgraded if its BCA is downgraded or if its loss-absorbing liabilities decline significantly and beyond our expectations, thereby resulting in fewer notches of rating uplift from our Advanced LGF analysis.

Aareal's BCA could be downgraded if the bank fails to protect its current financial profile, for example in case of a full pay-out of the expected capital gain in combination with a higher than expected asset quality deterioration, or unexpected funding challenges, including deposit outflows.

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in March 2024 and available at <https://ratings.moodys.com/rmc-documents/409852>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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REFERENCES/CITATIONS

[1] Press Release AAREAL BANK AND ADVENT INTERNATIONAL TO SELL AAREON TO TPG FOR APPROXIMATELY €3.9 BILLION 24-Jun-2024

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