

Rating Action: Moody's takes rating actions on Heta, Pfandbriefbank (Oesterreich) and 2 Austrian regional mortgage banks

Global Credit Research - 23 May 2016

Frankfurt am Main, May 23, 2016 -- Moody's Investors Service has today placed on review for upgrade the backed debt ratings of Heta Asset Resolution AG (Heta), Pfandbriefbank (Oesterreich) AG (Pfandbriefbank) and the debt and deposit ratings of Hypo Tirol Bank AG (Hypo Tirol). At the same time, the rating agency affirmed the debt and deposit ratings of Vorarlberger Landes- und Hypothekenbank AG (VLH).

The rating actions follow the announcement by Austria's Finance Minister Schelling on 18 May 2016 of a renewed tender offer for Heta's senior unsecured and subordinate debt obligations which benefit from a grandfathered statutory guarantee of the regional State of Carinthia (B3 negative) with a higher recovery than previously offered. Additionally, Mr. Schelling announced that a Memorandum of Understanding had been signed by the Government of Austria (Aaa negative) and 72 of Heta's creditors, representing close to 50% of such outstanding guaranteed claims, increasing the likelihood of a successful debt exchange. Today's rating actions reflect Moody's preliminary assessment of the potential implications of the announced debt exchange on the fundamental credit profiles or ratings of the banks affected by today's announcement.

Moody's has taken the following rating actions:

--- Initiation of a review for upgrade of Heta's Ca senior unsecured debt rating and of its C subordinate debt rating, all guaranteed by Carinthia. Heta's Austrian government-guaranteed subordinated debt rating of Aaa is unaffected by today's rating action;

--- Initiation of a review for upgrade of Hypo Tirol's Ba1 long-term debt and deposit ratings, of the bank's backed long-term debt and deposit ratings of Baa2, and of its subordinated debt program rating of (P)B1 and its backed subordinated debt ratings of Ba2. Moody's further initiated a review for upgrade of Hypo Tirol's short-term deposit ratings of Not-Prime, its standalone baseline credit assessment (BCA) and adjusted BCA of ba3, and its Counterparty Risk Assessment (CR Assessment) of Baa3(cr)/Prime-3(cr). Its backed short-term deposit ratings of Prime-2 are unaffected by today's rating actions;

--- Affirmation of the Baa1 long-term debt, issuer and deposit ratings of VLH, of the bank's Prime-2 short-term issuer and deposit ratings and of its baa3 BCA and adjusted BCA. All other ratings or rating inputs of VLH were unaffected by today's rating actions;

--- Initiation of a review for upgrade of Pfandbriefbank's Ba1 backed senior unsecured debt ratings.

During the review period, Moody's expects to obtain more visibility about the acceptance of the offer as a precondition to a successful debt exchange which is targeted by the Finance Minister by October 2016. Consequently, the conclusion of the review period is expected to occur latest close to the date of the eventual debt exchange.

Please refer to the end of this press release for a list of all affected ratings.

RATINGS RATIONALE

-- RATIONALE FOR THE REVIEW FOR UPGRADE OF HETA'S DEFICIENCY-GUARANTEED RATINGS

The review for upgrade reflects the increased likelihood that Heta's unsecured creditors will bear lower losses than implied by the current rating levels of Ca for deficiency-guaranteed senior unsecured debt and C for deficiency-guaranteed subordinated debt. These ratings reflect the rating agency's current assessment that expected losses will be in the 35%-65% and the greater-than-65% range, respectively. The agreement signed on 18 May 2016 between Austria and 72 creditors could, if it results in the execution of the proposed distressed debt exchange, limit the losses to deficiency-guaranteed senior unsecured creditors to less than 35% of their claims and for deficiency-guaranteed subordinate creditors to less than 65%. As a result, Heta's deficiency-guaranteed senior unsecured debt could be upgraded by up to two notches and its deficiency-guaranteed subordinated debt could be upgraded by one notch. During the rating review, Moody's will monitor

the completion of the prerequisites to a successful debt exchange, including, but not limited to, the degree of creditor acceptance of the offer and the development of legal uncertainties around Heta.

-- RATIONALE FOR THE REVIEW FOR UPGRADE OF HYPO TIROL'S RATINGS

The review for upgrade reflects the anticipated significant reduction of downside risks related to Hypo Tirol's contingent liabilities resulting from its joint and several liability shared with fellow members of Pfandbriefbank. If the proposed Heta debt exchange is successful, Moody's expects Hypo Tirol to benefit from a sizable one-off profit resulting from the reversal of reserves and impairments booked against its exposure to Heta, which will support Hypo Tirol's efforts to further strengthen its capitalisation. Moody's expects the beneficial effects of a successful debt exchange at Heta for the BCA of Hypo Tirol to be limited to one notch. The rating review on Hypo Tirol's long-term debt and deposit ratings reflects the high likelihood that a BCA upgrade would translate into an upgrade of the bank's other ratings placed under review.

Hypo Tirol's exposure to Heta is mostly indirectly through its joint and several liability for Pfandbriefbank. In line with regulatory guidance, Hypo Tirol has built conservative reserves and impairments of 50% of the principal claim against the future and already paid-out liquidity commitment to Pfandbriefbank on the back of this bank's liquidity problems following the 2015 debt moratorium on Heta.

-- RATIONALE FOR THE AFFIRMATION OF VLH'S RATINGS

Overall, Moody's expects the combined effect of the possible improvements in VLH's solvency profile to remain within the bandwidth of the bank's current baa3 BCA, which has already taken into account mitigating factors to risks emanating from Pfandbriefbank, in particular the bank's above sector-average profitability. In the event of a significant reduction of downside risks for the member banks of Pfandbriefbank, asset risks for VLH would be reduced. If the proposed Heta debt exchange is successful, Moody's expects VLH to benefit from a moderate improvement in its capitalisation through a partial retention of one-off earnings resulting from the reversal of reserves and impairments booked against its exposure to Heta.

VLH's exposure to Heta is mostly indirectly through its joint and several liability for Pfandbriefbank. In line with regulatory guidance, VLH has built conservative reserves and impairments of 50% of the principal claim against the future and already paid-out liquidity commitment to Pfandbriefbank on the back of this bank's liquidity problems following the 2015 debt moratorium on Heta. The State of Vorarlberg (unrated) considers recovering its part of the financial burden through a special dividend of VLH, which partly limits the additional earnings retention potential of VLH resulting from a possible one-off gain following a distressed debt exchange at Heta.

-- RATIONALE FOR THE REVIEW FOR UPGRADE OF PFANDBRIEFBANK'S RATINGS

The review for upgrade reflects Moody's assessment that an implementation of the announced debt exchange would exert upward pressure on Pfandbriefbank's supporting member banks' creditworthiness from which Pfandbriefbank's ratings are derived. The upward pressure results from potentially lower-than-previously expected losses imposed on their direct and indirect Heta debt exposure based on the offering memorandum and reducing tail risk related to Pfandbriefbank support. Moody's expects the beneficial effects on Pfandbriefbank's ratings of a successful debt exchange at Heta to be limited to one notch.

Pfandbriefbank's rating continues to be purely based on the member banks' creditworthiness and does not include uplift from public-sector entities, reflecting the ongoing lack of commitment by several federal states to honour their obligations under the existing joint and several liability framework.

Given its business profile as a poorly capitalised issuing vehicle for its member banks, i.e., the Austrian Landeshypothekenbanken or their legal successors, Pfandbriefbank relies fully on the performance of its concentrated assets to service its liabilities. The Heta moratorium in March 2015 therefore impaired its liquidity and solvency. Pfandbriefbank came under stress after the regulator in Austria imposed a payment moratorium on the liabilities of Heta to which Pfandbriefbank had a EUR1.2 billion exposure as of March 2015.

In April 2015, the member banks and the majority - but not all - of the Austrian Federal states agreed support measures that fully cover Pfandbriefbank's Heta exposure and have therefore eliminated immediate liquidity and solvency concerns for the entity. However, the Austrian states' individual contributions were not uniformly provided, as timely support has been withheld by several states, undermining the reliability of the multi-recourse support structure. Pfandbriefbank's liabilities are grandfathered under a statutory joint and several guarantee from member banks and their former guarantors, i.e. the relevant Austrian federal states, according to Austrian federal law.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Heta Asset Resolution AG

As indicated by the direction of the rating review, an upgrade of Heta's deficiency-guaranteed senior unsecured and subordinate ratings could result from broad creditor acceptance and a successful execution of the proposed distressed debt exchange and from the associated better recovery value expectations for creditors based on Moody's estimates.

Hypo Tirol Bank AG

An upgrade of Hypo Tirol's long-term debt and deposit ratings could result from an upgrade of its standalone BCA and/or (2) higher rating uplift as a result of Moody's Advanced LGF analysis. As indicated by the direction of the rating review, an upgrade of Hypo Tirol's BCA could result from broad creditor acceptance and a successful execution of Heta's proposed distressed debt exchange which in Moody's opinion could result in a beneficial reversal of impairments and provisions as well as remove some downside risks for Hypo Tirol related to Pfandbriefbank.

Vorarlberger Landes- und Hypothekenbank AG

An upgrade of VLH's long-term debt and deposit ratings could result from (1) an upgrade of its standalone BCA and/or (2) higher rating uplift as a result of Moody's Advanced LGF analysis.

A downgrade of VLH's long-term debt and deposit ratings could be triggered following (1) a downgrade of the bank's standalone BCA; and/or (2) an increase in the expected loss severity following a material shift in the bank's funding mix as part of its ongoing refinancing of deficiency-guaranteed debt maturities with foremost covered bond issuance could result in a future decline in uplift for senior debts as a result of Moody's LGF analysis.

Pfandbriefbank (Oesterreich) AG

An upgrade could result from (1) a strengthening of the member banks' credit profiles; (2) a clarification of the legal obligations of the Austrian federal member-states under the guarantee framework, to the extent that this removes any doubts over the full, unconditional liability of all parties to support Pfandbriefbank in a timely fashion.

LIST OF AFFECTED RATINGS

On Review for Possible Upgrade:

..Issuer: Heta Asset Resolution AG

....Backed Senior Unsecured Rating, currently Ca, outlook changed to Rating Under Review from Developing

....Backed Subordinate Rating, currently C

..Issuer: Hypo Tirol Bank AG

....Adjusted Baseline Credit Assessment, currently ba3

....Baseline Credit Assessment, currently ba3

....Long Term Counterparty Risk Assessment, currently Baa3(cr)

....Short Term Counterparty Risk Assessment, currently P-3(cr)

....Long Term Bank Deposit Ratings, currently Ba1, outlook changed to Rating Under Review from Stable

....Short Term Bank Deposit Ratings, currently NP

....Senior Unsecured Rating, currently Ba1, outlook changed to Rating Under Review from Stable

....Senior Unsecured MTN Rating, currently (P)Ba1

...Subordinate MTN Rating, currently (P)B1

...Backed Long Term Bank Deposit Ratings, currently Baa2, outlook changed to Rating Under Review from Stable

...Backed Senior Unsecured Ratings, currently Baa2, outlook changed to Rating Under Review from Stable

...Backed Senior Unsecured MTN Rating, currently (P)Baa2

...Backed Subordinate Rating, currently Ba2

...Backed Senior Subordinate Rating, currently Ba2

...Backed Subordinate MTN Rating, currently (P)Ba2

..Issuer: Pfandbriefbank (Oesterreich) AG

...Backed Senior Unsecured Ratings, currently Ba1, outlook changed to Rating Under Review from Stable

Affirmations:

..Issuer: Vorarlberger Landes- und Hypothekenbank AG

...Adjusted Baseline Credit Assessment, affirmed at baa3

...Baseline Credit Assessment, affirmed at baa3

...Long Term Bank Deposit Ratings, affirmed at Baa1 Stable

...Short Term Bank Deposit Ratings, affirmed at P-2

...Senior Unsecured Ratings, affirmed at Baa1 Stable

...Senior Unsecured MTN Rating, affirmed at (P)Baa1

...Long-Term Issuer Ratings, affirmed at Baa1 Stable

...Short Term Issuer Rating, affirmed at P-2

Not Affected:

..Issuer: Heta Asset Resolution AG

...Backed Subordinate Rating, currently Aaa

..Issuer: Hypo Tirol Bank AG

...Backed Short-Term Bank Deposit Rating, currently P-2

..Issuer: Vorarlberger Landes- und Hypothekenbank AG

...Long Term Counterparty Risk Assessment, currently A3(cr)

...Short Term Counterparty Risk Assessment, currently P-2(cr)

...Subordinate MTN Rating, currently (P)Ba1

...Backed Long Term Bank Deposit Rating, currently A3 Stable

...Backed Short-Term Bank Deposit Rating, currently P-2

...Backed Senior Unsecured Ratings, currently A3 Stable

...Backed Senior Unsecured MTN Rating, currently (P)A3

...Backed Subordinate Rating, currently Baa3

...Backed Subordinate MTN Rating, currently (P)Baa3

Outlook Actions:

..Issuer: Heta Asset Resolution AG

...Outlook, changed to Rating Under Review from Developing

..Issuer: Hypo Tirol Bank AG

...Outlook, changed to Rating Under Review from Stable

..Issuer: Vorarlberger Landes- und Hypothekenbank AG

...Outlook, remains Stable

..Issuer: Pfandbriefbank (Oesterreich) AG

...Outlook, changed to Rating Under Review from Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

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