RATING ACTION COMMENTARY

Fitch Revises Volksbanken-Verbund's Outlook to Negative; Affirms IDR at 'BBB+'

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Fitch Ratings - Frankfurt am Main - 21 May 2025: Fitch Ratings has revised Volksbanken-Verbund's (VB-Verbund) Outlook to Negative from Stable, while affirming its Long-Term Issuer Default Rating (IDR) at 'BBB+' and Viability Rating (VR) at 'bbb+'. A full list of rating actions is provided below.

KEY RATING DRIVERS

The Outlook revision to Negative reflects VB Verbund's recent material deterioration in the quality of its sizeable commercial real estate portfolio, leading to weaker asset quality and profitability metrics which - if not improved - could lead to a downgrade over the next 12 to 18 months.

VB-Verbund is a medium-sized network of regional cooperative banks, not a legal entity, and Volksbank Wien AG (VBW) acts as VB Verbund's central organisation. The group's strong cohesion is primarily ensured by its mutual support scheme. VB-Verbund's IDRs apply to each of its member banks, in line with Fitch's' criteria for rating banking structures backed by mutual support mechanisms.

The group's Long-Term IDR is driven by its VR. The latter reflects VB-Verbund's smaller domestic franchise and less diverse business model than higher-rated peers', which results in below-average operating profitability and cost efficiency, and ultimately limits the group's financial flexibility. The VR also reflects the group's higher historically reasonable, but worsening asset quality, robust capitalisation, and good liquidity and funding profile.

Sharp Asset Quality Deterioration: VB-Verbund's impaired loan ratio (stage 3 loans/gross loans) rose sharply to 5.5% at end-2024 (2023: 2.7%), well above most European peers'. This was due primarily to major defaults in the commercial real estate sector as a result of interest rate increases since 2022 and higher construction costs, but also due to the impact of a weak domestic economy on the corporate loan book. We expect impaired loans to be higher than average over the medium term, despite a targeted workout strategy towards a ratio of below 3%.

Pressure on Risk Profile: The group's overall risk profile benefits from a focus on core products, lending to a well-known long-term customer base of mostly domestic retail, self-employed and SME borrowers. However, high exposures to domestic commercial real estate projects and developers have compromised the group's low loan concentrations and made it vulnerable to cyclical downturns, as evident in 2024, when the domestic commercial real estate sector came under pressure.

Established Retail Business Profile: VB-Verbund has a solid record in operating a retail-oriented cooperative franchise focused on the domestic market. Its business model principally generates revenues from traditional commercial banking. Its business profile benefits from a loyal, although ageing customer base, but is constrained by its moderate size and regional focus, resulting in limited diversification and pricing power.

Volatile Profitability: VB-Verbund's operating profit/risk-weighted assets (RWAs) ratio of 1% at end-2024 was below last year's 2.4%. Lower net interest income and rising costs but primarily increased loan loss provisions in the commercial real estate sector well above historical levels have eroded the group's profitability. We expect another decline in operating profitability in 2025, followed by a moderate recovery from 2026, as loan impairment charges decline.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) ratio (end-2024: 15.5%) is robust and offers ample headroom over its regulatory capital requirements. VB-Verbund's leverage ratio at end-2024 was solid, at 7.3%. The standardised approach for the calculation of RWAs also mitigates the impact of the recent asset quality deterioration on the group's CET1 ratio. However, we expect VB Verbund's CET1 ratio to fall in 2025, primarily due to negative transitional Basel 4 effects.

Stable Funding Franchise: VB-Verbund's granular retail and SME deposit base is a reliable source to fully fund its customer loan growth. Customer deposits rose almost 5% in 2024. Wholesale market activities are moderate but expanded in 2024, particularly with the issuance of Tier 2 debt, underpinning a broadening funding franchise. VB Verbund's liquidity profile is solid and benefits from the joint pooling scheme of the group.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Inability to stabilise or improve VB-Verbund's asset quality, leading to consistently higher impairment charges and weighing on profitability could lead to a downgrade. In particular, further pressure on VB-Verbund's operating profit, leading to a four-year average of below 1% of RWAs, would put pressure on VB-Verbund's ratings.

A reduction in VB-Verbund's common equity Tier 1 ratio to below 11.5% without clear recovery prospects could also lead to a downgrade.

The Short-Term IDRs are sensitive to downgrades of the Long-Term IDRs, in conjunction with a deterioration of the group's funding and liquidity profile.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

We could revise the Outlook to Stable if VB-Verbund's impaired loans ratio improves to below 4% and its four-year average operating profit remains comfortably above 1% of RWAs, which would indicate a recovery in VB-Verbund's credit profile.

An upgrade of the IDRs and VR is unlikely over the medium term and would require a major improvement in asset quality metrics, combined with a solid and sustainable improvement in average operating profit of at least 1.5% of RWAs, while maintaining good capitalisation and a solid funding and liquidity profile. Ratings could also benefit from a stronger franchise, including more diversified customer, funding and revenues bases, together with a stable risk profile.

An upgrade of the Short-Term IDR to 'F1' would require a one-notch upward revision of the funding and liquidity score to 'a'.

No Support Assumed: VB-Verbund's Government Support Rating reflects Fitch's view that the EU's resolution framework is likely to require senior creditors participating in losses ahead of a bank receiving sovereign support.

An upgrade of VB-Verbund's Government Support Rating would require a positive change in the sovereign's propensity to support banks. Fitch believes this is highly unlikely in light of the prevailing regulatory environment.

VR ADJUSTMENTS

The capitalisation and leverage score of 'bbb+' is below the implied 'a' category score due to the following adjustment reason: internal capital generation and growth (negative).

The earnings and profitability score of 'bbb+' is below the implied 'a' category score due to the following adjustment reason: historical and future metrics (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Volksbank Wien AG	LT IDR	BBB+ Rating Outlook Negative	Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
Volksbank Salzburg eG	LT IDR	BBB+ Rating Outlook Negative	Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2	Affirmed	F2

Volksbank Niederoesterreich AG	LT IDR	BBB+ Rating Outlook Negative Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2 Affirmed	F2
Volksbank Oberoesterreich AG	LT IDR	BBB+ Rating Outlook Negative Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2 Affirmed	F2
Volksbank Tirol AG	LT IDR	BBB+ Rating Outlook Negative Affirmed	BBB+ Rating Outlook Stable
	ST IDR	F2 Affirmed	F2

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 21 Mar 2025) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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