Research Update:

Deutsche Pfandbriefbank Outlook Revised To Stable On Stabilizing Asset Quality; 'BBB-/A-3' Ratings Affirmed

March 11, 2025

PRIMARY CREDIT ANALYST

Heiko Verhaag, CFA, FRM
Frankfurt
+49 69 33999 215
heiko.verhaag
@spglobal.com

SECONDARY CONTACT

Benjamin Heinrich, CFA, FRM
Frankfurt
+49 69 33999 167
benjamin.heinrich
@spglobal.com

Overview

- We expect commercial real estate (CRE) valuations and transaction volumes in the U.S. and Europe are nearing their cyclical lows, reducing the risk of further material deterioration in asset quality for Deutsche Pfandbriefbank AG.
- The bank's portfolio derisking enhances its resilience against potential market fluctuations. Although key risks remain in the U.S. office and German development portfolios, we think these will be adequately covered by preprovision income, thereby reducing downside risk to its credit profile.
- The bank's continuing strong capitalization, resilient funding and liquidity profile, and strong gone concern loss absorption buffers support its credit profile.
- We therefore revised the outlook to stable from negative and affirmed our 'BBB-/A-3' long- and short-term issuer credit ratings and related issue ratings.

Rating Action

On March 11, 2025, S&P Global Ratings revised the outlook on Germany-based Deutsche Pfandbriefbank AG (PBB) to stable from negative and affirmed its 'BBB-/A-3' long- and short-term issuer credit ratings.

We also affirmed our 'BBB/A-2' long- and short-term resolution counterparty ratings on PBB. At the same time, we affirmed all issue ratings.

Rationale

We expect CRE valuations and transaction volumes in the U.S. and Europe are nearing or past their cyclical lows, thereby reducing downside risks to PBB's credit profile. While CRE prices, particularly on office loans, have fallen substantially in PBB's core markets over 2022 and 2023, we observed stabilizing prices and a slight recovery in transaction activity over 2024. Despite the uncertain rate environment in Europe and the U.S., we do not expect further material deterioration in valuations in our base case. For PBB, this means asset quality has likely stabilized, particularly due to its derisking activities executed in 2024, which included selling performing loans to reduce concentration, materially reducing development loans, and substantially lowering exposure to the U.S. office portfolio. As such, we expect loan loss provisions to come down further in 2025 to about 35 basis points (bps), from 45bps in 2024, and nonperforming loans (NPLs) to be managed down from 5.1% as of year-end 2024. Nevertheless, transaction activity will likely remain relatively weak and PBB will experience further defaults, requiring continuing relatively high levels of loan loss provisions. In our view, these can be well absorbed by preprovision income, while bottom line profitability will remain weak.

In 2025, PBB will need to show tangible progress on its 2027 strategy. PBB has a concentrated, wholesale-oriented business model with weak profitability. Its 2027 strategy, announced in October 2024, targets to improve business model resilience by gradually reducing concentration in its CRE book, with a lower share of office exposure in favor of other asset classes such as hotels, serviced/senior living, and data centers. The strategy also aims to reduce PBB's reliance on net interest income by offering real estate investment services to institutional investors, as well as achieve assets under management of €4 billion-€6 billion in 2027 through a combination of organic growth and purchases of smaller asset management providers. It also plans to establish a CRE-focused broker service to increase cooperation in deal sourcing and servicing. These initiatives are designed to push fee income to about 10% of operating revenues in 2027. We see this as ambitious and have so far seen little tangible progress in PBB's service offerings to institutional investors.

Strong capital and tight cost controls provide headroom for necessary strategic investments. PBB continues to show strong capitalization, with an estimated S&P Global Ratings' risk-adjusted capital ratio that increased to about 13% as of year-end 2024 from 11.8% in 2023, and a pro forma regulatory CET1 ratio of 16.8% under the new foundation internal ratings-based approach. The proposed dividend and share buyback in 2025 indicate that management is comfortable with current capitalization, which is above the long-term target of a CET1 ratio of 15.5%. As such, the bank has some excess capital available that can be used for the targeted inorganic growth in the asset management space. In addition, expected costs savings in its financing business from the IT transformation and improved digitalization can be invested in its growth area of real estate investment services, without materially weakening its cost income ratio of about 50%, which is our base case.

Investor confidence has largely returned, and funding is available at reasonable spreads. In early 2024, PBB's capital market spreads across its liability stack peaked amid high investor scrutiny of its CRE exposure, which made it difficult for the bank to attract wholesale funding at reasonable spreads. Investor confidence has since recovered substantially, with funding spreads returning to more sustainable levels. Although the senior preferred bond issued in November 2024 lacked market demand and was initially partly retained by underwriting banks, we see spreads have recovered further. Notably, covered bond funding was available throughout 2024, and retail deposits became a crucial stabilizing factor in PBB's funding profile. We think the strategic funding mix of 50% covered bonds and 50% retail deposits and unsecured bonds will ensure a stable funding profile despite market scrutiny regarding weak asset quality and the business model.

PBB's senior preferred investors continue to benefit from high loss-absorbing capacity in the event of a resolution. We think a resolution scenario is more likely than liquidation, which is why we continue to apply a one-notch uplift to the additional loss absorption capacity (ALAC) in our 'bb+' stand-alone credit profile (SACP) assessment of the bank. We expect PBB will reduce its ALAC buffer to about 700bps of S&P Global Ratings' risk-weighted assets by year-end 2026 due to amortizing minimum requirement for own funds and eligible liabilities (MREL) instruments, from an estimated 8.5% as of Dec. 31, 2024. We expect new MREL issuances will resume by 2027 at the latest. We include a one-notch ALAC uplift to our long-term issuer credit rating on PBB, rather than the two notches that are common for banks with ALAC ratios above 6%. This considers that pbb is a more nuanced case in terms of expected resolution measures relative to other systemically important banks.

Outlook

The stable outlook reflects our view that PBB will absorb the ongoing challenges posed by weak CRE markets and the related cost of risk with preprovision earnings over the next two years. We also expect continued resolution of problem loans, aided by stabilizing office prices in the U.S. To maintain its current credit profile, PBB must uphold strong capitalization, sustainable profitability, a resilient funding profile, and sufficient loss-absorbing capacity.

Downside scenario

We could lower our ratings over the next two years if:

- CRE markets, particularly in the U.S. and Germany, show renewed signs of stress due to increasing rates or weaker economic developments, which could consequently increase risks to PBB's asst quality and capitalization.
- Strategic revisions to PBB's business model fail to increase its resilience, while competitive pressure further weighs on profitability.
- A decline in investor confidence restricts PBB's market access at reasonable spreads for a prolonged time.

Upside scenario

We consider an upgrade as remote and dependent on PBB materially improving its business diversification and resilience by successfully implementing its 2027 strategy, along with significantly increasing its fee income contribution and improving its CRE book diversification. An upgrade would also require PBB to materially improve its risk-adjusted profitability and significantly reduce its NPLs.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	**BBB-/Stable/A-3**	**BBB-/Negative/A-3**
Stand-alone credit profile	bb+	bb+
Anchor	bbb+	bbb+
Business position	Constrained (-2)	Constrained (-2)
Capital and earnings	Strong (+1)	Strong (+1)
Risk position	Constrained (-2)	Constrained (-2)
Funding and liquidity	Adequate and adequate (0)	Adequate and adequate (0)
Comparable ratings analysis	0	0
Support	+1	+1
ALAC support	+1	+1

ALAC--Additional loss absorption capacity.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, Feb. 10, 2025
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, April 30, 2024
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Deutsche Pfandbriefbank AG; Jan 15, 2025
- German Banking Outlook 2025: Resilient In The Face Of Adversity; Jan 23, 2025
- Deutsche Pfandbriefbank Continues To Navigate Difficult Commercial Real Estate Markets, Aug. 14, 2024
- Deutsche Pfandbriefbank's First Quarter Results Show A Mixed Picture, May 14, 2024
- Deutsche Pfandbriefbank Downgraded To 'BBB-/A-3' On Challenges From Commercial Real Estate; Outlook Negative, Feb. 14, 2024

Ratings List

Ratings Affirmed		
Deutsche Pfandbriefbank AG		
Resolution Counterparty Rating	BBB/--/A-2	
Deutsche Pfandbriefbank AG		
Senior Unsecured	BBB-	
Senior Subordinated	BB-	
Subordinated	B+	
Junior Subordinated	B-	
Commercial Paper	A-3	
Ratings Affirmed; Outlook Action		
	To	**From**
Deutsche Pfandbriefbank AG		
Issuer Credit Rating	BBB-/Stable/A-3	BBB-/Negative/A-3

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

Copyright © 2025 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.