

Covered Bond Report

No. 01

Please read the notices on the last page!

15/01/2009

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BayernLB Covered Bond Portfolio

We would like to take account of the financial market turmoil of recent months and then explain our allocation decision.

We basically see the money market as the driving force for all spread products. We expect the money market to stabilise in the first quarter of 2009. Swap spreads should then recover in further course of the first half. The swing in bank profits in our scenario and stabilisation of the financial system argue in favour of that. However, the steep yield curve and possibility of funding by way of state-guaranteed bonds will also help improve bank profitability. There should then be a significant movement of yield spreads in late summer at the latest, even though the exact starting point of the narrowing is uncertain.

For details, we refer the reader to our Fixed Income Special "Credit and covered bond markets: What strategy is appropriate for the crisis?" (January 2009).

Spread levels, particularly of weaker covered bond issuers from countries that have had to cope with the largest spread widening because of the crisis, should remain high in the first half of the year. Spreads are also likely to continue at current levels in the case of securities from issuers without a significant retail base, which depend more on funding geared to the capital market.

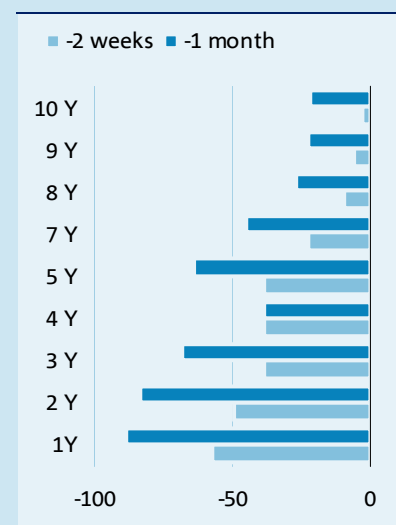
Fixed Income Research

Covered Bond Research

Total return of iBoxx covered bonds and sovereigns

	Total return (%)		
	2w	1m	1y
Covered 1-3Y	0,71	1,52	6,05
Sovereign 1-3Y	0,73	1,61	6,97
difference (pp)	-0,02	-0,09	-0,93
Covered 3-5Y	1,07	2,25	6,47
Sovereign 3-5Y	0,70	2,57	8,10
difference (pp)	0,37	-0,32	-1,63
Covered 5-7Y	1,27	2,61	5,77
Sovereign 5-7Y	0,47	2,92	8,61
difference (pp)	0,80	-0,31	-2,84
Covered 7-10Y	1,22	2,77	4,88
Sovereign 7-10Y	0,24	2,56	8,75
difference (pp)	0,98	0,21	-3,87

Pfandbrief yields (bp)



Sources: BayernLB Research; Bloomberg; iBoxx

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In particular, competition will continue to be felt on the primary market in the first and second quarters due to the issuance of state-guaranteed bonds. On the whole, however, we do not see any further significant spread widening in the first half of 2009. The fundamental arguments for that are the still very solid safety mechanisms of covered bonds and the individual systemic support mechanisms.

► **Second half of 2009**

In the second half of the year, we expect gradual first signs of economic stabilisation and calming on international real estate markets. In particular, we regard a stabilisation of the US real estate market as a “must” for such a calming. As a result, the confidence of market participants should return along with sustained calm on the money market. The potential for spread narrowing in the covered bond market is driven by growing confidence in the stability of financial institutions and reduction of illiquidity premium. The revival of the covered bond primary market will also lead to a positive reaction in secondary spreads. Consequently, spreads should then head south. The forecast of narrowing spreads is also supported by the negative correlation of spreads to the general yield level. Subsequently, yield differences should narrow when government bond yields rise.

Moreover, covered bonds are benefiting, for one thing, from a higher current return compared with Bunds. For another, a steep yield curve will bring investors out of “safe havens” and into riskier investments like spread products. Because of the general curve steepening on our scenario, a shift to medium and long maturities may be expected. Consequently, covered bonds will no longer be viewed as a product in competition with 3-year state-guaranteed bonds beginning in the third quarter. Overall, we expect spreads of covered bond maturities rated better by the market to narrow first, followed by the main victims of the crisis in corresponding order: cédulas, multi cédulas, and UK covered bonds.

► **Summary of secondary market scenario**

In summary, we regard the following secondary market scenario as likely. The covered bond market will return to calmer waters in the second half of the year. The volatility of risk premiums will also decline like the spreads themselves. However, we do not expect a picture comparable to the first half of 2007. Instead, it seems likely that investors will differentiate by credit rating both at the issuer level and especially at the country level. The consequence of such a development is spreads that are significantly farther apart than was the case in times of extremely high spread convergence up to mid-2007. A full correction of the cheapening movements of the last 18 months is thus not to be expected.

► **Portfolio allocation**

Concrete recommendations for our portfolio allocation emerge from the scenario that we consider most likely. Many covered bonds are very cheap by historical and fundamental criteria, particularly considering that the default rates of these debt securities are virtually zero. In addition, extreme systemic support and duty to protect bondholders have recently been manifested openly (US and UK). The quality of the relevant cover portfolios will worsen somewhat, but that will be cushioned by sufficient legal

safety mechanisms. Moreover, the financial strength of individual issuers is now improving thanks to government support mechanisms.

The main reason for our current portfolio weightings is our expectation that covered bonds from countries that have had to cope with the greatest spread widening because of the crisis will show better performance in the long run than those that have suffered from the market turmoil not at all or only to a very limited extent.

► **Already invested: hold; new investors: increase weighting of most strongly widened covered bonds**

For the already invested, we recommend holding the strongly widened asset classes in order to profit more than proportionately from the upcoming spread narrowing. New investors less sensitive to market prices should increase weightings of the most heavily hit countries in order to participate in expected spread performance.

► **Spread recovery in cédulas earlier than in UK covered bonds**

Basically, it may be assumed that spreads of Spanish bonds will recover sooner than those of UK bonds. That will be determined, we believe, by the situation on the respective real estate markets. As a result of more restrictive lending processes in Spain, the subprime segment there is much less prominent than in the United Kingdom. The Spanish central bank estimates the subprime segment at 3% of total mortgage lending. Moreover, the anticyclical loan loss provisions that Spanish banks are required to form by the Spanish central bank and the comparatively higher repayment morale of Spanish borrowers argue for a faster calming on the real estate market on the Iberian Peninsula than across the Channel.

► **Pro Spain, UK, and Other**

In line with the strategy just outlined, the high active weights of the regions Spain, United Kingdom, and Other stand out, as do the lower active weights of covered bonds from France and Germany. Selection within the individual segments can likewise diverge from the index composition. Our segment "Other" comprises both the securities from the iBoxx Euro Covered Other and various smaller iBoxx subindices (Sweden, Norway, Luxembourg, etc.). However, we continue to advise against exposure in US covered bonds because of the significantly increased downside risks.

Weighting recommendations for covered bonds

Index	iBoxx weight	BayernLB weight	iBoxx modified duration
iBoxx € Germany Covered	28,0%	21,0%	2,79
iBoxx € Mortgage Pfandbriefe	8,5%	6,0%	3,02
iBoxx € Public Pfandbriefe	19,3%	15,0%	2,70
iBoxx € France Covered	17,7%	10,0%	4,06
iBoxx € Spain Covered	30,9%	36,0%	5,34
iBoxx € Ireland Covered	3,2%	3,0%	4,19
iBoxx € UK Covered	7,2%	12,0%	4,76
iBoxx € Other Covered	13,1%	18,0%	3,00
iBoxx € Covered	100,0%	100,0%	4,06
Duration neutralisation*			
BayernLB Covered Bond Portfolio*			

Sources: BayernLB Research; Datastream * Neutralisation of duration differences by means of Bund future contracts

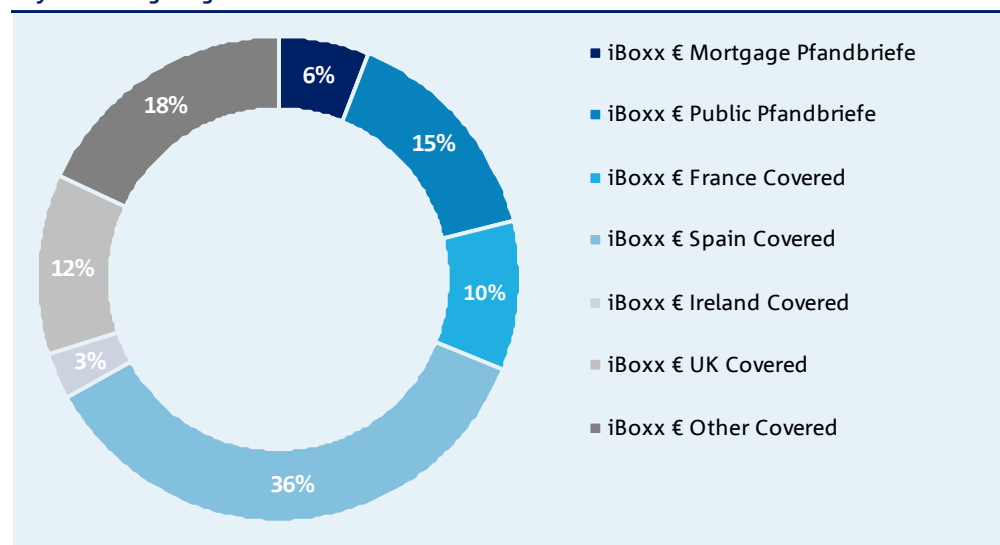
► **Investors less inclined to take risk should prefer Germany and France**

However, since we also assume that spreads of more crisis-resistant covered bonds will narrow, we advise investors who are less inclined to take risks to refrain from new investments in the United Kingdom or Spain and give preference to issues from, e.g., Germany and France or also from Scandinavia. Buy-and-hold investors should also achieve solid spread performance there.

► **Short-term setbacks not out of the question**

Finally, we would note that this strategy is based on a long-term market forecast. Investors should therefore be able to accept short-term value fluctuations and setbacks.

BayernLB weighting recommendations for covered bonds



Source: BayernLB Research

The latest on state-guaranteed bank bonds

► The band plays on for state-guaranteed bank bonds

State-guaranteed bank bonds are drawing the attention of many primary market investors again this year. In a generally favourable environment for these bonds, new issues have come from France, Portugal, and Denmark and for the first time from Germany (see list below).

New issues of state-guaranteed bank bonds since the start of 2009

Issuer	Date	Vol.		Maturity	Coupon	Type	Issue rating	ISIN	Swap Spread	
			m						%	*
SFEF	07/01/09	5.000	EUR	16/01/14	3,250	FR Govt Gtee	Aaa/AAA/AAA	FR0010709253	ms +15	ms 17,1
BES	08/01/09	1.500	EUR	19/01/12	3,750	PT Govt Gtee	Aa2 / AA-/AA	PTBEMPOE0018	ms +100	ms 98,4
Commerzbank	08/01/09	5.000	EUR	13/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	DE000CB896A7	ms +30	ms 20,9
BCP	12/01/08	1.500	EUR	19/01/12	3,625	PT Govt Gtee	Aa2 / AA-/AA	PTBCP9OM0051	ms +100	ms 99,1
HSHN	12/01/09	3.000	EUR	20/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	DE000HSH2539	ms +28	ms 23,2
Danske	14/01/09	3.000	EUR	21/09/10	2,500	DK Govt Gtee	Aaa/AAA/AAA	XS0409220836	ms +40	ms 20,2
BayernLB	15/01/09	5.000	EUR	23/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	DE000BLB5N07	ms +28	ms n.a.

Sources: BayernLB Research; Bloomberg

► Commerzbank very successfully led the way among German issuers ...

Like almost all guaranteed bond issues, the two German ones from Commerzbank and HSH Nordbank – both with 3-year maturities – were very successful. Commerzbank led the way, placing EUR 5 bn instead of the initially planned EUR 2.5 bn. The issuing spread was MS +30 bp, squarely within the marketed range of MS +25-35 bp, and the order book was bursting with more than 400 orders (EUR 9 bn) within just a few hours.

► ... and HSH Nordbank fared at least equally well

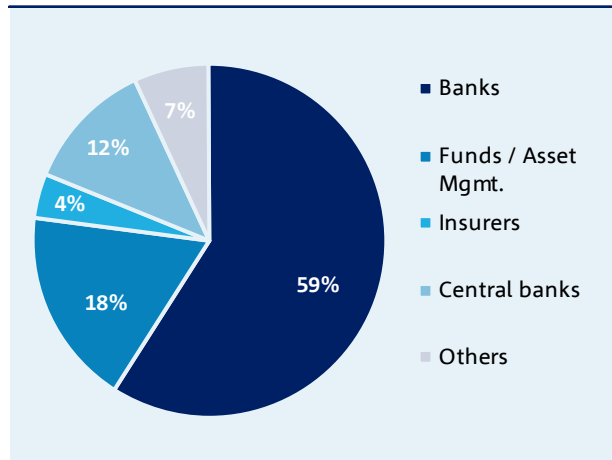
The following week, HSH Nordbank's state-guaranteed issue, which had initially been planned for the end of last year but was then postponed to this year due to a less favourable environment and lower liquidity, did almost better. Investors again showed keen interest, placing some EUR 6 bn in orders in the first hour alone. In the end, the order books were closed with a volume of EUR 9 bn, and the issue spread was set at MS +28 bp (marketing started in the MS +30 bp range).

► German investors especially eager to buy

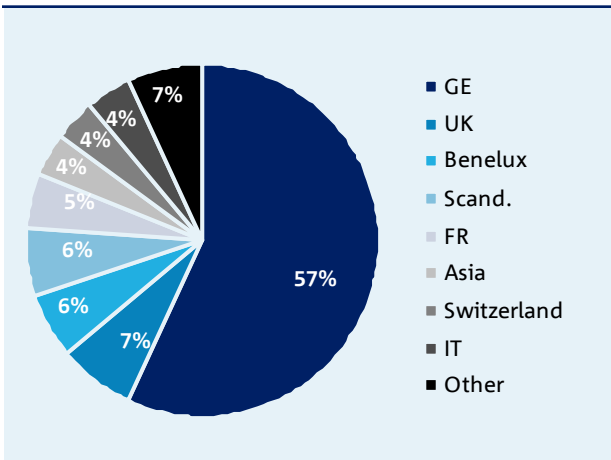
The large order books testify to continued strong interest in state-guaranteed bonds among investors. As was the case for last year's British and French issues of guaranteed bonds, the biggest investor groups for the first two German issues were domestic institutions (see the charts below for a volume breakdown of HSH Nordbank's state-guaranteed bond).

Breakdown of issuing volume of HSH Nordbank's state-guaranteed bond

By investor type



By region



Sources: BayernLB Research; HSH Nordbank

► **Investor types:**
Banks, insurance companies, and asset managers were biggest buyers

Of the two issuing volumes, German investors accounted for 42% of the Commerzbank bond and 57% of the HSH Nordbank bond. They were followed by investors from the UK, the Benelux countries, Scandinavia, and France. In the breakdown by investor type, banks and insurance companies were by far the biggest buyers for both the Commerzbank bond (55%) and the HSH bond (63%). They were followed in both cases by asset managers and central banks.

► **BayernLB and Danske Bank to follow suit**

Over the course of the day this past Thursday, BayernLB completed its own state-guaranteed issue, also with a 3-year maturity. Investor demand was also strong. The order book closed with about EUR 12 bn in orders, and the total issue volume was set at EUR 5 bn. Pricing was MS +28 bp. Danske Bank became the first Danish issuer to place a state-guaranteed bank bond on the market. With a maturity of September 2010, the EUR 3 bn transaction was priced at MS +40 bp.

► **EUR 24 bn in state-guaranteed bonds issued since the start of 2009 ...**

All told, an impressive EUR 24 bn in new state-guaranteed bonds has been placed on the market since the start of this year. The total volume from European issuers (denominated in EUR or GBP) since the first British issue by Barclays last October has already passed the EUR 70 bn mark. That means, apart from government bonds, state-guaranteed bonds continue to be the undeniable "heart" of new issuing activity despite a recent surge in primary market activity for corporates.

- ▶ **... and plenty more to follow**

We expect the state-guaranteed bonds segment to continue to grow rapidly in Germany and the rest of Europe. In Germany, IKB has already announced its intention to launch its debut issue and will likely be the next to hit the market. As the primary market environment remains difficult for covered bonds and unsecured bonds, the vast amount of liquidity that is available – as the enormous order volumes for the state-guaranteed bond issues have shown – will continue to go primarily into state-guaranteed bonds.
- ▶ **Points in favour of state-guaranteed bonds, both from an investor's perspective...**

The potential pool of investors for state-guaranteed bonds is very large, comprising sovereign risk (agencies, *Länder*) investors and covered bond investors as well as corporate (and financial) bond investors. Yields are another factor favouring state-guaranteed bonds: Given the sharp drop in government bond yields (10-year Bund yields are now below 3%), these bonds are far from providing the target yields that insurance companies need. State-guaranteed bonds are increasingly interesting since they continue to offer attractive spreads, with a comparable risk of default.
- ▶ **... and from an issuer's perspective**

A number of other points recommend state-guaranteed bonds. The far higher cost of funding by way of alternative instruments, coupled with competitive pressures from other financial institutions, could force banks to choose state-guaranteed bonds as the means for obtaining new funds and bringing their capital ratios back “to benchmark levels.”
- ▶ **What does this all mean for covered bonds?**

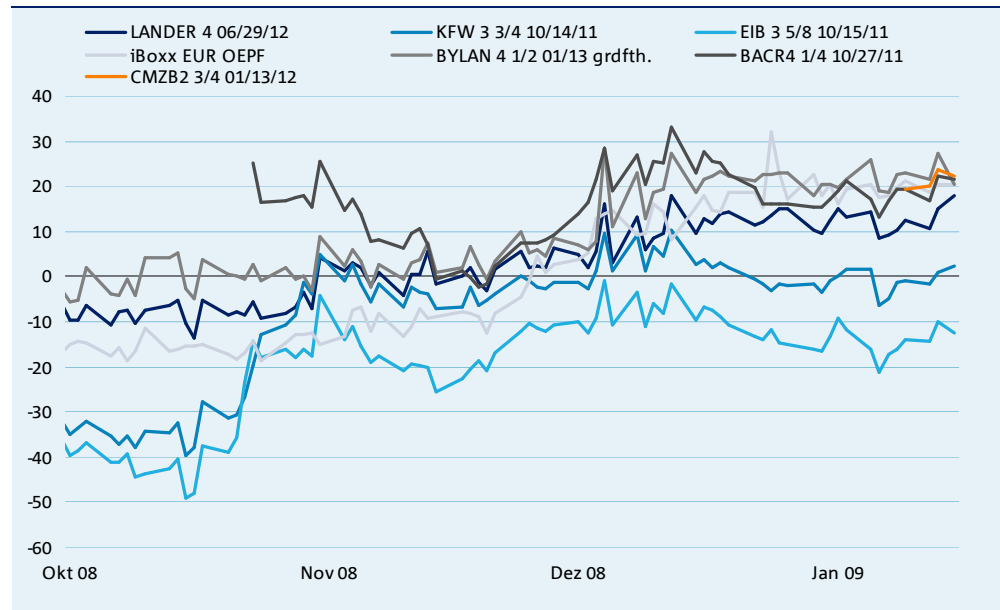
What does this all mean for covered bonds? Although the primary market for covered bonds has begun to reopen – as BNP's recent issue of a 5-year structured covered bond (EUR 1.5 bn at MS +110 bp) demonstrates, state-guaranteed bonds are clearly the dominant player on the primary market right now. It is impossible to tell when issuers will return to using covered bonds as a source of funding on a larger scale.
- ▶ **Covered bonds still dominated by state-guaranteed bonds and bonds from *Länder***

This is particularly true since investors are reluctant to invest in this segment, even when spread levels are attractive. In fact, covered bonds' future position within the hierarchy is a fundamental question. If the new 5-year *Länder* bond from Baden-Württemberg is priced at MS +35 bp, where will Pfandbriefe be priced?
- ▶ **Rethinking of relative valuation of “liquid” asset classes needed**

Thus, the relative valuations of asset classes like *Länder* and agency bonds and covered bonds – all once considered liquid – seem to have been thrown into complete disarray and will inevitably need to be reordered, with the corresponding adjustment processes.

Spread development of state-guaranteed bonds and their peer groups

ASW in bp



Sources: BayernLB Research; Bloomberg

► **Fixed Income Special will attempt to provide initial answers**

Although the answers to these questions will begin to emerge only gradually, we would like to refer readers to our forthcoming Fixed Income Special on state-guaranteed bonds, which will look at the latest developments in this asset class in more detail, provide a relative value classification, and include a more detailed discussion of the impact on covered bonds.

Newsflash

SoFFin extends framework guarantee for Hypo Real Estate Group

The German Financial Market Stabilization Fund (SoFFin) has extended its EUR 30 billion framework guarantee for Hypo Real Estate Group from 15 January 2009 to 15 April 2009.

Hypo Real Estate Bank AG, which belongs to Hypo Real Estate Group, can use the guarantees to be made by SoFFin to collateralise debt securities to be issued, which are due for repayment by 15 April at the latest. Talks between Hypo Real Estate Group and SoFFin continue concerning more extensive and longer-term liquidity and capital support measures for the group.

► **Government considering emergency acquisition of stake in Hypo Real Estate**

Furthermore, according to press reports, the German federal government is considering an emergency acquisition of a stake in distressed mortgage lender Hypo Real Estate.

iBoxx EUR Covered has new subindices

Index service provider Markit has introduced new subindices for the iBoxx EUR Covered Index as of 31 December 2008. A completely new addition is the iBoxx EUR Italy Covered. The previous iBoxx EUR Spain Covered is being split into two components, iBoxx EUR Spain Covered Single Cédulas and iBoxx EUR Spain Covered Pooled Cédulas, which we consider appropriate in view of the differences in structure, design, and current spread levels.

Markit has new pricing method for iBoxx indices

As of 29 December 2008, index service provider Markit has introduced changes in its rules for pricing iBoxx indices. The background for this decision is improved pricing in times of illiquid and volatile markets.

The new rules may found on the internet at:

http://www.iboxx.com/download/news/367/Markit_EURGBPConsRules.pdf

Partial nationalisation of the new Commerzbank

► **Core capital ratio of the new bank at about 10%**

The German Financial Market Stabilization Fund (SoFFin), Allianz, and Commerzbank intend to strengthen the equity of Dresdner Bank and Commerzbank. Through the planned capital measures, the new Commerzbank will achieve a core capital ratio (Tier 1) of about 10%. The bank is thus expected to fulfil the considerably increased capital requirements for banks prompted by the worsened financial crisis.

► **Additional capital of EUR 10 bn; government is large shareholder with 25% plus 1**

SoFFin intends to make additional capital in the amount of EUR 10 bn available to Commerzbank. That will occur through the issue of about 295 m ordinary shares and a silent capital contribution of about EUR 8.2 bn. A price of EUR 6 per share has been agreed. After the transaction, the federal government will own a stake of 25% plus 1 share in the new Commerzbank.

► **Allianz strengthens capital base of Dresdner Bank by EUR 1.45 bn**

It is also planned that Allianz strengthen the capital base of Dresdner Bank by completing the takeover. That will be accomplished by acquiring CDOs nominally worth EUR 2 bn for a purchase price of EUR 1.1 bn. Under Basel II, that means for the new Commerzbank a discharge of EUR 17.5 bn in risk-weighted assets and will thus release

equity of EUR 700 m. Allianz will continue to make a silent capital contribution of EUR 750 m.

The course has thus been set for the takeover of Dresdner Bank, which is now to be completed on 12 January 2009.

Primary market

Primary market: Jumbo issues of the past two weeks

Issuer	Date	Type	Vol.	Maturity	Coupon	Type	Issue rating	ISIN	Swap Spread*3	
			EUR m		%	*1			M / S&P / F	at issue
BNP Paribas	08/01/09	New issue	1.500	15/01/14	4,125	CB	Aaa / AAA / AAA	FR0010709386	ms +110	ms 96,7
EIB	13/01/09	New issue	3.000	15/04/14	3,125	Agency	Aaa / AAA / AAA	XS0408966199	ms +20	ms 15,1
KfW	13/01/09	New issue	3.000	21/01/19	3,875	Agency	Aaa / AAA / AAA	DE000A0L1CY5	ms +37	ms 34,2
Baden-Württemberg	15/01/09	New issue	2.000	22/01/14	3,250	Länder	Aaa / AA+ / AAA	DE0001040616	ms +35	ms n.a.
Baden-Württemberg	15/01/09	New issue	1.250	22/01/19	4,000	Länder	Aaa / AA+ / AAA	DE0001040624	ms +45	ms n.a.

Sources: BayernLB Research; Bloomberg, Reuters *1-5 explanation see legend p. 19

► Primary market rather sluggish

The pipeline continues to be quite full, but thanks to competition from state-guaranteed bonds (see next page), activity on the primary market has been rather sluggish. Besides the structured covered bond from BNP Paribas, no “genuine” covered bond issuers have emerged on the market. For that, however, EIB, KfW, and the state of Baden-Württemberg have successfully conducted issues.

Primary market: Jumbo issue pipeline

Data are currently provisional or based on estimates

Issuer	Launch expected	Maturity years	Vol. EUR m	Type *1	Issue rating M / S&P / F	Spread talk / news
National Bank of Greece*2		3	2500	GRCB		New issuer
Alpha Bank				GRCB		New issuer
Banca Carige				OBG		New issuer
Bank of Nova Scotia			benchmark	CCB		New issuer; StrCB
Barclays				UKCB		New issuer
Bilbao Bizkaia Kutxa (BBK)			benchmark	CH		New issuer
Caixa Economica Montepic			benchmark	OH		New issuer
Caixa Geral			benchmark	OH		
Coventry Building Society				UKCB	Aaa / - / AAA*5	New issuer
Credit Agricole		medium	benchmark	CB	Aaa / AAA / AAA	New issuer; StrCB
CRH		5	benchmark	CB	Aaa / - / AAA	
Dexia LDG Bank				LDG		
HSBC France			benchmark	CB		New issuer
Intesa Sanpaolo				OBG		New issuer
Kookmin Bank*2			1000	CB		New issuer
Lansfoersaekringar			benchmark	SO		New issuer
Nykredit			benchmark	DKCB		New issuer
SNS			1500	NLCB		New issuer
UBI				OBG		New issuer
WestLB				OEPF	Aaa / AAA / -	
Woori Bank			1000	CB		New issuer

Sources: BayernLB Research; Bloomberg, Reuters *1-5 Explanation see legend p. 19

Primary market state-guaranteed bank bonds

Primary market: State-guaranteed bond issues of the past two weeks

Issuer	Date	Vol.		Maturity	Coupon	Type	Issue rating	ISIN	Swap Spread	
			m							at issue
					%	*	M / S&P / F			
SFEF	07/01/09	5.000	EUR	16/01/14	3,250	FR Govt Gtee	Aaa/AAA/AAA	FR0010709253	ms +15	ms 17,1
BES	08/01/09	1.500	EUR	19/01/12	3,750	PT Govt Gtee	Aa2 / AA-AA	PTBEMPOE0018	ms +100	ms 98,4
Commerzbank	08/01/09	5.000	EUR	13/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	DE000CB896A7	ms +30	ms 20,9
BCP	12/01/08	1.500	EUR	19/01/12	3,625	PT Govt Gtee	Aa2 / AA-AA	PTBCP9OM0051	ms +100	ms 99,1
HSHN	12/01/09	3.000	EUR	20/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	DE000HSH2539	ms +28	ms 23,2
Danske	14/01/09	3.000	EUR	21/09/10	2,500	DK Govt Gtee	Aaa/AAA/AAA	XS0409220836	ms +40	ms 20,2
BayernLB	15/01/09	5.000	EUR	23/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	DE000BLB5N07	ms +28	ms n.a.

Sources: BayernLB Research; Bloomberg

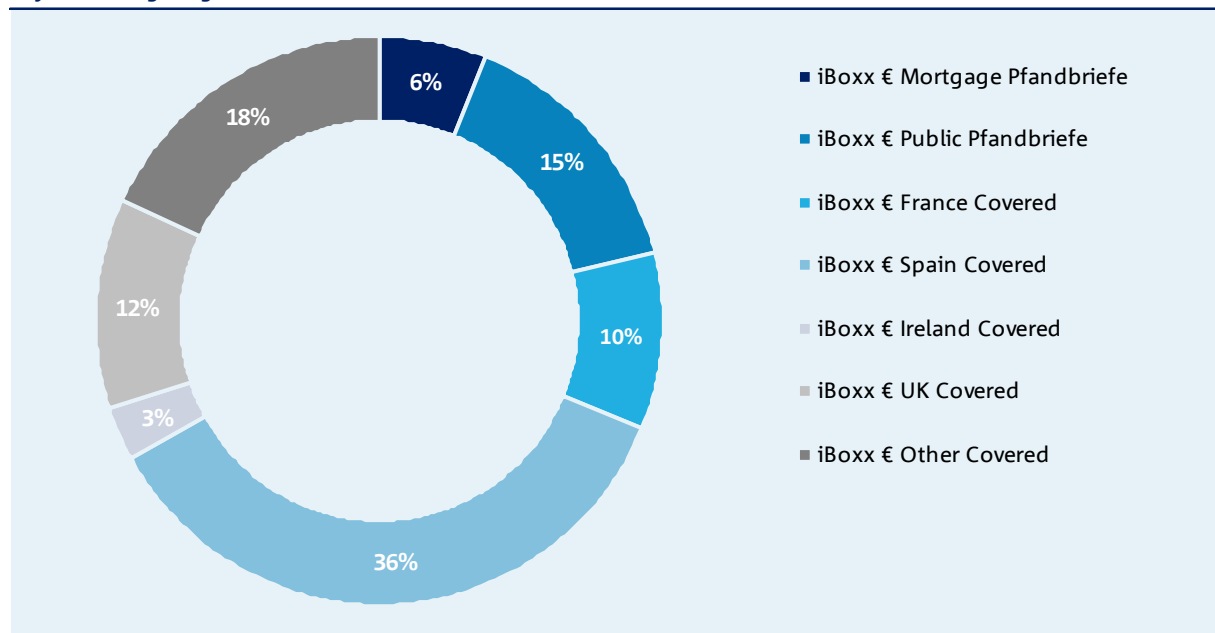
BayernLB Covered Bond Portfolio

Duration-adjusted weighting recommendations for covered bonds

Index	iBoxx	BayernLB	iBoxx	BayernLB	BayernLB	change
	weight	weight	modified duration	modified duration	weight duration-adj.	
iBoxx € Germany Covered	28,0%	21,0%	2,79	2,79	14,5%	1,3%
iBoxx € Mortgage Pfandbriefe	8,5%	6,0%	3,02	3,02	4,5%	0,0%
iBoxx € Public Pfandbriefe	19,3%	15,0%	2,70	2,70	10,0%	1,3%
iBoxx € France Covered	17,7%	10,0%	4,06	4,06	10,0%	10,0%
iBoxx € Spain Covered	30,9%	36,0%	5,34	7,00	62,1%	-7,7%
iBoxx € Ireland Covered	3,2%	3,0%	4,19	4,19	3,1%	0,1%
iBoxx € UK Covered	7,2%	12,0%	4,76	5,50	16,3%	-7,8%
iBoxx € Other Covered	13,1%	18,0%	3,00	3,00	13,3%	-0,7%
iBoxx € Covered	100,0%	100,0%	4,06	4,84	119,3%	-4,8%
Duration neutralisation*				7,56	-19,3%	4,8%
BayernLB Covered Bond Portfolio*				4,06	100,0%	0,0%

Sources: BayernLB Research; Datastream *Neutralisation of duration differences by means of Bund future contracts

BayernLB weighting recommendations for covered bonds



Source: BayernLB Research

Selected issuers

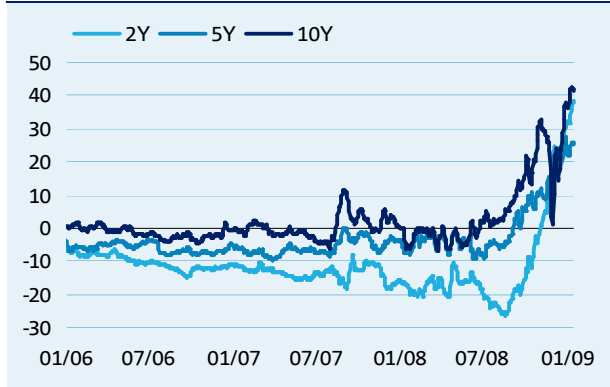
Issuer	Date	Recommendation previous	Recommendation current	Comments
Aareal Bank ^{2,3,4}	26.06.08	neutral	neutral	Portfolio of private housing loans in the amount of EUR 1.47 bn sold to Deutsche Postbank. Focus on core business (financing commercial real estate) is positive for future business development.
DG Hyp	26.06.08	underweight	slightly overweight	Emphasis of credit portfolio in (eastern) Germany; mortgage portfolio: mainly in small-business loans; public-sector portfolio: hardly any loans to national government, mainly local government level
Dt Hyp ^{2,3,4}	26.06.08	neutral	neutral	Due to the merger with NordLB, the credit portfolio should benefit from increasing diversification resulting from different business models.
Eurohypo ²	26.06.08	slightly overweight	slightly overweight	Because of the integration of Hyp Essen, the outstanding covered bonds of the two institutions will probably quote under the name Eurohypo in the future. We do not expect any immediate spread reactions, but the cover pools of the two issuers should benefit in the long run from being combined in virtue of growing diversification.
Hyp Essen ²	26.06.08	slightly overweight	neutral	Because of the integration into Eurohypo, the outstanding covered bonds of the two institutions will probably quote under the name Eurohypo in the future. We do not expect any immediate spread reactions, but the cover pools of the two issuers should benefit in the long run from being combined in virtue of growing diversification.
HRE Bank ² , HRE Bank Int. ^{2,3,4}	02.10.08	overweight	neutral	In view of the current turmoil surrounding Hypo Real Estate (package of emergency measures) and the huge widening of spreads, we are lowering our recommendation from "overweight" to "neutral". Investors inclined to take risks should use the current spread levels for selective buying.
Münchener Hyp ^{2,3,4}	26.06.08	overweight	slightly underweight	Strong regional concentration on Bavaria, excellent asset quality, low risk profile, low proportion of commercial construction loans in total business

^{2,3,4}: Please note the conflicts of interest on the last pages

Sources: BayernLB Research; Benchmark iBoxx Covered Germany

Secondary market

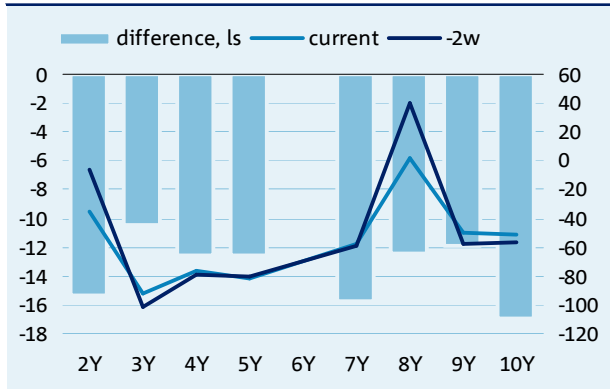
Jumbo swap spreads bp



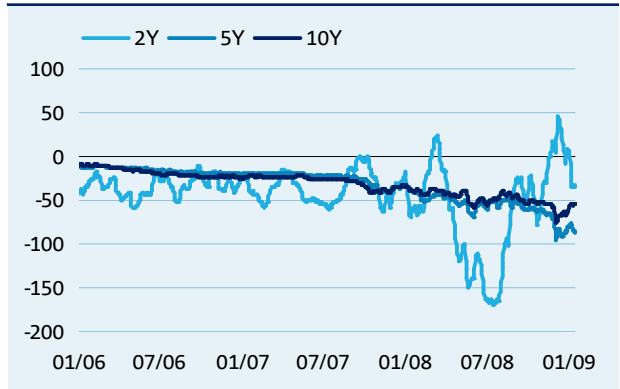
Jumbo Bund spreads bp



Bund swap curve (bp)

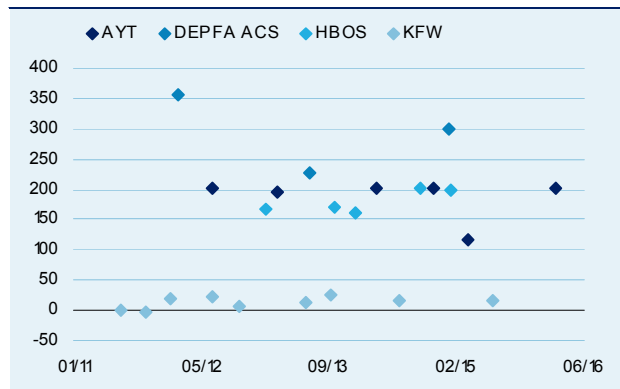
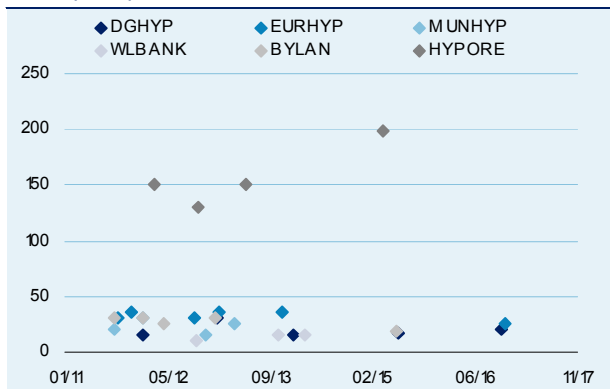


Bund swap spread development (bp)



Sources: BayernLB Research; Bloomberg

Credit curve of selected issuers vs. swap in bp



Source: BayernLB Research

BayernLB: Managing jumbo issues

Issuer	Date	Vol. EUR m	Maturity	Coupon %	Type *1	Issue rating M / S&P / F	ISIN	Swap Spread*3			
								at issue	current	-2w	
SEB AG	04.04.07	1.000	14.04.09	4,000	HYPF	Aaa / - / -	Joint Lead	DE000SEB0H25	-9,5	-6,3	23,7
Münchener Hyp	12.09.06	1.500	21.09.09	3,750	OEPF	Aaa / - / -	Joint Lead	DE000MHB01J2	-6,0	-42,5	-6,0
Essen Hyp	10.11.05	1.500	17.02.10	3,000	OEPF	Aaa / AAA / AA+	Co Lead	DE000HBE0E62	-2,0	-21,8	-6,2
WL-Bank	20.04.05	1.000	01.03.10	2,750	OEPF	- / AAA / -	Joint Lead	DE000A0EC859	-3,0	-30,4	2,2
BNP Paribas	15.03.07	2.000	22.03.10	4,000	CB	Aaa / AAA / AA+	Co Lead	FR0010451393	-5,0	27,0	-4,1
BayernLB	21.03.06	1.500	29.03.10	3,500	OEPF	Aaa / AAA / AA+	Joint Lead	DE000BLB2WU9	-4,0	-3,6	16,1
Hypo Re Int.	15.04.08	1.000	22.04.10	4,250	HYPF	Aa2 / AAA / -	Joint Lead	DE000A0SM1A7	+9	107,9	3,2
BAWAG	08.06.05	1.000	15.06.10	2,500	ACB	Aaa / - / -	Joint Lead	XS0222014507	-2	59,7	-8,9
HSH Nordbank	21.06.07	1.000	28.06.10	4,625	OEPF	Aaa / - / -	Joint Lead	DE000HSH2K85	-9,5	24,9	6,8
Essen Hyp	28.06.05	1.000	05.07.10	2,635	OEPF	Aaa / AAA / AA+	Co Lead	DE000HBE0E0	-2,0	16,4	-6,8
AHBR	07.09.05	1.000	14.09.10	2,500	HYPF	Aa3 / AAA / AA+	Co Lead	DE000A0BVA14	4,0	44,6	13,9
Länder Nr. 22	29.09.05	1.000	07.10.10	2,625	Länder	- / - / AAA	Co Lead	DE0001240216	-3	-5,9	-13,0
Deutsche Hypo	02.02.05	1.000	09.02.11	3,000	OEPF	Aaa / AAA / -	Joint Lead	DE0002538758	-1,0	18,7	-0,5
Länder Nr. 21	23.06.05	1.000	29.06.11	2,750	OEPF	- / - / AAA	Co Lead	DE0001240208	-2,5	7,7	17,7
NRW	28.10.05	500	15.11.11	3,000	Länder	Aa2 / AA- / AAA	Co Lead	DE000NRW1X15	-2,5	3,0	-3,8
Essen Hyp	13.02.07	1.500	21.11.11	4,000	OEPF	Aaa / AAA / AA+	Co Lead	DE000HBE1NT5	-3,5	41,3	2,4
DKB	21.11.06	1.000	29.11.11	3,750	OEPF	Aaa / - / -	Joint Lead	DE0003678421	-4,0	29,6	-14,3
BNP Paribas	06.12.06	2.500	13.12.11	3,750	CB	Aaa / AAA / AA+	Co Lead	FR0010398347	-2,0	58,3	4,5
BayernLB	11.04.08	1.500	16.01.12	4,000	OEPF	Aaa / AAA / AA+	Joint Lead	DE000BLB3791	1,0	29,6	4,8
BSCH	27.01.05	2.000	07.02.12	3,250	CH	Aa1 / - / AA+	Co Lead	ES0413900079	7,0	81,3	3,7
Nationwide	21.02.07	2.000	27.02.12	4,125	UKCB	Aaa / AAA / AA+	Co Lead	XS0289011271	-1,0	132,7	2,7
Länder Nr. 20	22.02.05	1.500	28.02.12	3,375	Länder	- / - / AAA	Joint Lead	DE0001240190	-1,5	13,3	4,6
SEB AG	27.02.07	1.000	06.03.12	4,000	OEPF	Aaa / - / -	Joint Lead	DE000SEB1P32	-6,0	18,7	-8,6
HRE Bank	08.03.05	1.500	16.03.12	3,250	HYPF	Aa3 / - / AA+	Co Lead	DE000A0C43T6	+5	125,0	-11,1
Bayern LB	25.04.07	1.000	02.05.12	4,250	OEPF	Aaa / AAA / AA+	Joint Lead	DE000BLB2348	-7,0	31,3	10,1
Spk Köln Bonn	05.06.07	500	12.06.12	4,500	OEPF	Aaa / - / -	Co Lead	DE0005K0AAB3	-4,0	30,3	1,6
Caixa Geral	20.06.07	2.000	28.06.12	4,625	OH	Aaa / AAA / AA+	Co Lead	PTCGFC1E0029	-2,0	107,8	24,4
NRW	26.07.07	750	15.08.12	4,625	Länder	Aa1 / AA- / AAA	Joint Lead	DE000NRW1055	-7,0	19,4	-1,1
Essen Hyp	21.09.06	1.200	28.09.12	3,750	OEPF	Aaa / AAA / AA+	Joint Lead	DE000HBE1LM4	-4,0	21,4	-11,8
Münchener Hyp	16.11.05	1.000	23.11.12	3,250	HYPF	Aaa / - / -	Co Lead	DE0002158946	-1	21,5	2,8
Freist. Bayern	22.06.05	1.250	21.01.13	3,375	Länder	Aaa / AAA / AA+	Joint Lead	DE0001053205	-5,5	-16,1	5,4
Länder 23	26.01.05	1.500	06.02.13	3,375	Länder	- / - / AAA	Joint Lead	DE0001240224	-3,0	11,4	14,9
HRE Bank	24.05.06	1.250	31.05.13	3,750	HYPF	Aa3 / - / AA+	Co Lead	DE000A0JFHLO	2,0	133,7	-8,2
WL Bank	10.11.06	1.000	04.11.13	3,750	OEPF	- / AAA / -	Joint Lead	DE000A0KAA75	-4,0	19,9	1,5
Essen Hyp	14.11.06	1.000	21.11.13	3,750	OEPF	Aaa / AAA / AA+	Co Lead	DE000HBE1MM2	-1,0	29,9	1,8
Berlin	26.10.05	500	15.01.14	3,250	Länder	Aa3 / AAA / AA+	Joint Lead	DE000A0E9XV9	-1,0	20,8	12,1
Freist. Bayern	10.01.06	1.000	16.01.14	3,125	Länder	Aaa / AAA / AA+	Joint Lead	DE0001053213	-6,5	0,1	15,2
Länder 26	18.01.07	1.250	24.01.14	4,125	Länder	- / - / AAA	Joint Lead	DE0001240257	-6,5	21,5	18,6
Land RP	06.04.06	750	01.04.14	4,000	Länder	- / - / AAA	Joint Lead	DE0001731495	0,0	20,1	15,6
BayernLB	01.06.05	1.250	08.06.15	3,250	OEPF	Aaa / AAA / AA+	Joint Lead	DE000BLB1YQ5	-2,0	20,3	4,8
Eurohypo	19.10.05	2.000	26.10.15	3,250	HYPF	Aa1 / AAA / AA+	Co Lead	DE000EH0A2E9	1,0	33,5	2,0
Nationwide	29.11.05	2.000	07.12.15	3,500	UKCB	Aaa / AAA / AA+	Co Lead	XS0237259329	+8	142,3	15,4
Niedersachsen	15.02.06	1.500	22.02.16	3,500	Länder	- / - / AAA	Co Lead	DE0001590644	-2,5	22,7	18,2
Deutsche Hypo	11.05.06	1.250	18.05.16	4,250	HYPF	Aaa / - / -	Joint Lead	DE000DHY1AA6	flat	36,4	14,0
Essen Hyp	14.11.06	1.000	21.11.16	3,875	OEPF	Aaa / AAA / AA+	Co Lead	DE000HBE1MP5	-2,0	24,3	-1,9
Bayern	09.01.07	1.000	16.01.17	4,125	Länder	Aaa / AAA / AA+	Joint Lead	DE0001053221	-9,0	14,7	12,4
Banco Sabadell	09.01.07	1.500	24.01.17	4,000	CH	Aaa / - / -	Co Lead	ES0413860067	8,0	121,4	6,1
NRW	28.02.05	500	03.03.17	3,750	Länder	Aa2 / AA- / AAA	Joint Lead	DE000NRW1V17	-1	15,6	7,8
BHH	21.03.07	1.000	28.03.17	4,125	OEPF	Aaa / AAA / -	Co Lead	DE000A0NKTQ6	flat	23,4	5,6
Berlin	19.06.07	1.250	26.06.17	4,875	Länder	Aa1 / - / AAA	Co Lead	DE000A0NKUD2	-3,5	28,1	15,7
Eurohypo	27.05.08	1.000	04.06.18	4,750	HYPF	Aaa / AAA / AA+	Co Lead	DE000EH094Y1	13,0	40,2	5,7

Sources: BayernLB Research; Bloomberg; Reuters *1-5 Explanation see page 19

BayernLB: Managing state-guaranteed bond issues

Issuer	Date	Vol.	Maturity	Coupon	Type	Issue rating		ISIN	Swap Spread* ³		
		EUR m		%					M / S&P / F	at issue	current
Commerzbank	08/01/09	5.000	13/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	Joint Lead	DE000CB896A7	30,0	22,2	n.a.
HSHN	12/01/09	3.000	20/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	Joint Lead	DE000HSH2539	28,0	19,5	n.a.
BayernLB	15/01/09	5.000	23/01/12	2,750	GE Govt Gtee	Aaa/AAA/AAA	Joint Lead	DE000BLB5N07	28,0	n.a.	n.a.

Sources: BayernLB Research; Bloomberg

Performance

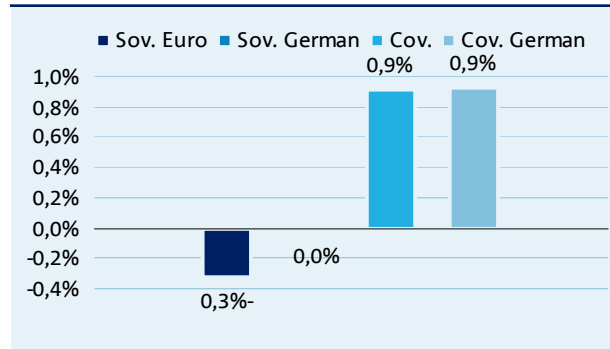
iBoxx indices: Comparison of total returns (%)

	YTD	-12m	-1m	-2w	weighting	duration mod.	Ø time to maturity
	01.01.08						
iBoxx € Sovereigns Eurozone	8,78	7,06	1,73	-0,32	100,0%	5,95	8,41
iBoxx € Sovereigns Germany	12,14	10,31	2,19	-0,03	23,7%	5,87	7,84
iBoxx € Sub-Sovereigns	8,45	6,74	2,19	0,87	100,0%	4,35	5,44
iBoxx € Sub-Sov. Public Banks	8,48	6,77	2,07	0,91	12,2%	3,95	4,61
iBoxx € Sub-Sov. Regions	9,67	7,87	1,71	0,60	19,1%	4,53	5,90
iBoxx € Sub-Sov. Supranationals	10,01	8,07	2,38	0,56	14,8%	5,24	6,89
iBoxx € Collateralized	6,71	5,11	2,06	0,91	100,0%	4,04	5,11
iBoxx € Covered	6,82	5,23	2,09	0,91	96,1%	4,06	5,13
iBoxx € Germany Covered	7,98	6,67	1,99	0,93	28,0%	2,79	3,14
iBoxx € Hypothekenpfandbriefe	8,40	6,92	2,13	0,99	30,5%	3,02	3,41
iBoxx € Öffentliche Pfandbriefe	7,81	6,56	1,94	0,90	69,0%	2,70	3,04
iBoxx € France Covered	7,68	5,94	2,19	0,82	17,7%	4,06	5,06
iBoxx € Ireland Covered	3,41	1,80	2,28	0,88	3,2%	4,19	5,01
iBoxx € UK Covered	4,74	3,08	2,39	1,29	7,2%	4,76	6,08
iBoxx € Spain Covered	6,08	4,28	2,12	0,87	30,9%	5,34	7,16
iBoxx € Other Covered	7,15	5,57	1,77	0,95	2,2%	3,00	3,47

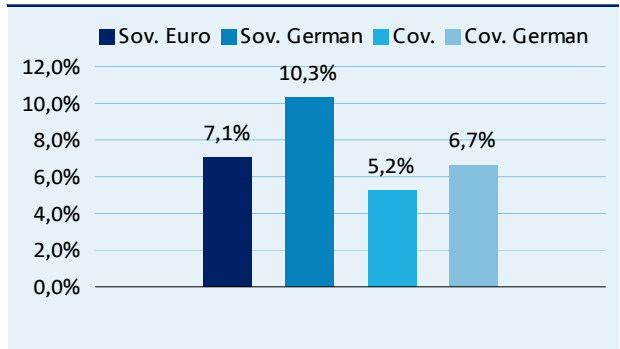
Sources: BayernLB Research; Datastream; iBoxx

Jumbo covered bonds compared with sovereigns

2 weeks change

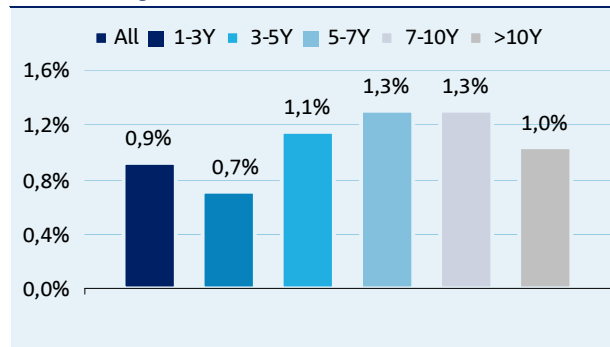


12 months change



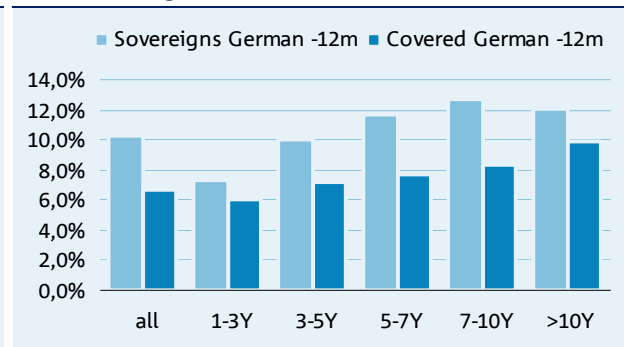
Jumbo Pfandbriefe by maturity

2 weeks change



Jumbo Pfandbriefe versus Bunds

12 months change



Sources: BayernLB Research; Datastream; iBoxx

Legend

* ¹ Covered bond type	
ACB	Fundierte Bankschuldverschreibung (Austrian Covered Bond);
ACS	Asset covered security
CH	Cédulas hipotecarias
CT	Cédulas territoriales
FICB	Finnbrief (Finnish covered bond)
HYPF	Hypothekpfandbrief (mortgage Pfandbrief)
ICB	Italian covered bond (≠ Obbligazioni Bancarie Garantite)
NorCB	Obligasjoner med Fortrinnsrett (Norwegian Covered Bond)
OEFP	Öffentlicher Pfandbrief (public-sector Pfandbrief)
OF	Obligations foncières
OH	Obrigações hipotecárias
SO	Säkerställda obligationer (Swedish covered bond)
Str CB	Structured covered bond
UKCB	UK covered bond
* ²	New!
* ³	At issue: reoffer; current: offer
* ⁴	With participation of BayernLB
* ⁵	Expected rating
* ⁶	Cheap / expensive analysis on a Z-score basis

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The current prices/yields in this issue are based upon closing prices from BayernLB as of the day preceding publication.

Updating will be provided depending on circumstances; advance notice will be given when coverage is discontinued.

Valuation methods and principles

Valuation method

The investment suggestions for covered bonds made by BayernLB's Fixed Income Research are based primarily on a valuation of the issuer and in particular of the cover pool provided and administered by the issuers. The protective mechanisms of country-specific laws are of key importance for the quality of a cover pool. In addition, the asset quality of the cover pool is analysed. The decisive factors are the diversification by regions, ultimate debtors, and property types, the granularity of the cover pool, the matching of maturities between outstanding covered bonds and cover pool, the nominal and net-present-value over collateralisation and its robustness against interest rate changes, and the extent of problem loans. Finally, an assessment of the issuer's ability to manage the dynamic cover pool in the medium and long term and the issuer's rating flow into the analysis. The final valuation is arrived at only after a comparison of the fundamental valuations of the issuers relative to each other with the spreads paid for these issuers or their spread curve.

On the other hand, selecting the bonds of a single issuer plays a subordinate role, as that brings to the fore short-term "relative-value" considerations, the tax treatment, and the liquidity of individual issues.

Time frame of investment recommendations:

Investment horizon	Short term =	2 to 4 weeks
	Medium term =	4 weeks to 3 months
	Long term =	3 to 12 months

Reference is made in the recommendation to the respectively appropriate investment horizon.

Recommendation system

The credit spread is the key point of the recommendation system. A credit spread is the difference between the yield of a covered bond (specific credit quality) and the yield of a benchmark government bond of the highest credit rating and as far as possible the same maturity/duration. When investing in covered bonds subject to credit risk, the danger exists that the issuer might not meet its obligations to the creditor, i.e., payment of the bond's interest or principal, on time, in full, or at all because of economic difficulties despite extensive protection measures. For the bondholder, it is therefore of great importance to be compensated sufficiently for the additional credit risk by way of the credit spread.

Overweight: The spread-duration-weighted exposure in this issuer's covered bonds should be above the corresponding exposure in the iBoxx Covered Index or a comparable alternative index. BayernLB expects that the issuer's covered bonds (duration-adjusted) will generate a higher return than the index average (outperformance). In addition to the level of current interest paid (carry), the relatively better development of the credit spread plays a crucial role in that.

Outperformance occurs when the credit spread of the recommended issuer or its covered bonds tightens more in a market environment that is positive for covered bonds, or widens less in a market environment that is negative for covered bonds, in relation to comparable issuers/covered bonds in the index.

Neutral: The spread-duration-weighted exposure in this issuer's covered bonds should match the corresponding exposure in the iBoxx Covered Index or a comparable alternative index. BayernLB expects that the issuer's covered bonds (duration-adjusted) will generate a similar return in relation to the index average.

Underweight: The spread-duration-weighted exposure in this issuer's covered bonds should be below the corresponding exposure in the iBoxx Covered Index or a comparable alternative index. BayernLB expects that the issuer's covered bonds (duration-adjusted) will generate a lower return than the index average (underperformance). In addition to the level of current interest paid (carry), the relatively poorer development of the credit spread plays a crucial role in that. Outperformance occurs when the credit spread of the recommended issuer or its covered bonds tightens more in a market environment that is positive for covered bonds, or widens less in a market environment that is negative for covered bonds, in relation to comparable issuers/covered bonds in the index.

Previous divergent Recommendation (during the last 12 months)

12.06.2008	Covered Bond Report	Overweight	Münchener Hypothekbank eG
18.09.2008	Covered Bond Report	Overweight	Hypo Real Estate Bank

Distribution of Recommendations

Distribution of all recommendations over the last three months, compared to the recommendations for those companies, for which investment banking services over the past 12 months had been carried out.

Distribution of all recommendations

Buy	Overweight	Hold	Neutral	Sell	Underweight
47%	3%	27%	8%	11%	4%

Distribution of all recommendations for those issuers, for which investment banking services over the past 12 months had been carried out

Buy	Overweight	Hold	Neutral	Sell	Underweight
50%	4%	15%	11%	12%	8%

The distribution is based on all recommendations of BayernLB Research for equity, corporate-, covered-, and government bonds.

Notes on potential conflicts of interest:

AAreal Bank AG:	3), 4)
Depfa ACS Bank:	-
DePfa Deutsche Pfandbriefbank AG:	-
Deutsche Genossenschafts-Hypothekbank AG:	-
Deutsche Hypothekbank AG:	2)
Eurohypo AG:	2)
Hypo Real Estate Bank:	2)
Hypo Real Estate International:	2), 3), 4)
Kommunalkredit Austria AG:	2)
Münchener Hypothekbank eG:	2)

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- 4) Bayerische Landesbank and/or its affiliate(s) received compensation for the rendering of investment banking services to the issuer or was/were bound to a corresponding agreement within the past 12 months.

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