

Mortgage
Germany
Credit Analysis

Bayerische Landesbank - Mortgage Pfandbriefe

Ratings

Securities	Rating
Mortgage Pfandbriefe	AAA

Pool Key Data

03 Dec 07

Cover assets (EURbn)	6.42
Covered bonds (EURbn)	5.54
Nominal overcollateralisation (OC, %)	15.82
Weighted-average asset maturity (years)	5.25
Weighted-average liability maturity (years)	3.32
Floating-rate assets (% of cover assets)	16.91
Floating-rate covered bonds (% of cover assets)	9.89
D-Factor (%)	11.7

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Related Research

- ["Fitch Launches New Covered Bonds Rating Methodology", dated 19 February 2007](#)
- ["Covered Bonds Rating Criteria – Stop or Continue?", dated 13 July 2006](#)
- ["Credit Analysis on Bayerische Landesbank", dated 19 September 2007](#)
- ["2007 Comparative Study of Covered Bonds", dated 12 October 2007](#)

Rating Rationale

- The mortgage Pfandbriefe of Bayerische Landesbank (BayernLB) are rated 'AAA'. This rating is based on BayernLB's Long-Term Issuer Default Rating (IDR) of 'A+' (Stable Outlook), on a Discontinuity Factor (D-Factor) of 11.7%, and on the conclusions drawn from Fitch Ratings' assets and cash flow analysis.
- The rating also takes into account the overcollateralisation (OC) between the cover assets and the covered bonds. The agency ascertained the lowest nominal OC over the last 12 months to be sufficient to withstand a 'AAA' scenario applied to the credit risk of the assets and to the assets and liabilities mismatches.
- All else being equal, BayernLB's covered bonds rating could be maintained at 'AAA' (based on the probability of default of the covered bonds and on recoveries from the cover pool in case of a default of the covered bonds) if the issuer is rated at least 'BBB'.

Credit Committee Highlights

- BayernLB's public commitment to manage liquidity of the cover pool to offset the maximum liquidity gap for the next 180 days on a daily basis was positively taken into consideration in the liquidity section sub-score of the D-Factor.
- BayernLB's data delivery indicates good reporting standards and this has been factored into Fitch's assessment of the alternative management sub-score of the D-Factor.
- Since December 2006, the commercial mortgage loan part of BayernLB's cover pool has grown by 23%, in line with the bank's policy to increase the part of the cover pool assets backed by commercial properties.
- BayernLB's mortgage cover pool includes a relatively low number of split loans due to the amortisation of the loan parts outside the pool.
- There are no privileged swaps registered in the mortgage cover pool.

Issuer Background

- BayernLB (rated 'A+'/'F1+'/Stable Outlook) is Germany's eighth-largest bank by equity and its second-largest Landesbank. The bank is 100%-owned by BayernLB Holding AG, which in turn is owned by the state of Bavaria (50%) and the association of Bavarian savings banks (50%).
- BayernLB is the central bank for the 75 Bavarian savings banks and banker to the Bavarian government. It owns 75.1% of Landesbank Saar, 89.6% of MKB Bank Nyrt, 100% of Deutsche Kreditbank and 57.31% of the Austrian Hypo Group Alpe Adria.
- At the beginning of December 2007, BayernLB's outstanding mortgage Pfandbriefe totalled EUR5.54bn. Together with the public sector Pfandbriefe issued by BayernLB, covered bonds funding represented 15.58% of the bank's total balance sheet at end-June 2007.

D-Factor components

- Asset Segregation (50%)
- Liquidity Gaps (30%)
- Alternative Management (15%)
- Covered Bond Oversight (5%)

Continuity Analysis

Under Fitch's rating methodology, the covered bonds rated by the agency are assigned a D-Factor between 0% (best) and 100% (worst). This reflects the likelihood that they will default in the immediate aftermath of a default by the issuer. The D-Factor has four weighted elements.

Asset Segregation (50%)

In the agency's view, German Pfandbrief law ensures that the assets recorded on the dedicated register will be available for covered bond investors in the event of their issuer's insolvency, although residual uncertainty remains with respect to the interpretation of OC in excess of the regulatory limit but which is deemed to be obviously not necessary.

Liquidity Gaps (30%)

Fitch analyses liquidity gaps, defined as the difference between the revenues from the cover assets and the payments due to covered bond investors, shortly after an assumed issuer's default. The unstressed expected cash flows from BayernLB's assets and the issued Pfandbriefe display some shortfalls after the first quarter. However, the agency believes the liquid assets in the cover pool are sufficient to offset these. BayernLB has publicly committed itself to manage liquidity in such a way that the maximum liquidity gap for the next 180 days is covered by additional liquid assets.

Alternative Management (15%)

The fact that the German banking authorities must appoint a substitute manager (Sachwalter) for the cover pool, at latest upon the insolvency of the issuer, provides comfort that the cover pool could be managed without interruption. Despite BayernLB's inclusion of split loans in the mortgage pool, the structure of the pool is not overly complex, with only 7.3% of the loans backed by foreign properties. Fitch believes any transition to a substitute manager for BayernLB's mortgage pool would be facilitated by the cover pool's management IT systems, which are also used by several other German Pfandbrief issuers.

Covered Bond Oversight (5%)

In terms of a dedicated covered bond oversight, Fitch considers the extent of monitoring exercised by the German banking authorities on Pfandbrief issuers to be exemplary.

Fitch assigned BayernLB's mortgage covered bonds a D-Factor of 11.7%. Taking into account its IDR of 'A+', the mortgage Pfandbriefe can achieve a rating of 'AAA' on a probability-of-default (PD) basis (see *Appendix 2*). The agency carried out a cash flow analysis to determine whether the minimum nominal OC over the past 12 months was sufficient to withstand the credit risk of the cover pool, and the maturity, interest rate and currency mismatches between the cover pool and the covered bonds in a 'AAA' stress scenario.

Cover Pool

On 3 December 2007, BayernLB's outstanding mortgage Pfandbriefe amounted to EUR5.54bn and were backed by a pool of assets with a total value of EUR6.42bn, resulting in nominal OC of 15.82%.

The country breakdown shows that 92.7% of BayernLB's pool is concentrated in Germany. In line with the bank's business model, there is a

Table 1: Cover Assets by Country

Country	(%)
Germany	92.67
England	4.5
Poland	1.49
Switzerland	0.91
Austria	0.43
Total	100.00

Source: BayernLB's data, calculations by Fitch

considerable concentration of loans backed by properties located in Bavaria (54.12%) - where the bank has its main focus - and in the state of North-Rhine Westphalia (11.8%), the demographically strongest German state. The cover pool is also characterised by a relatively low exposure to eastern Germany (14.1%).

Loans secured by commercial and large residential mortgages account for around 64.8% of the cover pool, while residential loans secured on properties worth less than EUR1m and substitute assets (bonds) represent 30.5% and 4.7%, respectively.

Within the commercial real estate, office and retail properties add up to 65.5% of the sub-pool and lending to riskier types, like uncompleted properties or mortgages secured by land, is insignificant.

Owner-occupied housing accounts for the majority of the residential sub-pool (51.2%). A large part of the residential loans (62.8%) are backed by properties situated in Bavaria, whereas only 11.3% of this sub-pool is exposed to the former East German States. While residential loans are nearly exclusively granted to German borrowers (99.9%), 13% of the commercial sub-pool is backed by foreign properties.

In a 'AAA' scenario, Fitch assumed a pool's weighted average cumulative frequency of foreclosure (WAFF) of 31.94%, as well as a full recovery on defaulted cover assets (weighted average recovery rate, WARR).

Cash Flow Analysis

Fitch's covered bonds cash flow model compares stressed revenues from the cover assets to the interest and principal payments due on the Pfandbriefe in a wind-down scenario, where a third party would act as substitute manager. Based on the assumed cover pool's WAFF and WARR and on the current nominal OC of 15.82%, the pool withstands the 'AAA' stress levels on a probability of default basis.

Maturity Mismatches

The residual weighted-average maturities of the assets and liabilities are 5.25 and 3.32 years respectively, indicating maturity mismatches slightly higher than those of other German peers. The chart below compares the scheduled nominal amount of the cover pool with the residual amount of mortgage Pfandbriefe over time.

Table 2: Cover Assets by German Federal States

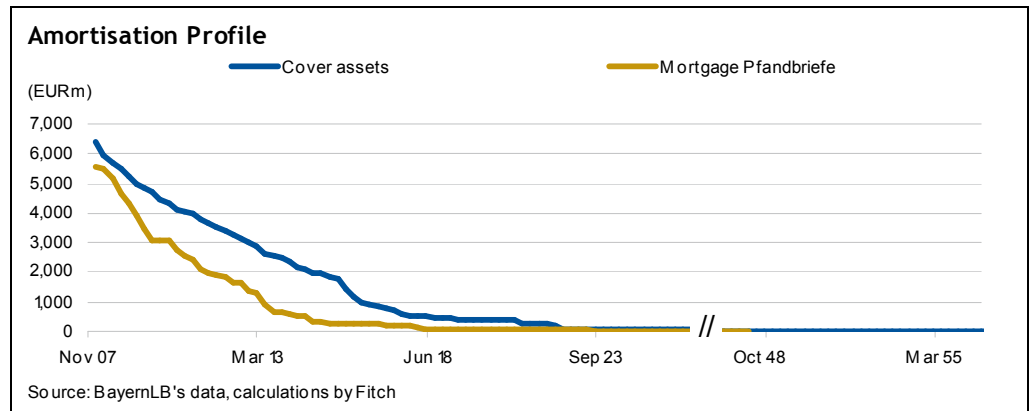
State	(%)
Bavaria	54.12
North-Rhine Westphalia	11.8
Hesse	8.79
Berlin	6.02
Baden-Württemberg	4.16
Saxony	3.03
Hamburg	2.71
Brandenburg	2.39
Lower-Saxony	2.14
Thuringia	1.51
Rhineland-Palatinate	0.99
Schleswig-Holstein	0.94
Mecklenburg-Vorpommern	0.86
Saxony-Anhalt	0.28
Saarland	0.15
Bremen	0.11
Total	100.00

Source: BayernLB's data, calculations by Fitch

Table 3: Commercial Lending by Property Type

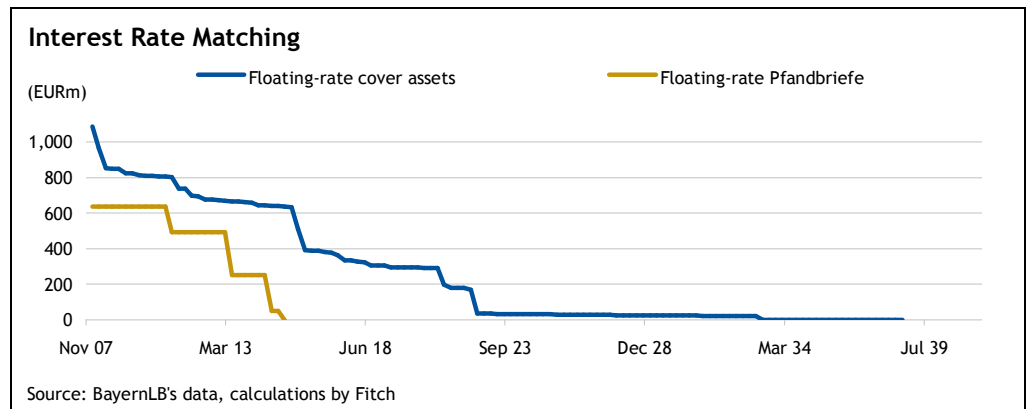
Office	40.48
Retail	25.07
Large residential	16.98
Other	7.78
Industrial	4.18
Land/uncompleted	3.47
Hotels, inns	2.04
Total	100.00

Source: BayernLB's data, calculations by Fitch



Interest Rate Mismatches

Fitch tested the cash flows by simulating both increasing and decreasing interest rate environments. The floating-rate cover assets exceeded the floating-rate Pfandbriefe by 7 % as at 3 December 2007. Consequently, in a cover pool wind-down situation following an issuer default, covered bonds investors would be exposed to the risk of reduced interest proceeds from the cover assets relative to the cost of covered bonds if interest rates declined.



Currency Mismatches

Most of the assets (92.4%) and liabilities (94.8%) are EUR-denominated. For the remaining currencies (CHF, GBP, JPY), the bank's policy is to apply natural hedging to minimize currency risk. As a result, only minor currency risk exists.

No swaps are included in the cover pool.

The cash flows were tested with the minimum nominal OC for the last 12 months, which was the current OC of 15.82%. Fitch's cash flow analysis shows that this OC is sufficient to withstand the 'AAA' level of stresses applied to the credit risk of the cover assets, and to the maturity, interest and currency mismatches between the mortgage cover pool and the related Pfandbriefe.

Conclusion

Under Fitch's covered bond methodology, BayernLB's mortgage Pfandbriefe achieve a 'AAA' rating on a probability of default basis. This result is based on BayernLB's IDR of 'A+', on a D-Factor of 11.7% and on the conclusions drawn from Fitch's assets and cash flow analysis. The agency will continue to monitor BayernLB's mortgage cover pool and the related Pfandbriefe, the profile of which may change over time.

Appendix 1: Main characteristics of German Pfandbriefe

Main characteristics of German Pfandbriefe

Covered bonds type	Legislation-based
Legal background	The German Pfandbrief Act (PfandBG) as of 19 July 2005
Issuer	Banks which hold a licence to issue Pfandbriefe
Cover register	Yes
Eligible collateral	<ul style="list-style-type: none"> Mortgage loans to EEA countries, Switzerland, the US, Canada and Japan. Residential and commercial mortgage loans are subject to a 60% maximum loan-to-mortgage-lending-value limit. Public sector assets to central governments and sub-sovereigns with a maximum 20% risk weighting in EEA countries, Switzerland, the US, Canada and Japan. Loans secured by a ship or shipbuilding. Mortgage/public sector loans from non-EU countries, in which the preferential claim of the Pfandbrief holder is not recognised, are only allowed to account for 10% of the sum of total EU mortgage/public sector loans in countries with a preferential claim.
Minimum overcollateralisation (OC)	<ul style="list-style-type: none"> The nominal value of the cover assets must permanently be higher than the total value of the Pfandbriefe and the interest income and interest expenses must be at least the same. 2% legally protected OC on a net NPV basis, after the effects of regulatory interest rate and currency stresses. According to §30 (4) PfandBG, the insolvency administrator may at any time demand that recorded assets, which will obviously not be necessary as cover for the respective Pfandbrief category and for the “securing OC” (ie, the mandatory OC), shall be surrendered to the insolvency estate by the cover pool administrator.
Substitute assets	The share of substitute collateral is restricted to a maximum of 20% of the total volume of outstanding mortgage and shipping Pfandbriefe among which 10% can consist of liquid assets. For public sector Pfandbriefe, this ratio may also not exceed 10%.
Cover pool monitor	Independent trustee appointed by the German regulator, BaFin.
Substitute manager	A dedicated cover pool administrator (Sachwalter), other than the insolvency administrator, will take over the management of the cover assets and outstanding liabilities. He will be appointed at the request of BaFin at the latest upon insolvency.

Source: Fitch

Appendix 2: Discontinuity Factor Matrix

Maximum Achievable Rating of Covered Bonds on a Probability of Default Basis

Issuer Default Rating (IDR)	5 yrs PD (%)	D-Factor												
		90.0%	80.0%	70.0%	60.0%	50.0%	40.0%	30.0%	20.0%	11.7%	10.0%	5.0%	0.0%	
AAA	0.030	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
AA+	0.094	AA+	AA+	AA+	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA	AAA
AA	0.203	AA	AA	AA+	AA+	AA+	AA+	AAA	AAA	AAA	AAA	AAA	AAA	AAA
AA-	0.255	AA-	AA	AA	AA	AA+	AA+	AA+	AAA	AAA	AAA	AAA	AAA	AAA
A+	0.501	A+	A+	AA-	AA-	AA-	AA	AA	AA+	AAA	AAA	AAA	AAA	AAA
A	0.561	A+	A+	A+	AA-	AA-	AA	AA	AA+	AA+	AAA	AAA	AAA	AAA
A-	0.787	A-	A	A	A+	A+	AA-	AA-	AA	AA+	AA+	AAA	AAA	AAA
BBB+	1.016	BBB+	A-	A-	A	A+	A+	AA-	AA	AA+	AA+	AAA	AAA	AAA
BBB	1.582	BBB	BBB+	BBB+	BBB+	A-	A	A+	AA-	AA	AA	AA+	AAA	AAA
BBB-	3.361	BBB-	BBB-	BBB	BBB	BBB	BBB	BBB+	A	A+	AA-	AA	AAA	AAA
BB+	5.355	BB+	BBB-	BBB-	BBB-	BBB-	BBB	BBB	BBB+	BBB+	A	A	AA-	AAA
BB	7.477	BB	BB+	BB+	BB+	BBB-	BBB-	BBB	BBB	BBB	A-	A-	AA-	AAA
BB-	11.007	BB-	BB	BB	BB	BB+	BB+	BBB-	BBB	BBB	BBB	BBB+	A	AAA
B+	15.370	B+	BB-	BB-	BB	BB	BB+	BB+	BBB-	BBB	BBB	BBB	A-	AAA
B	19.616	B	B+	B+	BB-	BB-	BB	BB	BBB-	BBB	BBB	BBB	BBB+	AAA
B-	25.538	B-	B	B	B+	BB-	BB-	BB	BBB-	BBB-	BBB-	BBB+	BBB+	AAA
CCC+/CCC	32.475	CCC	B-	B-	B	B+	BB-	BB-	BB	BBB-	BBB-	BBB	BBB	AAA

NB: the covered bonds rating on a probability of default basis will further depend on the level of overcollateralisation. The assigned rating may incorporate the effect of stressed recoveries from the cover pool in an event of the covered bonds' default. Depending on the assumed recovery percentage, an uplift of up to two notches at investment-grade level can be assigned.

Source: Fitch

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