

FITCH DOWNGRADES 1 GERMAN MORTGAGE PFANDBRIEF PROGRAMME, AFFIRMS 6 OTHERS, WITHDRAWS 2 RATINGS

Link to Fitch Ratings' Report: Germany Mortgage Covered Bond Programmes - Rating Action Report

<https://www.fitchratings.com/site/re/891593>

Fitch Ratings-Frankfurt/London-05 December 2016: Fitch Ratings has downgraded the rating of one German Mortgage Pfandbrief (covered bond) programme and has affirmed six others following the implementation of the agency's revised Covered Bonds Rating Criteria published on 26 October 2016.

Berlin Hyp AG's (BHB, A+/Stable/F1+) Mortgage Pfandbriefe ratings have been downgraded to 'AA' from 'AA+'. The Outlook is Stable.

The following six mortgage covered bond programmes have been affirmed at 'AAA' with Stable Outlook:

- Aareal Bank AG's (ARB, BBB+/Stable/F2) Mortgage Pfandbriefe
- Deutsche Postbank AG's (DPB, BBB+/Stable/F2) Mortgage Pfandbriefe
- Landesbank Hessen-Thüringen Girozentrale's (LBH, A+/Stable/F1+) Mortgage Pfandbriefe
- Unicredit Bank AG's (HVB, A-/Negative/F2) Mortgage Pfandbriefe
- Sparkasse Pforzheim Calw (SkPfcw, A+/Stable/F1+) Mortgage Pfandbriefe
- Commerzbank AG's (CBK, BBB+/Stable/F2) Mortgage Pfandbriefe

The ratings on BHB and CBK covered bond programmes have subsequently been withdrawn for commercial reasons.

Issuer Default Rating (IDR) Uplift

German Pfandbriefe are eligible for a maximum IDR uplift of two notches given their exemption from bail-in in a resolution scenario, Fitch's assessment that resolution of the issuer will not result in the direct enforcement of recourse against the cover pool and the low risk of undercollateralisation at the point of resolution (see Fitch's Jurisdictional Analysis of the Risk of Undercollateralisation of Covered Bonds - Excel file).

Fitch has assigned BHB's mortgage programme a one-notch IDR uplift, as the IDR of the bank is based on institutional support from the German savings banks (Sparkassen-Finanzgruppe (Sparkassen), A+/Stable/F1+/a+) and thus has a lower Viability Rating (VR) of 'bbb-'. The reduction of the IDR uplift to one notch is the reason for today's downgrade,

We have assigned the other six programmes a two-notch IDR uplift, as the banks' Long-Term IDRs are either driven by the banks' respective Viability Ratings (VR), which is the case for ARB, CBK, DPB and HVB, or because their Long-Term IDRs are based on their participation in a mutual support scheme, which is the case for LBH and SkPfcw.

Payment Continuity Uplift (PCU)

Fitch has assigned a PCU of four notches to all seven programmes based on the mandatory inclusion of liquid assets in the cover pool matching the maximum negative cumulated balance of cash flows for the next 180 days. Fitch also gives credit to the larger range of refinancing options offered for such cover pools. In our view this provides effective protection for interest and principal payments for standard German mortgage Pfandbriefe.

Recovery Uplift

CBK's, DPB's, LBH's, HVB's and SkPfCw' programmes benefit from a two-notch recovery uplift, as the overcollateralisation (OC) Fitch takes into account compensates for credit losses modelled in a stress scenario corresponding to the level of the respective covered bond ratings, and no material downside risk to recovery expectations has been identified.

ARB's and BHB's programmes could achieve a two-notch recovery uplift but the OC Fitch considers in its analysis does not offset the stressed credit loss and, hence, they have been assigned a one-notch recovery uplift.

Breakeven OC for Ratings

Given that Fitch does not necessarily test OC for timely payment if the covered bond rating can be reached based on a combination of the IDR uplift and two-notch recovery uplift, the breakeven OC will correspond to the stressed credit loss for the target rating level provided this is below the relied-upon OC. This is the case for the LBH's and SkPfCw's programmes and has led to a decrease in the 'AAA' breakeven OC for these programmes by 1.5% and 3.5% respectively.

As per criteria, Fitch floors the breakeven OC for the rating at the minimum regulatory level of 0% (or 2% on a net present value basis) when the agency's analysis results in a lower breakeven OC. This is the case for BHB's mortgage covered bond programme.

HVB's 'AAA' breakeven OC has decreased to 20% from 23% as no commingling loss has been reflected in the analysis given that HVB's IDR of 'A-' sufficiently mitigates commingling risk for the tested 'AA' rating on a tested Probability of Default (PD) basis. Fitch generally no longer accounts for commingling loss in the recovery uplift assessment.

A summary of rating steps for the programmes mentioned in this commentary can be found in the excel file "German Covered Bond Programmes - Rating Action Report" dated 5 December 2016 which can be accessed in the link above.

VARIATIONS FROM CRITERIA

CBK Mortgage Covered Bonds

Fitch applied variations from its "Criteria Addendum: Germany - Residential Mortgage Assumptions" published on 25 May 2016. The low prepayment scenario of 1% per year was tested as the observed data did not support a low prepayment assumption of 0% for residential mortgage programmes with a seasoning of five years. For occupancy types and property types not mentioned in the "Criteria Addendum: Germany - Residential Mortgage Assumptions", Fitch applied the highest hit on foreclosure frequency. The variations are reflected in the asset and cash flow analysis and have no impact on the rating of CBK's mortgage Pfandbriefe.

ARB, BHB, LBH Mortgage Covered Bonds

Fitch applied a variation from Criteria for the Analysis of Commercial Real Estate Loans Securing Covered Bonds, published on 10 December 2015. In the absence of CMBS guidance assumptions, Fitch assumed market value declines in line with the assumptions for German multifamily properties for office, retail, industrial and multifamily properties in Austria, Belgium, Finland, Sweden and Switzerland for which Fitch is provided with rental information.

KEY RATING DRIVERS

ARB Mortgage Pfandbriefe

ARB's mortgage covered bonds are rated 'AAA', seven notches above the bank's Long-Term IDR of BBB+'. This is based on an IDR uplift of two notches, a newly assigned PCU of four notches and a recovery uplift of one notch. The OC of 25.8% which Fitch relies upon in its analysis provides more protection than the breakeven OC of 24% for a 'AAA' rating. The breakeven OC

corresponds to a 'AA+' tested rating on a PD basis and a one-notch recovery uplift. The Stable Outlook on the covered bonds' rating reflects that on ARB's Long-Term IDR.

BHB Mortgage Pfandbriefe

Prior to its withdrawal BHB's mortgage covered bonds 'AA' rating was based on the bank's Long-Term IDR of A+, an IDR uplift of one notch and a recovery uplift of another notch. The OC of 7.8% Fitch relies upon in its analysis provides more protection than the breakeven OC of 0% for a 'AA' rating. The breakeven OC corresponds to the legal minimum OC and allows for a one-notch recovery uplift. The Stable Outlook on the covered bonds' rating reflects that on BHB's Long-Term IDR.

CBK Mortgage Pfandbriefe

Prior to its withdrawal CBK's mortgage covered bonds 'AAA' rating was based on the bank's Long-Term IDR of 'BBB+', an IDR uplift of two notches, a newly assigned PCU of four notches and a recovery uplift of two notches. The OC of 26.4% Fitch relies upon in its analysis provides more protection than the breakeven OC of 15% for a 'AAA' rating. The breakeven OC corresponds to a 'AA' tested rating on a PD basis and a two-notch recovery uplift. The Stable Outlook on the covered bonds' rating reflected that on CBK's Long-Term IDR and a one-notch buffer against a downgrade of the bank due to different uplift factors above the bank's IDR.

DPB Mortgage Pfandbriefe

DPB's mortgage covered bonds are rated 'AAA', seven notches above the bank's Long-Term IDR of 'BBB+'. This is based on an IDR uplift of two notches, a newly assigned PCU of four notches and a recovery uplift of two notches. The OC of 15% Fitch relies upon in its analysis equals the breakeven OC of 15% for a 'AAA' rating. The breakeven OC corresponds to a 'AA' tested rating on a PD basis and a two-notch recovery uplift. The Stable Outlook on the covered bonds' rating reflects that on DPB's Long-Term IDR and the one-notch buffer against a downgrade of the bank due to different uplift factors above the bank's IDR.

LBH Mortgage Pfandbriefe

LBH's mortgage covered bonds are rated 'AAA', four notches above the bank's Long-Term IDR of 'A+'. This is based on an IDR uplift of two notches and a two-notch recovery uplift. The covered bonds achieve the 'AAA' rating on a recovery basis as the OC relied-upon of 23.6% covers the rating level credit loss of 13%. The Stable Outlook on the covered bonds' rating reflects that on LBH's Long-Term IDR and the four-notch buffer against a downgrade of the bank due to different uplift factors above the bank's IDR.

HVB Mortgage Pfandbriefe

HVB's mortgage covered bonds are rated 'AAA', six notches above the bank's Long-Term IDR of 'A-'. This is based on an IDR uplift of two notches, a newly assigned PCU of four notches and a recovery uplift of two notches. The OC of 52% Fitch relies upon in its analysis provides more protection than the breakeven OC of 20% for a 'AAA' rating. The breakeven OC corresponds to a 'AA' tested rating on a PD basis and a two-notch recovery uplift. The Outlook on the covered bonds' rating is Stable despite the Negative Outlook on HVB's IDR given that a one notch downgrade to its parent's IDR would not result in a downgrade of the covered bonds due to the two-notch buffer against a downgrade as a result of different uplift factors above the bank's IDR.

SkPfcw Mortgage Pfandbriefe

SkPfcw's mortgage covered bonds are rated 'AAA', four notches above the bank's Long-Term IDR of 'A+'. This is based on an IDR uplift of two notches and a two-notch recovery uplift. The covered bonds achieve the 'AAA' rating on a recovery basis as the OC relied-upon of 80.1% covers the rating level credit loss of 10.5%. The Stable Outlook on the covered bonds' rating reflects that on LBH's Long-Term IDR and the four-notch buffer against a downgrade of the bank due to different uplift factors above the bank's IDR.

RATING SENSITIVITIES

Aareal Bank AG (ARB) Mortgage Covered Bonds

The 'AAA' rating would be vulnerable to downgrade if any of the following occurs: (i) ARB's Long-Term Issuer Default Rating (IDR) is downgraded by two or more notches to 'BBB-' or below or (ii) the OC that Fitch considers in its analysis drops below Fitch's 'AAA' breakeven level of 24%. If the OC that Fitch considers in its analysis drops to the legal minimum requirement of 0%, the rating would likely be downgraded to 'A+'.

Berlin Hyp AG (BHB) Mortgage Covered Bonds

Not applicable as the rating has been withdrawn.

Commerzbank AG (CBK) Mortgage Covered Bonds

Not applicable as rating has been withdrawn.

Deutsche Postbank AG (DPB) Mortgage Covered Bonds

The 'AAA' rating would be vulnerable to downgrade if any of the following occurs: (i) DPB's Long-Term Issuer Default Rating (IDR) is downgraded by two or more notches to 'BBB-' or below or (ii) the OC that Fitch considers in its analysis drops below Fitch's 'AAA' breakeven level of 15%. If the OC that Fitch considers in its analysis drops to the legal minimum requirement of 0%, the rating would likely be downgraded to 'A+'.

Landesbank Hessen-Thuringen (LBH) Mortgage Covered Bonds

The 'AAA' rating would be vulnerable to downgrade if LBH's IDR is downgraded to 'BBB-' or below or (ii) the OC that Fitch considers in its analysis drops below Fitch's 'AAA' breakeven level of 13%. If the OC that Fitch considers in its analysis drops to the legal minimum requirement of 0%, the rating would likely be downgraded to 'AA+'.

Unicredit Bank AG (HVB) Mortgage Covered Bonds

The 'AAA' rating would be vulnerable to downgrade if any of the following occurs: (i) HVB's IDR is downgraded by three or more notches to 'BBB-' or below or (ii) the OC that Fitch considers in its analysis drops below Fitch's 'AAA' breakeven level of 20%. If the OC that Fitch considers in its analysis drops to the legal minimum requirement of 0%, the rating would likely be downgraded to 'AA-'.

Sparkasse Pforzheim Calw (SkPfcw) Mortgage Covered Bonds

The 'AAA' rating would be vulnerable to downgrade if SkPfcw's IDR is downgraded to 'BBB-' or below or (ii) the OC that Fitch considers in its analysis drops below Fitch's 'AAA' breakeven level of 10.5%. If the OC that Fitch considers in its analysis drops to the legal minimum requirement of 0%, the rating would likely be downgraded to 'AA+'.

Fitch's breakeven OC for a given covered bond rating will be affected by, among other factors, the profile of the cover assets relative to outstanding covered bonds, which can change over time even in the absence of new issuance. Therefore, the breakeven OC for a covered bonds rating cannot be assumed to remain stable over time.

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Additional information is available on www.fitchratings.com

Applicable Criteria

Counterparty Criteria for Structured Finance and Covered Bonds (pub. 01 Sep 2016)

<https://www.fitchratings.com/site/re/886006>

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum (pub. 18 Jul 2016)

<https://www.fitchratings.com/site/re/884964>

Covered Bonds Rating Criteria (pub. 26 Oct 2016)

<https://www.fitchratings.com/site/re/888874>

Criteria for Country Risk in Global Structured Finance and Covered Bonds (pub. 26 Sep 2016)

<https://www.fitchratings.com/site/re/881269>

Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds (pub. 26 Oct 2016)

<https://www.fitchratings.com/site/re/888492>

Criteria for the Analysis of Commercial Real Estate Loans Securing Covered Bonds (pub. 17 Nov 2016)

<https://www.fitchratings.com/site/re/890302>

EMEA RMBS Rating Criteria (pub. 29 Nov 2016)

<https://www.fitchratings.com/site/re/891276>

Fitch's Cover Asset Refinancing Spread Level (RSL) Assumptions - Excel File (pub. 26 Oct 2016)

<https://www.fitchratings.com/site/re/888877>

Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds - Excel File (pub. 17 May 2016)

<https://www.fitchratings.com/site/re/880522>

Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File (pub. 26 Oct 2016)

<https://www.fitchratings.com/site/re/888865>

Global Bank Rating Criteria (pub. 25 Nov 2016)

<https://www.fitchratings.com/site/re/891051>

Rating Criteria for Commercial Mortgage-Backed Securities (CMBS) and Loans in EMEA (pub. 17 Nov 2016)

<https://www.fitchratings.com/site/re/890319>

Related Research

Fitch's Jurisdictional Analysis of the Risk of Undercollateralisation of Covered Bonds - Excel file

<https://www.fitchratings.com/site/re/884084>

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