MOODY'S INVESTORS SERVICE

CREDIT OPINION
12 January 2017

Update

Rate this Research

RATINGS

Landesbank Hessen-Thueringen GZ

Domicile	Frankfurt am Main, Germany
Long Term Debt	A1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Aa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Landesbank Hessen-Thueringen GZ

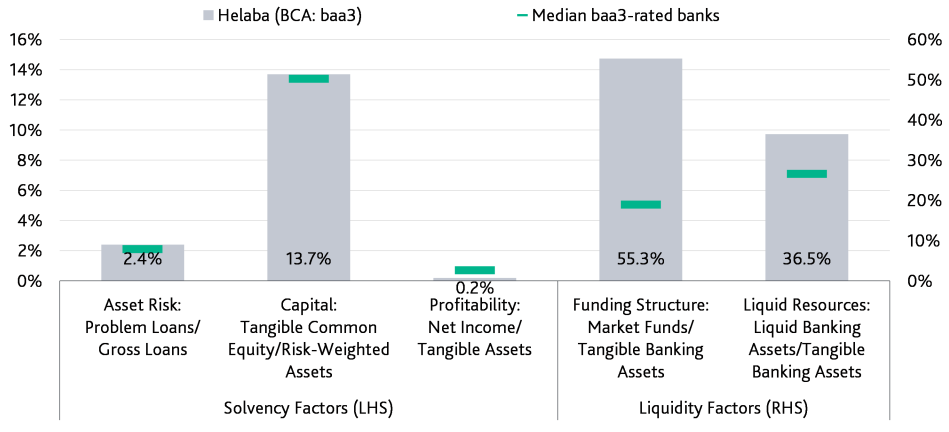
Update Following Recent Assignment of Aa3 Senior-Senior Rating

Summary Rating Rationale

On 21 November, we changed for certain debt instruments issued by Landesbank Hessen-Thueringen GZ (Helaba) the seniority level to senior-senior unsecured debt from senior unsecured debt and upgraded their ratings to Aa3 from A1. This change and upgrade reflects the revised insolvency framework in conjunction with a clarifying guidance provided by the German regulator; the common characteristics of the upgraded instruments is that certain structural features make these harder to value, resulting in additional complexity in case of bail-in. We further assign Aa3/P-1 deposit ratings and A1 senior unsecured debt ratings to Helaba, as well as an Aa3(cr)/P-1(cr) Counterparty Risk (CR) Assessment and a baa3 baseline credit assessment (BCA) and a baa1 Adjusted BCA.

The ratings reflect (1) its baa3 BCA; (2) its baa1 Adjusted BCA, incorporating two notches of rating uplift based on affiliate support from Sparkassen-Finanzgruppe (S-Group; Aa2 stable, a2)[1]; (3) the result of our Advanced Loss Given Failure (LGF) analysis, taking into account the loss severity faced by the different liability classes in resolution, which provides two notches of rating uplift for its senior debt and three notches of rating uplift for its senior-senior debt and deposit ratings; and (4) a moderate likelihood of government support, resulting in one notch of rating uplift.

Exhibit 1
Rating Scorecard - Key Financial Ratios



Source: Moody's Banking Financial Metrics

The baa3 BCA reflects (1) the group's improved capital and leverage ratios; (2) its moderate asset risk profile; and (3) its comfortable funding profile. At the same time, the stand-alone BCA is constrained by the bank's substantial exposure to international commercial real-estate (CRE) markets and the bank's modest, yet improving and solid, financial performance.

Credit Strengths and Challenges

» A sound risk management is reflected in declining problem loans

» Adequate and slightly improving capitalisation

» Good access to sector funds, supporting the liquidity profile

» High sector concentrations to cyclical CRE remain a rating restraint

» Level of risk-weighted profitability is low, yet stable

» Some dependence on confidence-sensitive market funding, despite access to sector funds

Rating Outlook

» The outlook on the bank's ratings is stable, reflecting our anticipation of stability in the bank's implied creditworthiness of its owners as well as existing cross-sector support mechanisms.

Factors that Could Lead to an Upgrade

» An upgrade of Helaba's ratings would be likely in the event of a pronounced upgrade of the bank's BCA. The debt ratings could also face upward rating pressure if the volume of its subordinated instruments increases meaningfully relative to the bank's tangible banking assets, which could result in one additional uplift from our LGF analysis.

» Upward pressure on Helaba's baa3 BCA could arise from (1) an improved Macro Profile; (2) a meaningful lowering of the bank's concentration risk, specifically with regards to CRE exposures; (3) a significant and sustained improvement of its profitability, and (4) a further reduction in Helaba's dependence on debt capital markets, resulting from higher funds available from and cooperation with a larger number of savings banks.

Factors that Could Lead to a Downgrade

» A downgrade of Helaba's ratings could be triggered following (1) a downgrade of its BCA; (2) a change in its ownership structure, as well as a deterioration in the implied creditworthiness of its owners; (3) weakening cross-sector support assumptions; and/or (4) a reduction in rating uplift as a result of our LGF analysis.

» Downward pressure on the bank's BCA could result from (1) a deterioration of the bank's financial strength, especially if followed by an unexpected and sustained weakening of its capital adequacy metrics; (2) material deterioration in asset quality; and/or (3) heightened turbulence in the European debt markets, leading to widening credit spreads negatively affecting Helaba's profitability metrics.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

LANDESBANK HESSEN-THUERINGEN GZ (Consolidated Financials) [1]

	6-16[2]	12-15[2]	12-14[2]	12-13[3]	12-12[3]	Avg.
Total Assets (EUR billion)	165.9	163.4	169.7	170.5	199.3	-4.5[4]
Total Assets (USD billion)	184.4	177.5	205.4	235.0	262.8	-8.5[4]
Tangible Common Equity (EUR billion)	7.2	7.3	7.0	7.0	6.4	2.8[4]
Tangible Common Equity (USD billion)	8.0	8.0	8.4	9.6	8.5	-1.5[4]
Problem Loans / Gross Loans (%)	-	1.8	2.2	3.2	3.0	2.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	13.7	13.4	12.9	12.9	10.6	13.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	-	20.4	25.6	36.1	35.2	29.3[5]
Net Interest Margin (%)	0.7	0.8	0.8	0.7	0.7	0.7[5]
PPI / Average RWA (%)	1.4	1.7	1.4	1.5	1.7	1.5[6]
Net Income / Tangible Assets (%)	0.2	0.3	0.2	0.2	0.2	0.2[5]
Cost / Income Ratio (%)	66.2	60.1	65.4	63.0	56.5	62.3[5]
Market Funds / Tangible Banking Assets (%)	55.3	55.3	58.5	61.2	65.0	59.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	34.7	36.5	39.1	41.5	42.4	38.8[5]
Gross loans / Due to customers (%)	190.3	195.3	201.0	207.3	190.8	196.9[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

Detailed Rating Considerations

IMPROVED CAPITALISATION AND SOUND RISK MANAGEMENT PARTLY MITIGATE HIGH SECTOR CONCENTRATIONS TO CYCLICAL COMMERCIAL REAL ESTATE

The bank benefits from sound capital buffers, as displayed by its further strengthened fully-loaded Basel III common equity Tier 1 (CET1) and total capital ratios of 13.3% and 20.0%, as of half-year 2016 (year-end 2015: 13.1% and 19.8%, respectively).

We also take account of the bank's balance sheet leverage ratio (4.1% as of half-year 2016), as well as our expectations regarding upcoming challenges for capitalisation by upcoming regulatory changes by adjusting our Capital score down by two notches to baa1.

Notwithstanding the bank's solid loss-absorption capacity, Helaba's total loan exposure to the CRE sector amounted to €32.3 billion as of half-year 2016, resulting in considerable concentration risk, especially when compared to the group's reported CET1 capital of €7.3 billion as of half-year 2016. We take account of the relating risks and the bank's exposure to market risk by adjusting our Asset Risk score down by three notches to baa2.

Despite this adjustment for the sizeable concentration risks, Helaba's CRE portfolio has a sound history of low credit losses compared with peers, owing to Helaba's focus on prime locations and properties with a high level of pre-arranged rental agreements, combined with limited ticket sizes, providing risk diversification. Furthermore, the bank displayed an improved problem loan ratio of 1.8% as of end-2015 (2.2% as of end-2014), and risk-related charges declined further to very low levels during 2015, reflecting a benign point in the credit cycle. Moreover, the group's corporate finance loan book is well diversified, and includes equally-sized lending activities with multinational corporates, asset-based lending focused on aircraft and (to a lesser degree) ship finance (€1.5 billion as of 31 March 2016), structured and project finance and leasing.

Helaba is predominantly active in Germany. The very high economic, institutional and government financial strength and very low susceptibility to event risk thus support the bank's BCA. However, operating conditions for the German banking system are constrained by high fragmentation in an over-saturated market, low fee income generation and intensifying competition for domestic business. Helaba's Strong+ Macro Profile also captures exposures to international corporate as well as CRE lending activities in countries with weaker Macro Profiles than Germany. An improvement of the bank's Macro Profile may positively affect its financial profile, all other things being equal.

LEVEL OF RISK-WEIGHTED PROFITABILITY IN TERMS OF GLOBAL COMPARISON IS LOW YET STABLE

For the first nine months of 2016, Helaba reported a pre-tax profit of €417 million (IFRS), down 14% year-on-year. Driven by the low interest rate environment, net interest income significantly declined by 7.1% to €913 million and following higher net additions, loan loss provisions increased to €140 million, from €114 million in the same period in 2015. Helaba was only partially able to balance its earnings through positive contributions from more volatile profit contributors like fair value changes on financial instruments and derivatives (€63 million compared to a loss of €1 million during the first 9 months 2015), while customer driven trading income was lower (€79 million vs a €119 million profit for Q3 2015).

For full-year 2015, Helaba reported a pre-tax profit of €596 million (IFRS), almost at previous year's level of €607 million. The result was driven by a slight increase in net interest income (+1.5%) year-over-year to €1.3 billion and a 51% increase in net trading income to €190 million, as well as a €173 million gain from other net operating income (2014: €70 million) reflecting higher income from its real estate subsidiary GWH, while 2014 was negatively impacted by one-off items. Negative effects stemmed from significantly higher loan loss provisions of €237 million compared to €80 million in 2014, mainly driven by accounting effects in 2014, and a €37 million impairment loss on a bond issued by the Austrian Heta Asset Resolution AG (Heta, Ca stable)[2].

We expect that Helaba will continue to show fairly stable operating performance and profitability levels on the back of positive effects from the integration of the Verbundbank (central bank business of former WestLB for savings banks in North-Rhine Westphalia and Brandenburg), despite exposure to market volatility. However, regulation-related expenses will continue to burden the operating costs of Helaba, while the low-yield environment places pressure on the bank's interest income. Helaba's performance metrics will continue to remain modest, also a result of the group's statutory obligation to perform promotional banking activities, which are run on a cost-coverage basis rather than on return targets, but provides a stable revenue source. An upward adjustment of one notch to ba3 has been assigned to the bank's Profitability score based on Helaba's resilient, stable and relatively high-quality earnings over the past several years.

IMPROVING LIQUIDITY METRICS AND FUNDING FROM THE SAVINGS BANKS SECTOR MITIGATE REMAINING WHOLESALE DEPENDENCE

Helaba partially depends on wholesale funding for a part of its lending business and is presently a net lender in the interbank market. Balancing factors are the bank's proven and recurring access to considerable excess liquidity of the regional savings banks and good access to debt capital markets, even in times of stress.

Notably, funding requirements are likely to remain stable over the foreseeable future, given the group's broadly matched funding profile for its medium- and long-term lending business. The bank typically issues approximately €12 billion - €15 billion in medium- and long-term debt instruments per year (as of half-year 2016: €9.6 billion), placed with a broad and diversified investor base. A growing portion of Helaba's unsecured wholesale debt issued is placed with savings banks and their retail clients.

To capture these benefits, we have positively adjusted our Funding Structure score by four notches to ba2. Our considerations regarding asset encumbrance, intragroup restrictions and the quality of liquid assets are reflected in our assigned Liquid Resources score of a3, two notches below the historic ratio.

Notching Considerations

AFFILIATE SUPPORT

Helaba benefits from cross-sector support from S-Group. Cross-sector support reduces the probability of default, as such support would be available to stabilise a distressed member bank, and not just compensate for losses in resolution. The "high" support assumption assigned to Helaba reflects its prominent service function for the sector, the majority ownership by S-Group members and the bank's cross-liability scheme. As a result, cross-sector support provides two notches of rating uplift to Helaba's debt, senior-senior, deposit and subordinated instrument ratings.

LOSS GIVEN FAILURE (LGF) ANALYSIS

Helaba is subject to the German Bank Recovery and Resolution Directive (AbwMechG), which we consider an Operational Resolution Regime. We therefore apply our Advanced LGF analysis, considering the risks faced by the different debt and deposit classes across the liability structure at failure. We revised this analysis to reflect changes in protection resulting from the subordination of certain senior unsecured debt obligations relative to other senior liabilities, including deposits. In line with the new German insolvency legislation that will effectively subordinate senior unsecured bonds and notes to deposits and senior senior debt in resolution from January 2017, we base our calculation on the assumption that deposits and senior-senior unsecured bonds are preferred to senior unsecured bonds. We continue to assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, a 5% run-off in preferred deposits and - following the legislative changes - a 100% probability to certain deposits being preferred to senior unsecured debt, according to our EU Full Deposit Preference waterfall.

For Helaba, our revised LGF analysis indicates an extremely low "loss-given-failure" for deposits and a very low "loss-given-failure" for senior unsecured debt. Deposits and senior unsecured debt benefit from three and two notches rating uplift from the bank's baa1 adjusted BCA, respectively. For senior-senior unsecured debt, our LGF analysis indicates an extremely low loss-given-failure, leading to a three-notch uplift from the bank's baa1 adjusted BCA.

SUBORDINATED AND HYBRID INSTRUMENTS

Our LGF analysis indicates a high "loss-given-failure" for subordinated debt classes, leading us to position the instrument's ratings one notch below the bank's baa1 adjusted BCA. Subordinated debt instruments do not benefit from any government support.

One €300 million Genussschein (junior subordinated debt) is rated Baa3(hyb), two notches below the bank's adjusted BCA, reflective of its cumulative coupon-skip mechanism tied to a balance-sheet loss trigger.

Helaba's silent participations (non-cumulative preferred securities) issued by Main Capital Funding Limited Partnership and Main Capital Funding II Limited Partnership are rated Ba1(hyb), three notches below the bank's Adjusted BCA, reflective of the instruments' net loss triggers.

GOVERNMENT SUPPORT

Given its size on a consolidated basis, we consider S-Group as domestically systemically relevant. We therefore attribute a "moderate" probability of German government support for all members of the sector, in line with support assumptions for other systemically relevant banking groups in Europe. For Helaba, this results in one notch of additional government support uplift for its senior debt and deposit ratings.

Rating Methodology and Scorecard Factors

Exhibit 3

LANDESBANK HESSEN-THUERINGEN GZ

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	2.4%	a2	← →	baa2	Sector concentration	Market risk
Capital						
TCE / RWA	13.7%	a2	← →	baa1	Nominal leverage	Expected trend
Profitability						
Net Income / Tangible Assets	0.2%	b1	← →	ba3	Earnings quality	
Combined Solvency Score		baa1		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	55.3%	b3	← →	ba2	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	36.5%	a1	← →	a3	Quality of liquid assets	Intragroup restrictions
Combined Liquidity Score		ba1		baa3		
Financial Profile				baa3		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				Aaa		
Scorecard Calculated BCA range				baa2-ba1		
Assigned BCA				baa3		
Affiliate Support notching				2		
Adjusted BCA				baa1		

Balance Sheet	in-scope (EUR million)	% in-scope	at-failure (EUR million)	% at-failure
Other liabilities	--	--	--	--
Deposits	--	--	--	--
Preferred deposits	--	--	--	--
Junior Deposits	--	--	--	--
Senior unsecured bank debt	--	--	--	--
Dated subordinated bank debt	--	--	--	--
Junior subordinated bank debt	--	--	--	--
Preference shares (bank)	--	--	--	--
Equity	--	--	--	--
Total Tangible Banking Assets	--	--	--	--

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + Subordination	Sub-ordination	Instrument volume + Subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	--	--	--	--	--	--	--	3	0	a1 (cr)
Deposits	--	--	--	--	--	--	--	3	0	a1
Senior senior unsecured bank debt	--	--	--	--	--	--	--	3	0	a1
Senior unsecured bank debt	--	--	--	--	--	--	--	2	0	a2
Dated subordinated bank debt	--	--	--	--	--	--	--	-1	0	baa2
Junior subordinated bank debt	--	--	--	--	--	--	--	-1	-1	baa3 (hyb)

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3 (cr)	--
Deposits	3	0	a1	1	Aa3	Aa3
Senior senior unsecured bank debt	3	0	a1	1	Aa3	--
Senior unsecured bank debt	2	0	a2	1	A1	A1
Dated subordinated bank debt	-1	0	baa2	0	Baa2	--
Junior subordinated bank debt	-1	-1	baa3 (hyb)	0	Baa3 (hyb)	--

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
LANDESBANK HESSEN-THUERINGEN GZ	
Outlook	Stable
Bank Deposits	Aa3/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Senior senior unsecured bank debt	Aa3
Senior Unsecured	A1
Subordinate -Dom Curr	Baa2
Jr Subordinate -Dom Curr	Baa3 (hyb)
Commercial Paper -Dom Curr	P-1
MAIN CAPITAL FUNDING II LIMITED PARTNERSHIP	
Pref. Stock Non-cumulative	Ba1 (hyb)
MAIN CAPITAL FUNDING LIMITED PARTNERSHIP	
Pref. Stock Non-cumulative	Ba1 (hyb)

Source: Moody's Investors Service

Output of the Baseline Credit Assessment Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Endnotes

1 The rating shown is S-Group's Corporate Family Rating and outlook, and its baseline credit assessment.

2 The rating shown is the Heta's Carinthian state-guaranteed senior unsecured debt rating and outlook

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