MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns definitive Aaa ratings to Aareal Bank's mortgage covered bonds

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EUR 9.6 billion of notes affected

Frankfurt am Main, January 12, 2017 -- Moody's Investors Service has today assigned definitive Aaa ratings to the mortgage covered bonds (Hypothekenpfandbriefe or covered bonds) issued by Aareal Bank AG (the issuer/Aareal Bank, deposits A3 stable; adjusted baseline credit assessment baa3; counterparty risk (CR) assessment A3(cr)), which are governed by the German Pfandbrief Act.

RATINGS RATIONALE

A covered bond benefits from (1) the issuer's promise to pay interest and principal on the bonds; and (2) following a CB anchor event, the economic benefit of a collateral pool (the cover pool). The ratings therefore reflect the following factors:

(1) The credit strength of Aareal Bank.

(2) Following a CB anchor event the value of the cover pool. The stressed level of losses on the cover pool assets following a CB anchor event (cover pool losses) for this transaction is 19.7%.

Moody's considered the following factors in its analysis of the cover pool's value:

a) The credit quality of the assets backing the covered bonds. The mortgage covered bonds are backed by commercial mortgage loans secured by properties located in a number of different markets with major concentrations in the US, Germany, the UK and France. The collateral score for the cover pool is 8.1%.

b) The protection provided by the Pfandbrief Act. Notable aspects of the Pfandbrief legal framework include the legal requirement for the issuer to maintain 2% over-collateralisation (OC) on a stressed present value basis. The framework imposes a loan-to-value (LTV) ratio threshold of 60% based on a clearly defined lending value. The issuer must also cover potential liquidity gaps over the next 180 days between payments expected to be received under the cover pool assets and the payments due under the outstanding covered bonds.

c) The exposure to market risk, which is 14.3% for this cover pool.

d) The over-collateralisation (OC) in the cover pool is 32.2%, of which Aareal Bank provides 2% on a "committed" basis (see Key Rating Assumptions/Factors, below).

The TPI assigned to this transaction is High. Moody's TPI framework does not constrain the rating.

As per 30 September 2016, the total value of the assets included in the cover pool is approximately EUR 12.43 billion, comprising EUR 11.56 billion of commercial mortgage loans and 0.87 billion of substitute assets. The commercial mortgage loans have a weighted average seasoning of 57 months and a weighted average LTV ratio of 57.7% (based on whole loan amounts and property market values).

KEY RATING ASSUMPTIONS/FACTORS

Moody's determines covered bond ratings using a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for this programme is CR assessment plus 1 notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or otherwise where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

The cover pool losses for Aareal Bank's mortgage covered bonds are 19.7%. This is an estimate of the losses Moody's currently models following a CB anchor event. Moody's splits cover pool losses between market risk of 14.3% and collateral risk of 5.4%. Market risk measures losses stemming from refinancing risk and risks related to interest-rate and currency mismatches (these losses may also include certain legal risks). Collateral risk measures losses resulting directly from cover pool assets' credit quality. Moody's derives collateral risk from the collateral score, which for this programme is currently 8.1%.

The over-collateralisation in the cover pool is 32.2%, of which Aareal Bank provides 2% on a "committed" basis. The minimum OC level consistent with the Aaa rating is 14.5%, of which the issuer should provide 2% in a "committed" form (numbers in present value terms). These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.

For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly. All numbers in this section are based on Moody's most recent modelling (based on data, as per 30 September 2016).

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

Factors that would lead to a downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to a downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "High", the TPI Leeway for this programme is 2 notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by more than 2 notches all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Martin Lenhard
VP - Senior Credit Officer
Structured Finance Group
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Juan Pablo Soriano
MD - Structured Finance
Structured Finance Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Deutschland GmbH
An der Welle 5
Frankfurt am Main 60322
Germany
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

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