

Germany
Credit Analysis

Landesbank Baden-
Württemberg — **Public Sector**
Pfandbriefe

Rating

LBBW Public sector PfandbriefeAAA

Cover Pool Key Data	30 June 07
Cover assets (EURbn)	78.74
Covered bonds (EURbn)	66.15
Nominal overcollateralisation (OC, %)	19.02
Weighted average asset maturity (years)	4.80
Weighted average liability maturity (years)	3.81
Floating-rate assets (% of cover assets)	21.27
Floating-rate covered bonds (% of cover assets)	8.14
D-Factor (%)	7.4

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■ Issuer Background

Landesbank Baden-Württemberg (LBBW, rated 'A+/F1+', see separate Fitch report on the bank) is a public law institution owned by the State of Baden Württemberg (BW) ('AAA', 35.6%), the savings bank association of BW (35.6%), the city of Stuttgart (19%), the savings bank association of Rheinland-Pfalz ('AAA', 4.9%) and the Landeskreditbank BW ('AAA', 4.9%). LBBW, one of Germany's 10 largest banking groups by assets, is the central bank for the savings banks in BW and the main bank for BW and the City of Stuttgart. It acquired 100% of LRP Landesbank Rheinland-Pfalz in 2005.

■ Highlights

With cover assets of EUR78.7bn, LBBW has the largest public sector pool of any German Pfandbrief issuer. Guaranteed assets from the German savings banks and Landesbanks account for around 66% (EUR52.0bn) of the cover pool exposure. As these assets are no longer available in the primary market, LBBW will diversify the pool structure. Nevertheless, the pool volume is expected to diminish significantly over the next few years.

■ Continuity Analysis

According to Fitch's covered bonds rating methodology, the covered bonds rated by the agency are assigned a discontinuity factor (D-Factor) between 0% (best) and 100% (worst). The D-Factor reflects the likelihood of the covered bonds defaulting in the immediate aftermath of a default by the issuer. The D-factor has four weighted elements: asset segregation (50%), alternative management (15%), liquidity gaps (30%) and covered bonds oversight (5%).

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 the overcollateralisation (OC) that is deemed to be obviously not necessary.

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. Fitch believes that a transition to a substitute manager for LBBW's public sector pool would be facilitated by the established IT system it uses for its cover pool management. Although LBBW has the largest public sector pool of any German Pfandbrief issuer, the Sachwalter should not face particular difficulties as LBBW's pool structure is less complex than those of peers.

Fitch analyses liquidity gaps, defined as the difference between revenues from the cover assets and the payments due to covered bond investors, shortly after an assumed issuer's default. In the case of LBBW's cash flows, the existing liquidity gaps are currently offset by the availability of sufficient liquid assets and further mitigated by internal guidelines.

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

Fitch assigned LBBW's public sector cover pool a D-factor of 7.4%. Taking into account its IDR of 'A+', the maximum rating the public sector Pfandbriefe can achieve on a probability of default basis is 'AAA' (see *Appendix*). 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.

■ Credit Quality of the Cover Pool

As at 30 June 2007, LBBW's outstanding public sector Pfandbriefe amounted to EUR66.2bn and were backed by a pool of assets with a total value of EUR78.7bn, resulting in a nominal OC of 19.0%.

As is common for most German public sector pools the concentration of assets in Germany is very high. As at 30 June 2007, German exposure accounted for around 95.6% of the pool.

Cover Assets by Country

Country	(%)
Germany	95.64
Switzerland	1.53
Italy	0.95
Greece	0.92
Japan	0.38
Spain	0.17
Canada	0.10
France	0.09
Portugal	0.06
Finland	0.04
Hungary	0.03
USA	0.03
Poland	0.02
Austria	0.02
Supranational	0.01
Total	100.00

Source: LBBW's data, calculations by Fitch

Within Germany, 46.5% of borrowers are located in the BW. Around 12.5% of the exposure to German

borrowers was originated in the eastern German states.

Cover Assets by German Federal States

State	(%)
Baden-Württemberg	46.50
North-Rhine Westphalia	16.29
Hesse	6.45
Bavaria	5.83
Lower-Saxony	5.57
Rhineland-Palatinate	5.43
Schleswig-Holstein	4.70
Saxony	2.96
Berlin	2.46
Bremen	0.94
Saarland	0.92
Saxony-Anhalt	0.64
Mecklenburg-Pomerania	0.55
Thuringia	0.42
Brandenburg	0.23
Hamburg	0.11
Total	100.00

Source: LBBW's data, calculations by Fitch

At 53.0%, guaranteed German savings banks represent the largest borrower group within the cover pool. Guaranteed German public sector banks and Landesbanks account for 19.0% of the pool assets. As guaranteed assets from savings banks and Landesbanks (together 66.0% of the cover assets) are no longer available in the primary market, the pool volume is expected to diminish significantly over the next few years. This effect will only be partially mitigated by the diversification of the cover pool structure.

Cover Assets by Borrower Group

Borrower group	(%)
German Savings Banks	53.05
Guaranteed Public Sector Banks and Landesbanks	18.97
German Sovereigns and Federal States	10.83
German Municipalities	8.17
German Public Sector Companies	3.99
Foreign Subnationals	2.20
Foreign Sovereigns	2.16
Other Financial institutions	0.63
Total	100.00

Source: LBBW's data, calculations by Fitch

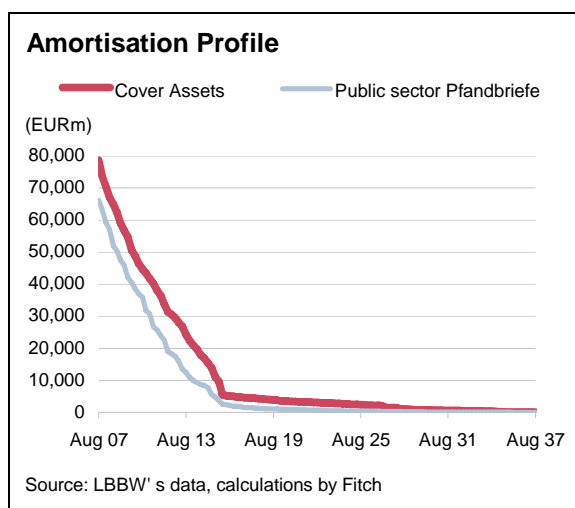
The cover pool shows a comparatively moderate concentration on a single-borrower basis: the 20 largest borrowers account for around 38.5%.

Fitch assumes a cumulative probability of default of approximately 9.1% and a recovery rate of 86.3% for the cover assets in a 'AAA' scenario.

■ Cash Flow Analysis

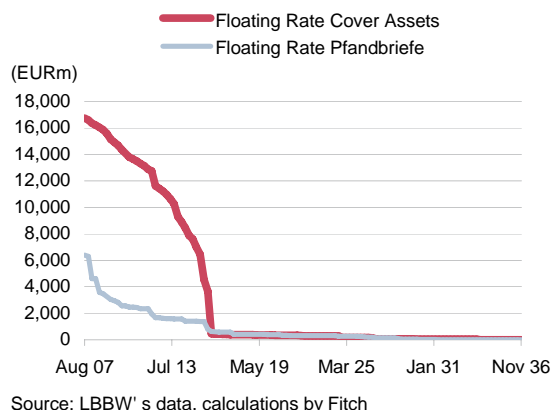
The agency compared the revenues from the cover pool with the cash flows due on the liability side in a wind-down scenario where a third party would act as substitute manager, and subject to 'AAA' stress assumptions for the credit risk as well as the maturity, interest rate and currency risks.

The weighted average maturities of the assets and liabilities are 4.8 and 3.8 years, respectively, indicating average maturity mismatches when compared with other German peers. The chart below compares the scheduled nominal amount of the cover pool with the residual amount of public sector Pfandbriefe over time. The asset pool includes around EUR8.7bn in ECB eligible bonds, which could also be used to meet timely payments in case of need.



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 13.1% of the cover assets as at 30 June 2007, which means cash flows would be adversely affected by declining interest rates in a wind-down scenario.

Interest Rate Matching



A high percentage of assets (96.6%) and liabilities (97.8%) are EUR-denominated. Some currency risk exists as open positions in CHF amount to 2.2% of the total cover assets. No privileged swaps are included in the cover pool.

Currency Mismatches

Currency	Assets (%)	Liabilities (%)
EUR	96.57	97.79
CHF	2.61	0.51
USD	0.68	1.63
JPY	0.13	0.07
Total	100.00	100.00

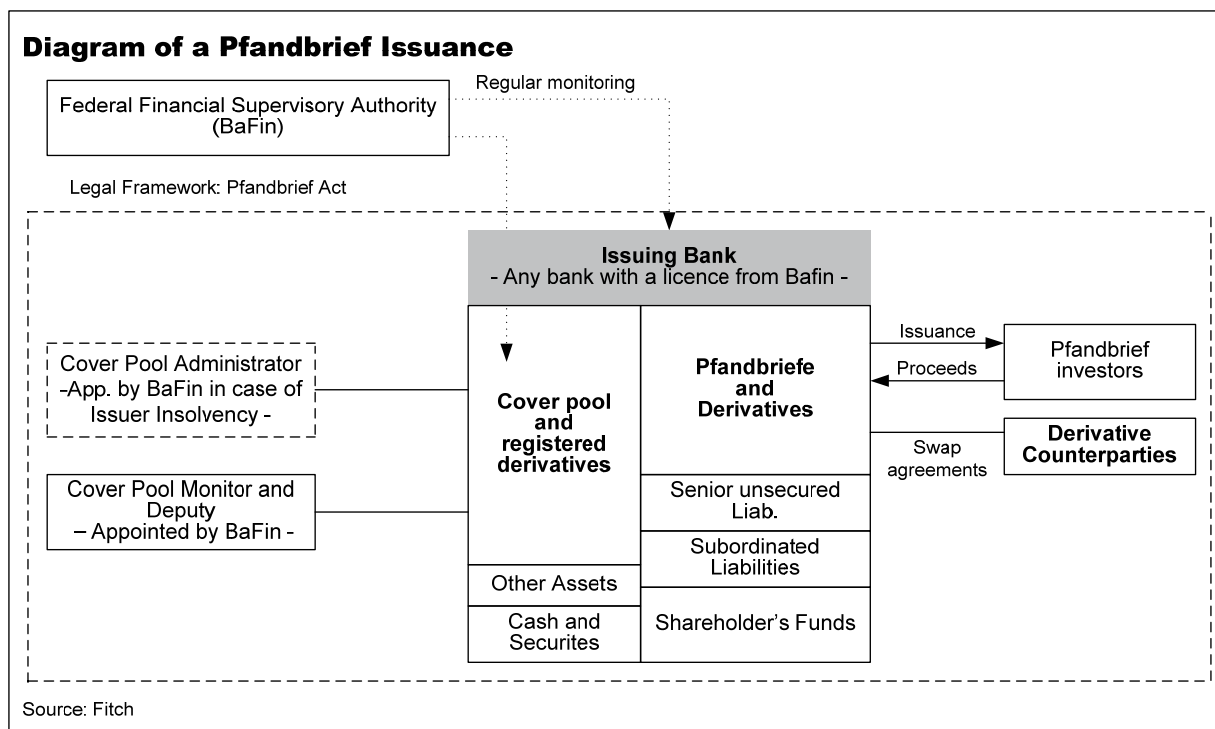
Source: LBBW's data, calculations by Fitch

The cash flows were tested with the minimum nominal OC for the last 12 months, which stands at 11.8%. 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 public sector cover pool and the related Pfandbriefe.

■ Conclusion

Under Fitch's covered bond methodology, LBBW's public sector Pfandbriefe achieve a 'AAA' rating on a probability of default basis. This result is based on LBBW's IDR of 'A+', on a D-Factor of 7.4% and on the conclusions drawn from Fitch's asset and cash flow analysis. The agency will continue to monitor LBBW's public sector cover pool and the related Pfandbriefe, whose profile may change over time.

■ Annex



Legal Overview

Covered bonds type	Legislation-based
Legal background	The German Pfandbrief Act (GPA) 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"> Public sector loans to EEA countries Switzerland, the US, Canada and Japan. Residential and commercial public sector loans are subject to a 60% maximum loan-to-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 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 public sector loans /public sector loans in countries with a preferential claim.
Minimum 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 must be at least the same. 2% legally protected OC on a net NPV basis, after the effect of regulatory interest rate and currency stresses. According to §30 (4) GPA, 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.
Liquid assets	The share of substitute collateral is restricted to a maximum of 20% of the total volume of outstanding mortgage and shipping Pfandbriefe. For public sector Pfandbriefe, this ratio may 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 latest upon insolvency.

Source: Fitch

D-Factor Matrix

Issuer Default Rating	5 yrs PD (in %)	D-Factor 90%	80%	70%	60%	50%	40%	30%	20%	10%	8%	7.4%	5%	0%
AAA	0.03	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+	AAA	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+	AA+	AAA	AAA
BBB	1.582	BBB	BBB+	BBB+	BBB+	A-	A	A+	AA-	AA	AA+	AA+	AA+	AAA
BBB-	3.361	BBB-	BBB-	BBB	BBB	BBB	BBB	BBB+	A	AA-	AA-	AA-	AA	AAA
BB+	5.355	BB+	BBB-	BBB-	BBB-	BBB-	BBB	BBB	BBB+	A	A+	A+	AA-	AAA
BB	7.477	BB	BB+	BB+	BB+	BBB-	BBB-	BBB	BBB	A-	A	A	AA-	AAA
BB-	11.007	BB-	BB	BB	BB	BB+	BB+	BBB-	BBB	BBB+	A-	A-	A	AAA
B+	15.37	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	BB+	BBB-	BBB	BBB	BBB+	AAA
CCC+/CCC	32.475	CCC	B-	B-	B	B+	BB-	BB-	BB	BBB-	BBB-	BBB	BBB	AAA

Source: Fitch

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