

Landesbank Baden-Wuerttemberg Mortgage Covered Bonds

Covered Bonds / Germany

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DEFINITIVE RATINGS

Cover Pool (€ million)	Ordinary Cover Assets	Covered Bonds (€ million)	Rating
3,787	Residential and commercial mortgages	1,418	Aaa

Numbers are as of 31 December 2007

The ratings address the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

OPINION

Strengths of the Transaction

- **Sponsor Bank:** The Mortgage Covered Bonds (or *Hypothekendarlehen*) are full recourse to Landesbank Baden-Wuerttemberg (rated **Aa1/Prime-1**).
- **The German legal framework:** The Mortgage Covered Bonds are governed by the German *Pfandbrief* Act (*Pfandbriefgesetz* or *PfandBG*). There are a number of strengths in the German *Pfandbrief* legislation, these include *inter alia* the following:
 - Pursuant to the terms of the German legislation, the Sponsor Bank is regulated and supervised by the Financial Supervisory Authority of Germany (*Bundesanstalt für Finanzdienstleistungsaufsicht* or *BaFin*).
 - Upon the insolvency of the Sponsor Bank, the claims of the *Pfandbrief* holder will be secured by a pool of assets (Cover Pool).
 - The *Pfandbrief* Act sets out strict eligibility criteria for assets in the Cover Pool. The ordinary Cover Pool assets – either residential or commercial mortgage loans – that are to be included in the Cover Pool are subject to a conservative evaluation of property values (Lending Value or *Beleihungswert*), and Mortgage Covered Bonds can only be issued against 60% of this Lending Value.
 - A minimum 2% stressed net present value (NPV) over-collateralisation has to be maintained at all times.
 - There is a Cover Pool monitor (*Treuhänder*) who is responsible for monitoring various operations with respect to the Cover Pool.
- **Credit Quality of the Cover Pool:**
 - The Mortgage Covered Bonds are supported by a Cover Pool. The Cover Pool comprises high-quality loans backed by residential and commercial properties. The majority of these assets are houses, flats or multi-family buildings.



- The weighted average Loan to Lending Value of all loans in the Cover Pool is at around 73% – as of the end of 2007.
 - All loans are believed to have been “income verified”, and income is assessed in all cases to be sufficient to pay off the principal of the loan over the life of the loan.
 - Valuations backing loans are carried out by internal or external valuers that meet the requirement of the German *Pfandbrief* legislation. In each case, the property has been visited when the valuation is carried out.
- **Refinancing Risk:**
- There is a well-established and deep market for German *Pfandbriefe*.
 - Currently, the cash flows of Cover Pool assets and outstanding Covered Bonds are reasonably well matched.
- **Market Risks:**
- The over-collateralisation of 2% on a NPV basis has to be maintained in stressed market conditions, e.g. movements of the yield curve and – if applicable – changes in the relevant exchange rates. Landesbank Baden-Wuerttemberg (“LBBW”) opted for the so-called static approach – which includes a parallel movement of the interest rate curve by 250 basis points – in order to meet mandatory stress tests requirements.
 - Currently, there is no currency mismatch between the Cover Pool assets and the Covered Bonds outstanding.
 - The weighted average life of the Cover Pool assets is below the average of other mortgage covered bonds rated by Moody’s.
- **De-Linkage:** Following Sponsor Bank Default,¹ the covered bondholders will benefit from an administrator (*Sachwalter*) that acts independently from the insolvency administrator of the Sponsor Bank. Furthermore, if the Financial Supervisory Authority of Germany deems it necessary, the *Sachwalter* may be appointed ahead of any Sponsor Bank Default.

¹ Sponsor Bank Default is defined in Moody’s Rating Approach to European Covered Bonds (rating methodology, published June 2005), as removal from the Cover Pool of (i) support provided by entities within the Sponsor Bank, (ii) ancillary activities of the Sponsor Bank (i.e. those not related to the Cover Pool) and (iii) usually, management functions of the Sponsor Bank.

Weaknesses with Mitigants

- **Sponsor Bank:** As with most covered bonds, up until Sponsor Bank Default the Sponsor Bank has the ability to materially change the nature of the programme. For example, new assets may be added to the Cover Pool, new Covered Bonds issued with varying promises and new hedging arrangements entered into. These changes could impact the credit quality of the Cover Pool as well as the overall refinancing risk and market risks. **Mitigant:** (i) the covered bondholders have a direct claim on the Sponsor Bank, rated **Aa1**, and (ii) the requirements and controls imposed by the *Pfandbrief* legislation.
- **Credit Quality of the Cover Pool:**
 - As of December 2007, the Cover Pool is concentrated with respect to the following aspects: (i) geographical concentration: more than 99% are loans secured by properties in Germany; and (ii) obligor concentration: the 20 largest obligors account for around 22.6% of the total loan balance of the Cover Pool. These facts increase the probability of significant defaults. **Mitigants:** Moody's collateral score models takes into account *inter alia* the impact of concentration on borrower, regional and country levels.
 - As with most covered bonds in Europe, there are few restrictions on the future composition of the Cover Pool, hence substitution risk exists. **Mitigants:** The quality of the Cover Pool, over time, will be protected by, among others, the requirements of the German *Pfandbrief* Act. This Act sets out rules detailing which assets qualify as ordinary cover assets for *Hypothekendarpfandbriefe*. In addition, Moody's will monitor the Cover Pool. If the quality of the collateral deteriorates below a certain threshold, the Sponsor Bank would have the ability, but not the obligation, to increase the over-collateralisation in the Cover Pool. Failure to increase the level of over-collateralisation following a deterioration of the Cover Pool could lead to negative rating actions.
- **Refinancing Risk:** Following Sponsor Bank Default, to achieve timely principal payment, covered bondholders may need to rely on proceeds being raised through the sale of, or borrowing against, assets in the Cover Pool. Following a Sponsor Bank Default, the market value of these assets may be subject to high volatility. **Mitigants:** (1) the high rating of the Sponsor Bank (**Aa1**). The higher the rating of the Sponsor Bank, the lower the chances of being exposed to this risk; (2) the depth of the German market; (3) the high level of support provided to *Pfandbriefe* in Germany; and (4) Moody's has used stressed refinancing margins in its modelling.
- **Market Risk:** As with the majority of European covered bonds, there is potential for market risks. For example, following Sponsor Bank Default, covered bondholders may be exposed to interest rate risk, which could arise from the different payment promises and durations made on the Cover Pool and the Covered Bonds. **Mitigant:** the requirement that the value of the Cover Pool has to exceed the stressed net present value (NPV) of the total of outstanding Covered Bonds issued against the Cover Pool by at least 2% (over-collateralisation).
- **Liquidity:** The programme does not benefit from any designated source of liquidity if cash flow collections are interrupted. **Mitigants:** (1) the strengths of the *Pfandbrief* Act, which include the alternatives given to the *Sachwalter* for raising funds against the Cover Pool; (2) the minimum 2% over-collateralisation on an NPV basis.
- **Time Subordination:** After Sponsor Bank Default, later-maturing Covered Bonds are subject to time subordination. Principal cash collections may be used on a first-come-first-served basis, paying earlier-maturing Covered Bonds prior to later-maturing Covered Bonds. This could lead to over-collateralisation being eroded away before any payments are made to later-paying Covered Bonds.

STRUCTURE SUMMARY

Issuer:	Landesbank Baden-Wuerttemberg (Aa1/Prime-1)
Sponsor Bank:	Landesbank Baden-Wuerttemberg (Aa1/Prime-1)
Structure Type:	Mortgage Covered Bonds (<i>Hypothekendarpfandbriefe</i>)
Issued under Covered Bonds Law:	Yes (<i>Pfandbrief Act</i>)
Applicable Covered Bonds Law:	Germany
Main Originator:	Landesbank Baden-Wuerttemberg
Main Servicer:	Landesbank Baden-Wuerttemberg
Intra group Swap Provider:	n.a.
Monitoring of Cover Pool:	Cover pool monitor (<i>Treuhänder</i>), mandatory by operation of the <i>Pfandbrief Act</i>
Trustees:	n.a.
Timely Payment Indicator:	Probable-High

COVERED BONDS SUMMARY

Total number of Covered Bonds outstanding:	64 (bearer bonds only)
Total amount of Covered Bond issuance outstanding:	€1,418,238,107
Currency of the Covered Bonds:	Euro (100%)
Extended Refinance Period:	No
Principal Payment Type:	Bullet
Interest Rate Type:	Fixed rate bonds (98%), other (2%)

COLLATERAL SUMMARY

Size of Cover Pool:	€3,787,021,423
Main collateral type in Cover Pool:	Residential Mortgages (24%), Multi-Family (39%), Commercial Mortgages (36%), Further Cover Assets (1%)
Main Asset Location:	Germany
Loans Count:	Residential and Multi-family (10,228), Commercial (820)
Currency:	Euro (100%)
Concentration of 20 largest borrowers:	23%
WA Current LTV (total Cover Pool):	73%
WA Seasoning (Residential):	76 months
WA Remaining Term:	Information not disclosed by the issuer
Interest Rate Type:	Fixed-rate loans (97%), variable-rate loans (3%)
“Committed” Over Collateralisation:	2% (mandatory minimum over-collateralisation based on NPV calculation required by the <i>Pfandbrief Act</i>)
Collateral Score:	8.5%
Further details:	Appendix 1
Pool Cut-off Date:	31 December 2007

TRANSACTION SUMMARY

Majority of Cover Pool assets are residential mortgages or loans secured by multi-family buildings

Moody's Investors Service has assigned definitive long-term ratings of **Aaa** to the bonds issued under the Mortgage Covered Bond programme (*Hypothekendarbriefe*) of Landesbank Baden-Wuerttemberg (**Aa1/Prime-1**). As of the end of December 2007, the value of the assets in the Cover Pool of Landesbank Baden-Wuerttemberg ("LBBW" or "Sponsor Bank") was €3.8 billion. The majority of the loans in the Cover Pool are loans secured by residential properties or multi-family buildings. Around 36% of the Cover Pool assets are commercial mortgages, in which the majority of the loans are secured by offices or retail buildings. The vast majority of the properties securing the loans are located in Germany (more than 99% as of the end of December 2007).

Among other things, the rating takes into account the following factors:

- (1) The credit strength of the Sponsor Bank
- (2) The German legal framework for *Pfandbriefe*
- (3) The credit quality of the Cover Pool

Moreover Moody's **Aaa** rating for this transaction does not currently rely on any over-collateralisation over and above that required by the *Pfandbrief* Act.

Rating does not currently rely on any over-collateralisation over and above that required by law

As is the case with other covered bonds, Moody's considers the transaction to be linked to the credit strength of the Sponsor Bank, particularly from a default probability perspective. Should the Sponsor Bank's credit strength deteriorate – all things being equal – the rating of the Mortgage Covered Bond may be expected to come under negative pressure. However, LBBW has the ability – but not the obligation – to commit voluntary enhancements to the transaction, such as further over-collateralisation, in order to increase the de-linkage from its credit strength.

It should be noted, however, that were the Sponsor Bank to be downgraded below a certain threshold in the single-A range, Moody's may remove from its analysis the benefit of any over-collateralisation that was not "committed".

STRUCTURAL AND LEGAL ASPECTS

Hypothekendarbriefe governed by the Pfandbrief Act

LBBW's Mortgage Covered Bonds (*Hypothekendarbrief*) are governed by the German *Pfandbrief* Act (*Pfandbriefgesetz*). No specific structural feature is envisaged by LBBW's Covered Bond Programme. A description of the general legal framework for Mortgage Covered Bonds governed by the *Pfandbrief* Act is contained in Appendix 3.

MOODY'S RATING METHODOLOGY

The approach used by Moody's for rating covered bond transactions is detailed in our Rating Methodology.² The impact of the credit strength of the Sponsor Bank, quality of the collateral, refinancing and market risks are considered below.

Credit Strength of the Sponsor Bank

The covered bondholders benefit from a direct claim against the Sponsor Bank, rated Aa1/Prime 1

The Covered Bonds are full recourse to Landesbank Baden-Wuerttemberg (rated **Aa1/Prime-1**). The rating derives from LBBW's strong regional franchise in both commercial and retail banking, good risk management capabilities and a sound financial profile. However, it also factors in the bank's high borrower concentrations, its currently subdued performance due to the persistent financial crisis and a slightly higher risk profile resulting from the acquisition of Landesbank Sachsen AG. LBBW's ratings are also based on our assumption of a very high probability of support – in terms of (i) cross-sector support from German public-sector banks, (ii) support from its public-sector owners, most prominently the State of Baden-Wuerttemberg (rated **Aaa**), the City of Stuttgart (unrated) and the savings bank association of Baden-Wuerttemberg (unrated) and (iii) systemic support.

For more information on the fundamental credit quality of the Sponsor Bank, please see Related Research section: Moody's latest Credit Opinion on Landesbank Baden-Wuerttemberg, published in March 2008.

² "Moody's Rating Approach to European Covered Bonds", published in June 2005 (see Related Research).

Note on the data

Moody's understands that LBBW has publicly stated its intention to merge the Cover Pools of Landesbank Sachsen Girozentrale (SachsenLB) and LRP Landesbank Rheinland-Pfalz (LRP) with its own Cover Pool of LBBW's Mortgage Covered Bonds; this is expected to take place later this year. Moody's has limited data on either SachsenLB's or LRP's Cover Pool. However, Moody's understands that the assets in those pools (i) comply with the *Pfandbrief* legislation, and that (ii) LBBW will assess the cover pool assets of SachsenLB and LRP before they are entered into LBBW's Cover Pool, in order to ensure that these assets meet LBBW's own credit requirements. Based on data as of December 2007, the combined amount of all three Cover Pools amounts to €4.55 billion. LBBW originated assets are expected to make up at least 83% of the future Cover Pool.

The following description of the Cover Pool reflects Moody's assessment of LBBW's Cover Pool only. However, Moody's does not currently expect that the credit risk profile of the joint Cover Pool to differ materially from the current Cover Pool.

The Credit Quality of the Cover Pool

Around 63% of the total Cover Pool assets are residential mortgage loans or loans secured by multi-family buildings

As of December 2007, the Cover Pool comprised residential and commercial mortgage loans (together "ordinary assets") plus some further cover assets. These claims add up to a volume of €3.8 billion. The nominal value of LBBW's currently outstanding Mortgage Covered Bonds amounts to €1.4 billion; therefore, on a nominal basis these numbers translate into an over-collateralisation of 167.1% as of December 2007.

Table 1:

Overview – Cover Pool assets

	(€ m)	(%)
Total pool	3,787	100.0%
Residential mortgage loans	914	24%
Multi Family	1,458	39%
Commercial mortgage loans	1,375	36%
Further cover assets	40	1%

Residential Mortgages

Well-seasoned residential loans

As of December 2007, around 24% of the total Cover Pool assets are residential mortgage loans located across Germany, with some focal points in Baden-Wuerttemberg, Saxony and North Rhine-Westphalia (NRW). Moody's understands that the majority of the properties securing the residential mortgage loans in the Cover Pool are (i) houses and (ii) flats (see Appendix 1 for more details).

From a credit perspective, Moody's regards the following characteristics of the residential mortgage pool as positive:

Low weighted average LTV

- The Cover Pool consists of performing residential mortgage loans.
- Seasoning: the loans are well seasoned, with a weighted average seasoning of above 6 years.
- Granularity and diversification: the number of borrowers in the residential mortgage pool is high and the properties are spread across the whole of Germany.
- Income underwriting. It is Moody's understanding that all loans have been "income verified" and income has been confirmed to be sufficient to repay principal over the life of the loan. The interest payment of the loan has been stressed by the lender in cases of variable rate loans or loans in which the time to re-set is below a certain threshold (see Appendix 2 for more details).
- The high number of long-dated, fixed-rate loans.
- Every property financed has been individually valued either by an internal or external appraisal and in all cases the properties have been inspected at the time of loan origination. In line with the requirements of the *Pfandbrief* legislation, these valuers are independent from the credit decision (see Appendix 3 for more details on requirements of the German Lending Value concept).

From a credit perspective, Moody's regards the following characteristics of the residential mortgage pool as negative:

Some regional concentration

- Moody's has not received information on *inter alia* employment type of the borrower or occupancy type. Where limited information has been provided, Moody's has made what we believe to be a conservative assumption.
- There are some regional concentrations in Baden-Wuerttemberg and Saxony.
- Junior loans. Limited information was provided. Therefore we have made what we believe are conservative assumptions on the amount of junior-ranking loans made by third parties against properties included in the Cover Pool.

Scoring model is used to assess credit quality of residential mortgages in the Cover Pool

The above-mentioned factors have been incorporated into Moody's analysis. Moody's calculates a Collateral Score based on the characteristics of the residential loan pool using a scoring model in order to assess the credit quality of this portion of the Cover Pool.

Commercial Mortgages**Commercial mortgages account for around 36% of the total Cover Pool**

As of December 2007, around 36% of the total Cover Pool assets are commercial mortgage loans, of which the vast majority are secured by properties located in Germany. Within Germany the properties are located countrywide, with some concentration in Baden-Wuerttemberg, Saxony and NRW. With respect to loans secured by properties outside Germany, these account for only around 1% of the exposure to commercial properties (including multi family). Offices as well as retail and multi-family buildings account for the vast majority of the commercial mortgages in the Cover Pool. See Appendix 1 for more information on the Cover Pool.

From a credit perspective, Moody's views the following characteristics of the commercial mortgages loan pool as positive:

High portion of offices, retail and multi-family

- High portion of, in particular multi-family, but also offices and retail.
- Granularity and diversification: the number of borrowers in the commercial mortgage pool is high and the properties are spread throughout Germany.
- Underwriting. It is Moody's understanding that cash flows stemming from the properties have been confirmed and are assessed to be sufficient to repay principal over the life of the loan.
- Every property financed has been individually valued either by an internal or external appraisal and in all cases the properties have been inspected at the time of loan origination. Moody's understands that in case of multi-family valuers also inspect the buildings from time to time on an ongoing basis. In line with the requirements of the *Pfandbrief* legislation these valuers are independent from the credit decision (see Appendix 3 for more details on requirements of the German Lending Value concept).

From a credit perspective, Moody's regards the following portfolio characteristics of the commercial pool as negative:

Some borrower concentration

- Hotels, storage facilities and industry facilities and other property types (including mixed use, land and developments) account for around 16% of the Cover Pool. Moody's has taken the property types into consideration when analysing the credit risks of the Cover Pool assets.
- Moody's has received information on the largest obligors in the Cover Pool. Based on this information there is some borrower concentration, which can be seen by the fact that the 20 largest obligors already account for around 23% of the Cover Pool.
- Apart from on the largest obligors Moody's has received stratified data which may mean analysis has been completed on a less precise basis than is usually the case. Moody's believes it has made conservative assumptions to adjust for this.
- The Cover Pool contains around 5% of secured claims against entities of the LBBW group, where the credit risk is expected to be more correlated with LBBW's credit strength than claims against entities outside the LBBW group. In its analysis, Moody's has taken this into consideration when calculating the credit risks in the Cover Pool.
- There is some regional concentration in Baden-Wuerttemberg and Saxony.
- Junior loans. Limited information was provided on junior loans. Therefore we have made what we believe are conservative assumptions on the amount of junior-ranking loans made by third parties against properties included in the Cover Pool.

Monte Carlo simulation is used to assess credit quality of commercial mortgages in the Cover Pool

The above-mentioned factors have been incorporated into Moody's analysis. Moody's calculates a Collateral Score based on the characteristics of the commercial portion of the pool using a Monte Carlo simulation approach in order to assess the credit quality of this portion of the Cover Pool. Moody's commercial calculator takes into account *inter alia* the impact of concentration on borrower, regional and country levels as well as the different types of properties securing the loan.

Collateral Score reflects adjustments made to the analysis

Results of the Collateral Analysis

The result of the Cover Pool analysis is the Collateral Score.³ Moody's calculates a Collateral Score based on the credit quality of the Cover Pool assets as described above. In addition, the Collateral Score published in this report reflects all adjustments made; this number therefore includes the cushion built in to address the factors described above. For this transaction, the Collateral Score is currently just under 8.5%.

Substitution risks are mitigated by the Pfandbrief Act

As with most covered bonds in Europe, there are few restrictions or limitations on the future composition of the Cover Pool. This may have the effect of creating substitution risk. Mitigants to substitution risk, which should protect the quality of the Cover Pool over time, include:

- Requirements of the *Pfandbrief Act*.
- The Cover Pool composition will be monitored.

If the quality of the collateral deteriorates below a certain threshold, the Sponsor Bank would have the ability, but not the obligation, to increase the over-collateralisation in the Cover Pool in order to support the current rating. If additional over-collateralisation is not added following a marked deterioration of the collateral, this could lead to a negative rating action.

For further information on the credit quality of the Cover Pool and income underwriting and valuation standards, see Appendix 1 and 2.

Refinancing the Cover Pool

Following the Sponsor Bank Default, where the "natural" amortisation of the Cover Pool assets alone cannot be relied on to repay principal, Moody's assumes that funds must be raised against the Cover Pool at a discount if covered bondholders are to receive timely principal payment. After a Sponsor Bank Default, the market value of these assets may be subject to certain volatility. Examples of the stressed refinance margins used by Moody's for different types of residential and commercial mortgage loans are published in Moody's covered bonds rating methodology. An update on the stressed refinance margins used has been published in February 2008.⁴

Lower refinancing risk than in other jurisdictions due to the level of support provided in the German Pfandbrief market

Aspects specific to this programme that are refinancing-positive include:

- *Pfandbrief Act*: The *Sachwalter* has the ability to sell all or part of the Cover Pool, with or without all or parts of the liabilities attached.
- The depth of the German market and the high level of support provided to *Pfandbriefe* in Germany, refinancing risk is perceived as lower than in most other jurisdictions. In the modelling of this transaction, Moody's has used refinance margins for mortgage loans that are lower than the refinance margins used for mortgage loans in most other jurisdictions.

All notes issued under this programme are bullet

Aspects specific to this programme that are refinancing-negative include:

- The programme does not benefit from any contractual provisions to allow for an extension of a principal refinancing period.
- The 36% of assets that are commercial (but excluding multi-family) are assessed as having slightly higher refinancing risk.

³ The Collateral Score can be seen as the amount of risk-free enhancement required to protect a **Aaa** rating from otherwise unsupported assets – therefore, the stronger the credit quality of the collateral, the lower the collateral score. This only considers the credit deterioration of the assets and ignores any risk from refinancing and market risk (see Rating Methodology "Moody's Rating Approach to European Covered Bonds").

⁴ Please see Related Research: "Moody's Rating Approach to European Covered Bonds", published in June 2005 and Press Release: "Moody's announces update of covered bond refinance stresses following credit crisis", published in February 2008.

Market Risk

As with the majority of European covered bonds, there is potential for market risks. For example, following Sponsor Bank Default, covered bondholders may be exposed to interest rate risk which could arise from the different payment promises and durations made on the Cover Pool and the Covered Bonds. Following Sponsor Bank Default, the Moody's Covered Bond Model looks separately at the impact of increasing and decreasing interest rates on the expected loss of the Covered Bonds, taking the path of interest rates that leads to the worst result.⁵

Table 2:

	Assets (%)	Liabilities (%)	WAL assets (years)	WAL liabilities (years)
Fixed rate	97.4	98	5.5	3.9
Variable rate	2.6	2		2.3

WAL = weighted average life (time to reset), number reflects the WAL of all assets in the Cover Pool (fixed rate and variable rate assets)

Mandatory “stressed” over-collateralisation of 2% on NPV-basis

Aspects specific to this programme that are market-risk-positive include:

- Currently, there are no currency mismatches between the Cover Pool assets and the Covered Bonds outstanding. Moody's has not modelled any currency risk in its calculations.
- The exposure to market risk is mitigated by the mandatory NPV test, taking stressed interest rates scenarios into consideration.
- The German *Pfandbrief* legislation requires *Pfandbrief* issuers to regularly run stress tests regarding interest rate and foreign exchange rate risks. LBBW has opted for a static stress test, which includes a minimum shift of the yield curve of 250 basis points, to meet the regulatory requirements. As of December 2007, LBBW had not entered any swaps into the Cover Pool register of its Mortgage Covered Bonds.
- The weighted average life of the Cover Pool assets is below the average of other mortgage covered bonds rated by Moody's

Majority of Cover Pool assets have a fixed rate

Aspects specific to this programme that are market risk negative include:

- The vast majority of the Cover Pool assets and the outstanding Mortgage Covered Bonds are fixed rate and the weighted average life of the Covered Bonds outstanding is shorter than the weighted average life of the Cover Pool assets. A potential sale of fixed-rate assets (to meet due payments on Covered Bonds following Sponsor Bank's Default) could therefore potentially lead to a crystallisation of interest rate losses.

The exposure to interest rates risk is mitigated by the mandatory NPV test, taking stressed interest rates scenarios into consideration

The result of Moody's calculations was that the more stressful scenario is currently one of increasing interest rates, as a potential sale of fixed-rate assets could potentially lead to a crystallisation of interest rate losses.

As of the publication date of this report, no derivatives have been entered into the Cover Pool.

In the case of insolvency of the Sponsor Bank, Moody's does not currently assume that the special cover pool administrator (*Sachwalter*) will always be able to efficiently manage any natural hedge between the Cover Pool and the Covered Bonds.

LINKAGE

All Covered Bonds are linked to the Issuer of the Covered Bonds

All covered bonds are linked to the issuer of the Covered Bonds (“the Issuer”). The Covered Bonds will therefore come under increasing rating stress as the Issuer's credit strength deteriorates. Reasons for this include:

- Refinancing risk: Following Issuer Default, if principal receipts from collections of the Cover Pool are not sufficient to meet the principal payment on a Covered Bond, funds may need to be raised against the Cover Pool. However, the fact that the Issuer has defaulted may negatively impact the ability to raise funds against the Cover Pool.

⁵ The interest and currency stressed rates used over different time horizons are published in Moody's Rating Methodology (please see Related Research: “Moody's Rating Approach to European Covered Bonds”, published in June 2005).

- The exposure of the programme to the choices of the Issuer. For example, prior to Issuer Default, the Issuer may add new assets to the Cover Pool, issue further bonds and enter new hedging arrangements. Each of these actions could negatively impact the value of the Cover Pool.
- More generally, by the incorporation of the strength of the Issuer in accordance with Moody's rating methodology.

As a result of this linkage, the probability of default of the Covered Bonds may be higher than expected for **Aaa** rated senior unsecured debt. However, Moody's primary rating target is the expected loss which also takes severity of loss into account, which in this case is consistent with a **Aaa** rating.

TPIs assess the likelihood that a timely payment will be made

Moody's Timely Payment Indicators ("TPIs")⁶ assess the likelihood that a timely payment will be made to covered bondholders following Sponsor Bank Default, and thus determine the maximum rating a covered bond programme can achieve with its current structure while allowing for the addition of a reasonable amount of over-collateralisation.

Having an independent cover pool administrator may reduce potential conflicts of interest between the Covered Bond investors and other creditors

Aspects specific to this programme that are TPI-positive include

- The high level of support provided to *Pfandbriefe* in Germany
- German *Pfandbrief* legislation, including:
 - At the time of the declaration of bankruptcy of the Issuer, or earlier if BaFin sees the need, a cover pool administrator (*Sachwalter*) will take over management responsibility of the Covered Bond programme.
 - The *Sachwalter* will act independently from the insolvency administrator of the Issuer. Having an independent cover pool administrator may reduce potential conflicts of interest between the Covered Bond investors and other creditors.
- Set-off: Moody's understanding from legal and industry advisors with respect to Mortgage Covered Bonds is that set-off risk for loans registered in the Cover Pool and made in Germany backed by German assets is excluded by the operation of the *Pfandbrief Act*.

Aspects specific to this programme that are TPI negative include:

- All Covered Bonds outstanding have a bullet repayment at maturity, without any extension period for the repayment of the bonds.
- The programme does not benefit from any designated source of liquidity if cash flow collections are interrupted.
- Commingling risk: Upon the appointment of the *Sachwalter*, it is Moody's understanding that the *Sachwalter* has priority claim on all cash flows stemming from the Cover Pool assets. However, the *Sachwalter* has to separate these cash flows from other cash flows to the Issuer before payment is made to covered bondholders.

Based on the considerations discussed above Moody's has assigned a TPI of Probable-High to this Covered Bond programme.

MONITORING

Moody's will monitor the transaction on an ongoing basis, including checking supporting ratings and reviewing the assets. Moody's receives data from the Sponsor Bank in line with our standard on a quarterly basis. Any subsequent changes in the rating will be publicly announced and disseminated through Moody's Client Service Desk.

⁶ See Moody's Rating Methodology: "Timely Payment in Covered Bonds following Sponsor Bank Default" published March 2008

RELATED RESEARCH

For a more detailed explanation of Moody's approach to this type of transaction as well as similar transactions, please refer to the following reports:

Rating Methodologies

- Timely Payment in Covered Bonds following Sponsor Bank Default, March 2008 (SF109992)
- Moody's Rating Approach to European Covered Bonds, June 2005 (English version - SF57011)
- Moody's Rating Approach to European Covered Bonds, July 2005 (German version – SF58550)

Special Reports

- 2007 Review & 2008 Outlook Covered Bonds: Strong Market Growth in 2007 but Credit Challenges Lie Ahead, February 2008 (SF121193)
- European Covered Bond Legal Frameworks: Moody's Legal Checklist, January 2006 (German version – SF67969)
- European Covered Bond Legal Frameworks: Moody's Legal Checklist, December 2005 (English version – SF66418)

Credit Opinion

- Moody's Global Credit Research – Credit Opinion: Landesbank Baden-Württemberg, 28 March 2008

Analysis

- Moody's Global Credit Research – Analysis: Landesbank Baden-Wuerttemberg, 20 December 2007

Announcement

- Moody's Announcement: Moody's announces update of covered bond refinance stresses following credit crisis, 29 February 2008

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

APPENDIX 1: COVER POOL INFORMATION

Table 3:
Residential Mortgages

Overview	
Collateral Score:	-
Asset balance:	2,372,143,303
Average loan balance:	231,926
Number of loans:	n/d
Number of borrowers:	10,228
Number of properties:	n/d
WA Remaining Term (in months):	n/d
WA Seasoning (in months):	75.7
Details on LTV	
WA current LTV (*):	72.6%
WA Indexed LTV:	n/a
Valuation type:	-
LTV threshold:	60%
Junior ranks:	n/d
Prior ranks:	0.0%

(*) Based on original property valuation

(**) Refers to Borrowers with previous missed payments, Borrowers with a previous personal bankruptcy or Borrowers with record of court claims against them at time of origination

(***) This "other" type refers to loans made directly to Housing Cooperatives and to Professional Landlords. The numbers provided under Residential Mortgages also include loans secured by multi-family buildings, which would usually be shown in the Commercial Mortgage section. The multi-family business reported as residential mortgage business and taken into consideration for these tables and charts accounts for around EUR 1,458 million or 61.5% of EUR 2,372 million.

(****) n/d : information not disclosed by Issuer

Specific Loan and Borrower characteristics

Loans benefiting from a guarantee:	0.0%
Interest Only Loans:	0.0%
Loans for second homes / Vacation:	0.0%
Buy to Let loans / Non owner occupied properties:	0.0%
Limited income verified	0.0%
Adverse Credit Characteristics(**):	0.0%

Performance

Loans in arrears (≥ 2months - < 6months):	0.0%
Loans in arrears (≥ 6months - < 12months):	0.0%
Loans in arrears (> 12months):	0.0%
Loans in a foreclosure procedure:	0.0%

Multi-Family Properties

Loans to tenants of tenant-owned Housing Cooperatives:	0.0%
Other type of Multi-Family loans (***)	61.5%

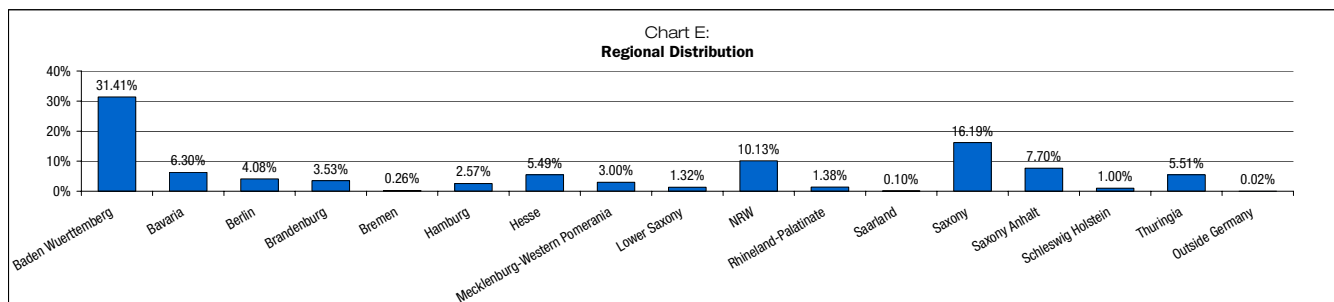
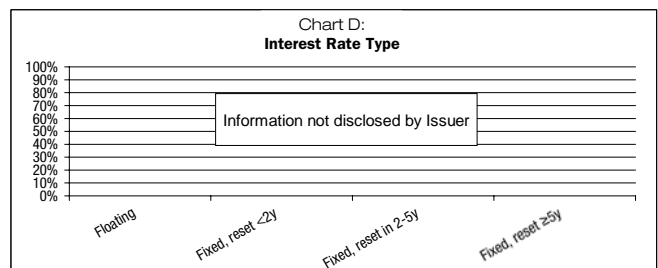
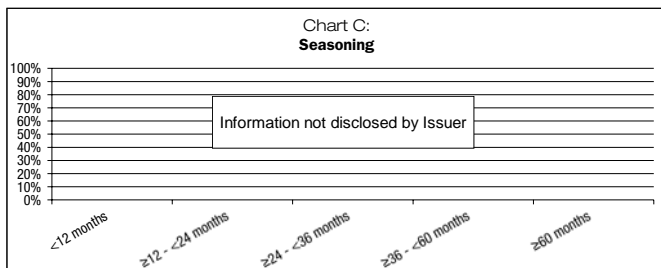
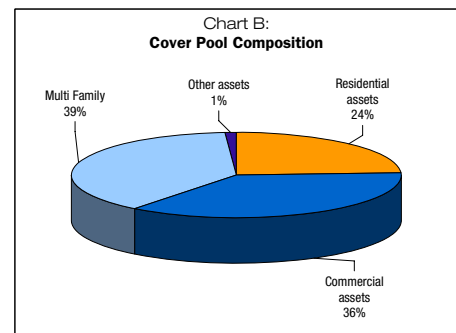
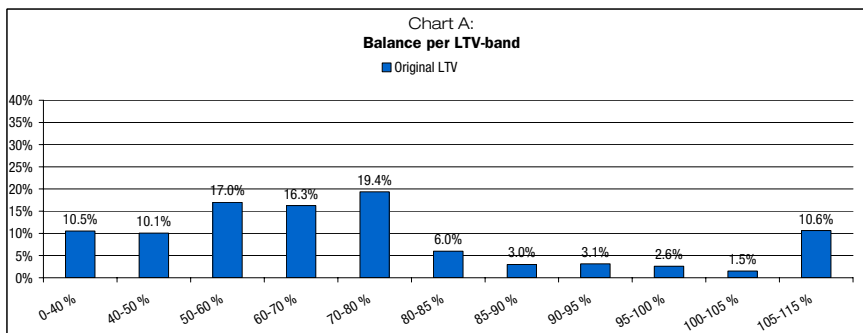


Table 4:
Commercial Mortgages

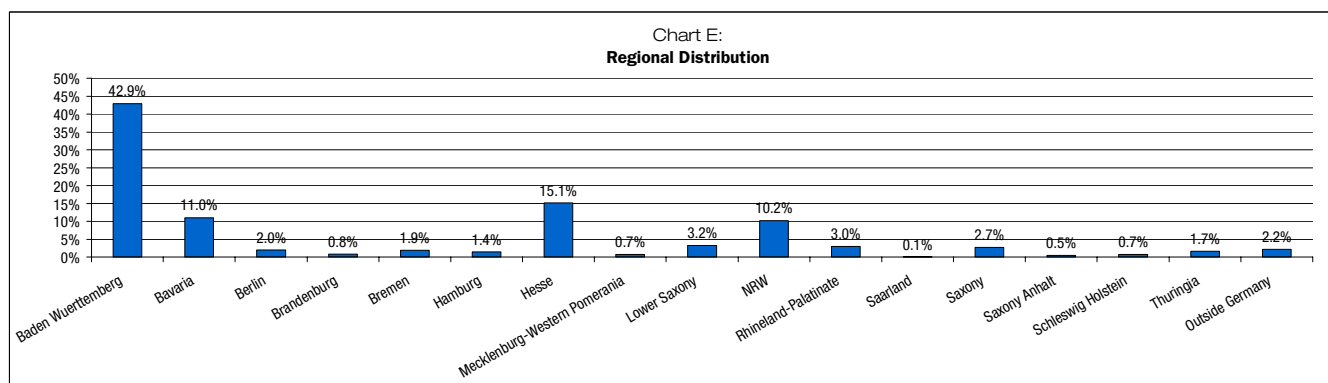
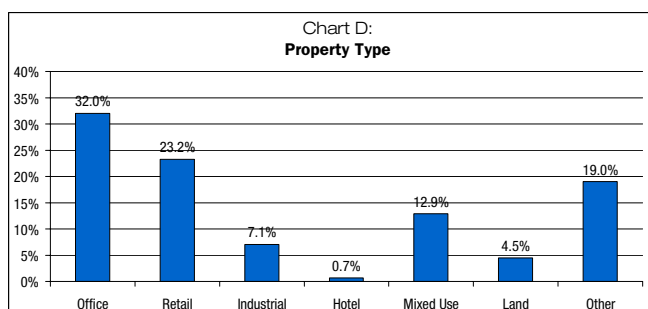
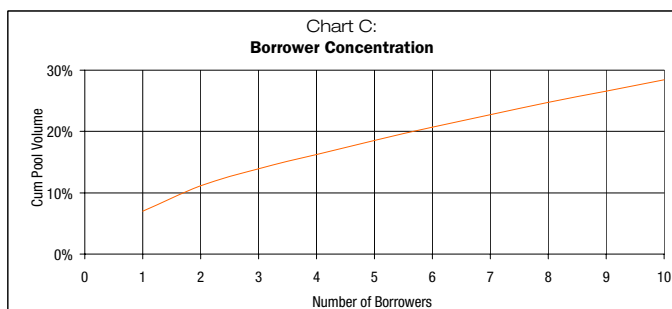
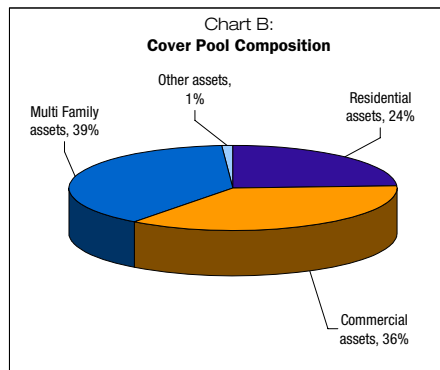
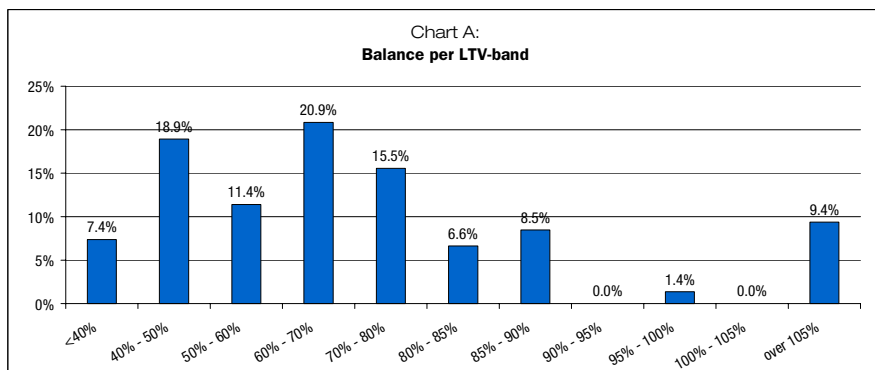
Overview

Collateral Score:	-
Asset balance:	1,374,878,120
Average loan balance:	1,676,680.6
Number of loans:	820
Number of borrowers:	561
Number of properties:	451
Largest 10 loans:	21.5%
Largest 10 borrowers (commercial pool):	28.4%
WA Remaining Term (in months):	n/d
WA Seasoning (in months):	n/d
Main Countries:	Germany

Specific Loan and Borrower characteristics

Bullet loans:	16.6%
Loans in non-domestic currency:	0.0%
Main Interest Rate Type:	fixed rate
Performance	
Loans in arrears (≥ 2months - < 6months):	0.0%
Loans in arrears (≥ 6months - < 12months):	0.0%
Loans in arrears (> 12months):	0.0%
Loans in a foreclosure procedure:	0.0%
Details on LTV	
WA current LTV (*):	73.6%
WA Indexed LTV:	-
Valuation type:	Lending Value
LTV Threshold:	60.0%
Junior ranks:	n/d
Prior ranks:	n/d

(*) Based on original property valuation
(**) n/d : information not disclosed by Issuer



Qualitative Collateral Information

All pool characteristics are actual levels (rather than assumed levels) based on reports from LBBW.

Loans to employees of LBBW are estimated at 3% of the bank's residential mortgage book, the same level has been assumed in Moody's analysis of the Cover Pool for the residential mortgage part of the Cover Pool.

LTV numbers reported are based on the Lending Value according to the German regulations in the *Pfandbrief* Act and the Lending Value Regulation. The LTV distribution displayed above reflects all mortgage loans in the Cover Pool (hence no separate LTV distribution for residential mortgages and commercial mortgages).

Residential Mortgages:

- The numbers provided under Residential Mortgages also include loans secured by multi-family buildings, which would usually be shown in the Commercial Mortgage section. The multi-family business reported as residential mortgage business and taken into consideration for these tables and charts accounts for around €1,458 million.
- No distribution for seasoning or interest type has been provided. However, the weighted average seasoning for these loans is 76 months, and the vast majority of these loans have a fixed rate (as 97% of the total pool assets have a fixed rate).

APPENDIX 2: INCOME UNDERWRITING AND VALUATION

1. Income Underwriting

1.1	Is income always checked?	Yes
1.2	Does this check ever rely on income stated by borrower ("limited income verification") income stated by the borrower?	No
1.3	Percentage of loans in Cover Pool that have limited income verification	None
1.4	If limited income verification loans are in the Cover Pool, describe what requirements lender has in place for these loans.	Not applicable
1.5	Does income in all cases constrain the amount lent (for example, through some form of Income Sufficiency Test ("IST"))?	Yes
1.6	If not, what percentage of cases are exceptions.	No exceptions
For the purposes of any IST		
1.7	Is there any confirmation that income after tax is sufficient to cover both interest and principal?	Yes
1.8	If so, over what period is it assumed that principal will be paid (typically on an annuity basis)? Any exceptions?	Payment of interest and principal typically on an annuity basis, which determines the duration of the loan. Typically residential mortgage loans have a duration of up to 35 years
1.9	Does the age of the borrower constrain the period over which principal can be amortised?	Yes
1.10	Are any stresses made to interest rates when carrying out the IST? If so, when and for what type of products?	Yes, in cases where the time to re-set is below 8 years for a fixed-rate loan, or in cases of variable rate loans a minimum interest rate is taken into consideration
1.11	Are all other debts of the borrower taken into account at point loan made?	Yes
1.12	How are living expenses of the borrower calculated? What is the stated maximum percentage of income (or income multiple if relevant) that will be relied on to cover debt payments. Please specify if income is pre or post tax?	Expenses take into account <i>inter alia</i> the number of persons living in the household and are based on standard indices prepared by the public statistic office (<i>Statistisches Bundesamt für Gesamtdeutschland</i>). These are published in current consumer price index (<i>Einkommens- und Verbraucherstichprobe</i>). The maximum ratio of total debt to net income may not exceed a certain level
Other Comments		None

2. Valuation

2.1	Are valuations based on market or lending values?	In order to determine the eligible loan volume for the Cover Pool, the Lending Value according to German lending value (or <i>Beleihungswert</i>) regulation has to be used. During the credit process the market value (or regulated <i>Marktwert</i>) of the property will also be calculated and taken into consideration.
2.2	Are all or the majority of valuations carried out by external valuers (i.e. with no direct ownership link to any company in the Sponsor Bank group)?	The majority of valuations are carried out by internal valuers. However, external valuers are also used from time-to-time.
2.3	How are valuations carried out where external valuers are not used?	Regardless of whether internal or external valuers are used, the valuation is carried out by appraisers that are independent from the credit decision. The German <i>Pfandbrief</i> legislation stipulates that the appraisers have the relevant skills and knowledge. In general, valuation has to meet the minimum requirement set out in the regulations for the Lending Value. Moody's understands that the German FSAs' remit is to check that the Lending Value has been calculated in accordance with the regulatory requirements during its regular cover pool audit once every two years.
2.4	What qualifications for external valuers require?	Valuers typically have a professional background as real estate appraisers. The required qualification can be proven by, for example, a relevant certificate (Moody's understands the German market standard is <i>CIS HypZert</i> in accordance with DIN EN ISO/IEC 17024).
2.5	What qualifications do internal valuers require?	Internal valuers typically have a professional background as real estate appraisers. The required qualification can be proven by, for example, a relevant certificate (Moody's understands the German market standard is <i>CIS HypZert</i> according to DIN EN ISO/IEC 17024).
2.6	Do all external valuations include an internal inspection of a property?	Yes
2.7	Any exceptions?	None
2.8	Do all internal valuations include an internal inspection of a property?	Yes
2.9	Any exceptions?	None
	Other comments	Not applicable

APPENDIX 3: LEGAL FRAMEWORK FOR GERMAN MORTGAGE COVERED BOND (HYPOTHEKENPFANDBRIEF)

1) Pfandbrief Act

Banks require licence from German FSA to issue Pfandbriefe

Pfandbrief issuers are regulated by the German Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht* or *BaFin*), which grants licences for *Pfandbrief* issuers (*Pfandbriefbank*). The granting of the licence for Mortgage *Pfandbrief* business is contingent upon the *Pfandbriefbank* meeting certain requirements under the *Pfandbrief* Act. This includes requirements on procedures and risk management systems to manage, monitor and control the risks for the Cover Pool and the issuance of *Pfandbriefe*.

Pfandbriefe are backed by the Cover Pool

The Mortgage Covered Bonds constitute in each case a direct, unconditional and senior obligation of the *Pfandbriefbank*; and are secured by a pool of assets (“the Cover Pool”). In general the Cover Pool may be composed of mortgage loans secured by residential or commercial properties, including building land and new buildings under construction, which may not exceed 10% of the Cover Pool or twice the *Pfandbriefbank*’s liable own capital. The *Pfandbrief* Act requires that the buildings must be insured against risks relevant to the location and type of the particular property throughout the remaining term of the loan.

Geographic restriction set limits for eligible cover pool assets outside Germany

The buildings serving as security for the loans that are included in the Cover Pool are subject to a conservative evaluation of property values (Lending Value or *Beleihungswert*), and *Pfandbriefe* can only be issued against 60% of this Lending Value. For more information on the lending value please see following sub-section of this appendix.

In general, the *Pfandbrief* Act sets out geographic restrictions with respect to the location of the properties that secure a mortgage loan. Such properties may not be located outside the following countries: Member States of the European Union (EU) or in another Contracting State to the Agreement on the European Economic Area (EEA), Switzerland, the United States of America (USA), Canada and Japan. For mortgage loans secured by properties located in the countries mentioned above – but outside Germany – the *Pfandbrief* Act requires that it must be ensured that the preferential right of the *Pfandbrief* holder shall extend after the declaration of bankruptcy of the *Pfandbriefbank* to the claims of the *Pfandbriefbank* related to such Cover Pool assets.

The “main” insolvency proceedings against a *Pfandbriefbank* can only be opened in Germany (by application of *BaFin*) and would have, according to German law, an international scope. However, it is Moody’s understanding that, following the declaration of bankruptcy of the *Pfandbriefbank*, a local court may commence proceedings against the non-EU-based branch that made the loan using local insolvency laws (local proceedings). The local insolvency laws may not recognise the preferential rights of *Pfandbrief* holders, which is valid under the German law. The *Pfandbrief* Act mitigates this risk by restricting the total volume of the mortgage loans from countries where the preferential right of the *Pfandbrief* holder might not be ensured in countries outside the EU to 10% of the total loan amount, and where the preferential right of the *Pfandbrief* holder is ensured upon the declaration of bankruptcy of the *Pfandbriefbank* (“10% limit”).

The Pfandbrief issuer is obligated to maintain a minimum over-collateralisation of at least 2% on a stressed NPV calculation basis

The *Pfandbrief* Act requires that the nominal amounts and the interest payable on the Cover Pool assets match the respective nominal amount and the interest payable in respect of the outstanding *Pfandbriefe* (PAR test). In addition, the *Pfandbriefbank* is obliged to maintain a minimum over-collateralisation of at least 2% on a stressed NPV calculation basis (NPV test). A regulation on the NPV test (*Pfandbrief-Barwertverordnung*)⁷ published by *BaFin* lays out three methods for stressing the interest rate and the currency exposure in the Cover Pool in order to meet regulatory requirements: (i) the static approach, (ii) the dynamic approach and (iii) a method based on the *Pfandbrief* issuer’s internal risk model, which has to be approved by *BaFin*.

⁷ Regulation on the Determination of the Mortgage Lending Value - in German: *Verordnung über die Sicherstellung der jederzeitigen Deckung von Hypothekendarwertverordnungen, Öffentlichen Pfandbriefen und Schiffspfandbriefen nach dem Barwert und dessen Berechnung bei Pfandbriefbanken (Pfandbrief-Barwertverordnung)* as of July 2005.

Covered Bond holders may benefit from voluntary and prescribed over-collateralisation in the Cover Pool following the commencement of *Pfandbrief* issuer insolvency proceedings. Claims of hedge counterparties rank equally with Covered Bond investors.

Regular audits of the Cover Pool conducted by the German FSA

BaFin has established a reporting mechanism, whereby the *Pfandbriefbank* has to report key figures regarding its *Pfandbrief* programme on a regular basis. Furthermore, *BaFin* will conduct audits of the Cover Pool (*Deckungsstockprüfung*) on a regular basis (at least once every two years). In addition, many of the operations in respect of the Cover Pool are monitored by an independent cover pool monitor (*Deckungsstocktreuhänder* or *Treuhänder*) on an ongoing, day-to-day, basis. For example, Moody's understanding from legal and industry advisors is that no assets may be de-registered from the Cover Pool without the prior written consent of the *Treuhänder* while, prior to the issuance of a new *Pfandbrief*, the *Treuhänder* checks if the regulatory requirements – such as the mandatory minimum over-collateralisation – will still be met following the issuance of the new Covered Bond.

The Sachwalter will take over management responsibility of the programme, and this may occur at or before the declaration of bankruptcy of the Pfandbriefbank

At the time of the declaration of bankruptcy of the *Pfandbriefbank*, or earlier if *BaFin* sees the need, a cover pool administrator (*Sachwalter*) will take over management responsibility of the Covered Bond programme. The *Sachwalter* will undertake to satisfy the Covered Bond holders by managing the Cover Pool and acts independently from the insolvency administrator of the *Pfandbriefbank*. Its duty of care is to the *Pfandbrief* investors and other preferential creditors such as the swap counterparties, should the swaps be registered into the Cover Pool. Having an independent cover pool administrator may reduce potential conflicts of interest between the Covered Bond investors and other creditors.

Having an independent cover pool administrator may reduce potential conflicts of interest between the Covered Bond investors and other creditors

In the event of insolvency of the *Pfandbriefbank*, the following scenarios may occur:

1. The *Sachwalter* manages to satisfy all claims of Covered Bond holders. Following its appointment, the *Sachwalter* will be responsible for managing the Cover Pool until all outstanding Covered Bonds have been repaid or transferred to another suitable *Pfandbriefbank*. In order to make timely payments, the *Sachwalter* has the right to attempt to raise funds against the Cover Pool through the sale of assets in the Cover Pool (either in part or in whole) or through bridge financing.⁸ In addition, the *Sachwalter* has the right to attempt to sell all or part of the Cover Pool as a package together with outstanding Covered Bonds, but only to another suitable *Pfandbrief* issuer.
2. The Cover Pool assets are not sufficient to satisfy all claims of Covered Bond holders. In this case, *BaFin* may apply for a separate insolvency proceeding for the Cover Pool. Following the initiation of an insolvency proceeding of the Cover Pool, all Covered Bonds will become due and payable and an insolvency administrator for the Cover Pool will be appointed. The insolvency administrator will distribute the proceeds stemming from the disposal of the Cover Pool assets among the Covered Bond holders and other preferred creditors on a *pari passu* basis. If the proceeds are not sufficient to meet all the claims of the Covered Bond holders, then the Covered Bond holders should have a senior unsecured claim against the general insolvency estate of the *Pfandbriefbank*.

In summary, the *Sachwalter* is expected to (i) run the programme until the maturity of the last Covered Bond or (ii) transfer the programme to another suitable *Pfandbriefbank*. The programme is only expected to be accelerated in the event of an insolvency of the Cover Pool. Upon acceleration, the *Pfandbrief* investors will rank on a *pari passu* basis.

Commingling risk: payments and receivables on the Cover Pool assets are not separated from other cash flows from the Issuer prior to the appointment of the Sachwalter
Set-off risk is mitigated by the operation of the Pfandbrief Act

Prior to the declaration of bankruptcy of the *Pfandbriefbank*, payments made from the Cover Pool assets are collected on a cash account, but not necessarily all cash flows on Cover Pool assets are separated from all other cash collections made by the *Pfandbriefbank*. Upon the appointment of the *Sachwalter*, the *Sachwalter* would have to separate these cash flows before payment is made to covered bondholders.

Moody's understanding from legal and industry advisors with respect to Mortgage Covered Bonds is that set-off risk for loans registered in the Cover Pool and made in Germany backed by German assets is excluded by the operation of the *Pfandbrief* Act within Germany. However, upon the declaration of bankruptcy of the *Pfandbriefbank*, potential set-off risks could arise; for example, during foreclosure proceedings where loans have been made outside Germany.

⁸ Moody's understanding from legal advisors is that the party providing bridge financing to the Cover Pool would not enjoy senior status with respect to the Covered Bond holders.

2) Lending Value Regulation

Lending Value concept

With respect to the valuation of a property serving as security for the mortgage loan (Cover Pool asset), Moody's understands that the *Pfandbrief* Act requires the following:

- The valuation has to be conducted by an appraiser, acting independently from the credit decision. This may be an internal or external appraisal, which must have adequate expertise and experience.
- As a rule, the property to be valued must be inspected as part of the valuation procedure.
- The Lending Value must not exceed the Market Value.⁹ The Lending Value is based on the long-term and sustainable aspects of the property under normal circumstances in the property market in the region where the specific property is situated.

While the Lending Value is defined by the *Pfandbrief* Act in general, *BaFin* published the "Regulation on the Determination of the Mortgage Lending Value (*Beleihungswertermittlungsverordnung* or *BelWertV*),¹⁰ which gives details of regulatory requirements of how the Lending Value has to be calculated for certain property types.

Methods to determine the lending value

Moody's understands that there are three methods to determine the Lending Value.

- i) Income Method ("*Ertragswertverfahren*"): The net income of the property, which is expected to be generated in the long-run and on a sustainable basis (based on current market conditions in the region where the property is situated), is discounted. The *BelWertV* details a number of property-specific factors for the calculation of – for example, minimum and maximum discount factors, limits for assumptions regarding the economically useful life of the property as well as minimum amounts regarding administration and maintenance costs when the net income stemming from the property is determined.
- ii) Cost Method ("*Sachwertverfahren*"): The Lending Value of the building reflects long-run and sustainable aspects of a building including (but not limited to) the construction costs of the property and mandatory haircuts. The construction costs must be appropriate for the region and the property type. Depreciation of the value of the building ("*Wertminderung wegen Alter*") needs to be taken into consideration, as well as the current and possible alternative uses ("*Drittverwendungsfähigkeit*") of the property under normal conditions of the specific regional market.
- iii) Comparison Method ("*Vergleichswertverfahren*"): This is applicable for *inter alia* flats and houses, and only in addition to the above-mentioned approaches in order to double-check the results. It is based on market data (i.e. observed transactions) for similar properties with respect to – for example, location, fixtures and fittings, property type (ideally in the same region). In addition, a safety margin of at least 10% must be deducted.

Moody's understands that, as a rule, the Income Method drives the Lending Value for a property in general. In case the value based on the Income Method exceeds 20% of the Cost Approach or Comparison Approach, the sustainability of the income generated by the property has to be double-checked.

⁹ The value resulting from a prudent assessment of the future marketability of the property

¹⁰ In German: *Verordnung über die Ermittlung der Beleihungswerte von Grundstücken nach §16 Abs. 1 und 2 des Pfandbriefgesetzes (Beleihungswertermittlungsverordnung, BelWertV)* as of May 2006.

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