

Credit Opinion: Muenchener Hypothekenbank eG

Münchener Hypothekenbank eG

Munich, Germany

Ratings

Category	Moody's Rating
Outlook	Stable
Bank Deposits	Aa3/P-1
Bank Financial Strength	C+
Public-sector Pfandbriefe	Aaa
Mortgage Pfandbriefe	Aaa
Senior Unsecured	Aa3
Subordinate -Dom Curr	A1
Other Short Term -Dom Curr	P-1
GFW Capital GmbH	
Outlook	Stable
Jr Subordinate -Dom Curr	A2

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Key Indicators

Muenchener Hypothekenbank eG

	[1]2007	2006	2005	2004	2003	Avg.
Total assets (EUR billion)	32.93	31.93	34.01	32.88	31.15	[2]1.97
Total capital (EUR billion)	0.78	0.80	0.83	0.68	0.63	[2]5.08
Return on average assets	0.04	0.03	0.03	0.03	0.11	0.05
Recurring earnings power [3]	0.15	0.19	0.14	0.11	0.20	0.16
Net interest margin	0.33	0.28	0.29	0.23	0.36	0.30
Cost/income ratio (%)	52.12	48.10	54.79	61.66	47.86	52.91
Problem loans % net loans	--	--	--	--	--	--
Tier 1 ratio (%)	--	--	--	--	--	--

[1] As of December 31. [2] Compound annual growth rate. [3] Preprovision income % average assets.

Opinion

SUMMARY RATING RATIONALE

Moody's assigns a bank financial strength rating (BFSR) of C+ to Münchener Hypothekenbank eG (MünchenerHyp), which translates into a Baseline Risk Assessment of A2. The rating derives from the bank's strong business franchise as a residential mortgage lender, its significant position as a Pfandbrief issuer in the German market and its affiliation with the German co-operative banks, which gives the bank access to a solid nationwide network of branches. However, it also takes into account the bank's weak risk-weighted profitability and modest capitalisation.

MünchenerHyp's long-term global local currency (GLC) debt and deposit ratings are at the Aa3 / Prime 1 level based on (i) the bank's intrinsic credit strength, reflected in its Baseline Credit Assessment of A2; (ii) Moody's assessment of a very high probability of cross-sector support from FinanzVerbund "BVR" (Bundesverband der Deutschen Volksbanken und Raiffeisenbanken - the German co-operative banks association); and (iii) our opinion

that there is a moderate probability of systemic support.

Consequently, there is a two-notch uplift for MünchenerHyp's GLC deposit rating from its A2 Baseline Credit Assessment.

Credit Strengths

- Low risk profile reflected by primary focus on residential mortgages in Germany, conservative approach to both commercial real estate lending and public sector lending
- Stable domestic franchise built on close ties with the German co-operative sector, further strengthened by its membership in the FinanzVerbund
- Good asset quality with low concentration risks and high diversification in the loan portfolio
- Stable funding profile based on good access to an international investor base

Credit Challenges

- Deteriorating outlook on European real estate markets, albeit somewhat better for Germany when compared with various other European economies
- Weak risk-weighted profitability
- Significant growth in international business could lead to asset deterioration

Rating Outlook

The outlook on all ratings is stable.

What Could Change the Rating - Up

We see limited rating upside at this time. However, positive pressure on the BFSR could result from a sustained improvement in the bank's financial fundamentals, especially if risk-adjusted recurring earnings power stays consistently above 2.5% which is however not expected for the foreseeable future..

What Could Change the Rating - Down

A failure to strengthen risk-adjusted profitability, especially if MünchenerHyp's performance becomes less predictable, could exert pressure on the BFSR. Lower granularity or deterioration in the quality of the loan portfolio, e.g. due to a significant increase in commercial property business, and reflected by a problem loan to gross loan ratio above 2% could also lead to pressure on the ratings. As a more remote scenario, a weakening in MünchenerHyp's links to (and expected support from) the co-operative banks would exert pressure on the senior unsecured debt and deposit ratings.

Recent Results and Company Events

In 2007, MünchenerHyp could expand its total assets from EUR 31.9 billion to EUR 32.9 billion mainly due to increased new mortgage business. The bank's portfolio of mortgage and other property finance loans rose from EUR 12.2 billion to EUR 14.1 billion reflecting an increase of 15.8%. Rising new business was supported by interest rates as the expectation of an interest rate hike motivated numerous customers to secure favourable conditions.

The cost to income ratio increased to 52.1% (versus 48.1% in 2006) despite the drop in operating expenses by 8.6% due to a reduced operating income of EUR 102 million (versus EUR 120 million in 2006, albeit impacted by a one-time effect). Consequently, pre provision income decreased to EUR 49 million from EUR 62 million.

Net income was slightly higher at EUR 12 million (versus EUR 11 million in 2006) after substantially reduced risk provisions (lower by EUR 22 million).

MünchenerHyp is not invested in US subprime assets due to its conservative risk policy and therefore the ongoing financial crisis has left the bank's franchise unharmed.

Despite worsening conditions in the international debt capital markets, MünchenerHyp did not face any serious difficulties in refinancing its business because the bank's funding needs are largely covered through issuing Pfandbriefe and the proven resilience and favourable pricing that this instrument has been enjoying during the

crisis.

At the end of 2007, the bank's core capital ratio according to Basel II (SolV) was 6.5%.

In May 2007 the management boards of MünchenerHyp and Deutsche Genossenschafts Hypothekenbank (DG Hyp, not rated by Moody's) started discussions on a potential merger of the two banks and signed a corresponding letter of understanding. However, after several months the talks were halted and the merger plans abandoned.

DETAILED RATING CONSIDERATIONS

Detailed considerations for MünchenerHyp's currently assigned ratings are as follows:

Bank Financial Strength Rating

Moody's BFSR of C+ for MünchenerHyp is supported by the bank's solid franchise as a residential mortgage lender in Germany, its affiliation with the German co-operative banks, as well as its excellent access to the German covered bond market and its highly diversified loan portfolio.

The BFSR also takes into account the bank's good cost efficiency and low risk profile, demonstrated by sound asset quality. This is characterised by both one of the lowest loan-to-value profiles among German mortgage banks and an increasing, but still relatively low, level of commercial real estate financing. A key element constraining the BFSR is the bank's modest profitability.

As a point of reference, the assigned BFSR is one notch above the C outcome of Moody's bank financial strength scorecard. Some subfactors in the scorecard were adjusted to give a clearer picture of MünchenerHyp's risk positioning and financial fundamentals: (1) the credit risk concentration score was adjusted to reflect the bank's prudent approach to borrower concentration, and (2) the liquidity ratio was adjusted to reflect the real exposure to unsecured and rating-sensitive market funding by deducting the amount of Pfandbriefe and other on-balance sheet securitisations from market funds.

Qualitative Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

MünchenerHyp is one of the mortgage banks in the German co-operative banking sector, focusing on residential mortgage lending to private individuals in Germany, as well as on commercial real estate and public sector finance in Germany and abroad. The bank's real estate business is dominated by residential mortgage loans. However, over time MünchenerHyp has steadily developed its commercial real estate activities, driven primarily by the increase in loans to international borrowers, especially in the US, the Netherlands, the UK and France.

The bank's domestic real estate business is largely derived from its close ties with the local co-operative banks in Germany, together holding a market share of approximately 17% in domestic lending and close to 20% in retail savings deposits. The co-operation with the co-operative sector gives MünchenerHyp access to the comprehensive and widespread branch network and the extensive client base of these local banks.

Approximately 70% of the bank's new domestic residential mortgage loans are originated via these banks. Whilst present throughout Germany, MünchenerHyp retains a stronger focus on the southern German states.

Public sector lending accounts for roughly 50% of the bank's assets. The public sector finance activities are declining because public sector loans or finance activities are entered into only if these comply with strict risk-return targets. MünchenerHyp is somewhat reluctant to focus extensively on a business line with low and ongoing pressure on margins, which therefore requires active and judicious interest rate matching.

In light of these elements, the overall score for the bank's franchise value is B-.

Factor 2: Risk Positioning

Trend: Neutral

MünchenerHyp's overall risk profile is very sound. The bank's activities are dominated by low-risk/low-margin business. We expect the bank to maintain its low risk profile, which is supported by the high quality of assets and low concentration risks in the loan and investment portfolios. Concentration risks in public sector and the interbank sector are not of major concern, given that these are largely highly rated borrowers. However, the bank's mortgage portfolio also contains concentration risks relating to its commercial real estate lending activities, which could put pressure on the bank's financial profile.

In recent years MünchenerHyp has improved its risk management systems and has continued to comply with its conservative underwriting standards. We expect MünchenerHyp to maintain its more cautious stance in comparison with some of its peers with similar public sector lending business by largely refraining from taking yield curve exposure and engaging in trading activities

MünchenerHyp's low risk profile is also supported by a very good liquidity management, i.e. effective measurement, monitoring and control systems, and by a moderate risk appetite in terms of market risk. Market risk is confined almost exclusively to interest rate risk as foreign exchange, equity and trading risks are minimal. While the use of derivatives is high in terms of notional values, these largely reflect interest rate swaps used for hedging.

MünchenerHyp's score for risk positioning is D+.

Factor 3: Regulatory Environment

All German banks are subject to the same score on the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether regulatory bodies are independent and credible demonstrate enforcement powers and adhere to global standards of best practices for risk control. According to Moody's country regulatory environment assessment Germany has an advanced regulatory environment. Refer to Moody's most recent Banking System Outlook for Germany to obtain a detailed discussion on the regulatory environment.

Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all German banks. Moody's assigns a B score for the overall operating environment. Refer to Moody's most recent Banking System Outlook for Germany to obtain a detailed discussion on the operating environment.

Quantitative Factors (50%)

Factor 5: Profitability

Trend: Neutral

The bank's profitability has historically been low even by German mortgage bank standards, but in particular on an international basis, principally reflecting the bank's concentration on low-yielding residential mortgage and public sector lending activities. However, when comparing the bank's profitability to that of peers, one has to bear in mind that profit maximisation is not a target of MünchenerHyp given its status as a member of and a service provider for the co-operative banking sector.

During the last three years MünchenerHyp's overall profitability levels have been improving, recovering from the 2004 low.

However, the overall score for profitability is E+.

Factor 6: Liquidity

Trend: Neutral

For its funding, MünchenerHyp largely depends on market funds, but also has deposit available (mostly from institutional clients in the coop sector) which have been stable in the past and at the end of 2007 funded approximately one fourth of total liabilities. Besides, the bank was a net lender in the interbank market, reflecting a satisfactory liquidity position.

MünchenerHyp's business strategy is supported by the bank's excellent access to the German covered bond (Pfandbrief) market. The low-margin character of the bank's assets is partially counterbalanced by the excellent funding conditions it enjoys in the capital markets for secured debt issuances. Moreover, the bank benefits from a satisfactory diversification of funding sources and, more importantly, strong relationships with key providers of funding, i.e. insurance companies, international banks and funds.

As the liquidity ratio does not adequately reflect the bank's liquidity position (as discussed above), we have adjusted the market funds by excluding Pfandbriefe. This change improves the liquidity score to B+ from C.

Factor 7: Capital Adequacy

Trend: Neutral

MünchenerHyp's equity-to-assets ratio of 2 % as at end of 2007 compares well with that of other German mortgage banks; however, it is modest by international standards. The risk-weighted (regulatory) capital ratios are satisfactory in comparison with banks on the same BFSR level, benefiting from the high proportion of 0% and low risk-weighted assets. As of end-2007 the total capital ratio was 9.7% and the Tier 1 ratio 6.5%, based on German Solvency Regulations (Basel II). We note, however, that MünchenerHyp still uses the standard approach to credit risk, bearing some potential for risk-weighted assets relief once the bank starts using the internal rating based approach (IRBA) under Basel II.

Close to 40% of Tier 1 capital is made up of hybrid capital products (silent participations). We view these hybrid instruments as lower-quality equity components and partly exclude silent participations from our tangible common equity calculations (TCE ratio) as we believe that these instruments have, to some extent, characteristics of debt.

MünchenerHyp's economic capital position is enhanced by a relatively high level of undisclosed reserves. In our opinion, the by and large modest risk of the bank's operations and the relatively sound earnings predictability, arising in particular from the German residential mortgage lending activities, mitigate to some extent the modest capitalisation levels. However, Moody's will monitor the risk of potentially rising risk charges going forward, which could put pressure on regulatory and economic capitalisation.

The unadjusted capital adequacy score is currently C.

Factor 8: Efficiency

Trend: Neutral

In recent years MünchenerHyp took measures to improve its efficiency. The IT investments and restructuring efforts, including the reduction of staff numbers, have started bearing fruits at the end of 2006. During recent years the cost-to-income ratio improved markedly, mainly based on a higher revenue level. The cost-to-income ratio fell to 52.1% as at end-2007 (YE 2006: 48%) from 62% in 2004 which, however, also was revenue-driven, and we note positively that total costs were lower in absolute terms.

We recognise that, in spite of the predominance of small-volume residential mortgage lending in its real estate loan book and the associated high level of expenses, the restructuring efforts of previous years now allow MünchenerHyp to keep operating expenses at low levels. MünchenerHyp scores B for efficiency, which is in the higher range of peers active in the real estate and public finance markets.

Factor 9: Asset Quality

Trend: Neutral

MünchenerHyp has historically maintained sound asset quality. However, in light of very difficult conditions witnessed in the German real estate markets in previous years, its asset quality deteriorated and loan loss provisions increased in 2003 and peaked in 2004. As a reaction to the deterioration in asset quality, MünchenerHyp reverted to a more conservative stance in underwriting, particularly in commercial real estate and took further steps to improve its asset quality by selling off non-performing loans.

We are comfortable with the overall characteristics of MünchenerHyp's loan portfolio, in which more than 60% of mortgage loans have a loan-to-value ratio (LTV) of 60% or lower and less than 10% have an LTV exceeding 80%. The mortgage loan portfolio is well diversified, both regionally and by borrower, and has a good granularity with around 75% of the loan volume represented by single loans below EUR 500,000. MünchenerHyp's involvement in real estate lending abroad is also following a cautious approach. So far, no exposure outside Germany has ever required provisions.

Overall, the bank has continued to follow a very conservative provisioning policy and as a result has an overall relatively low charge-off rate. The bank's relatively small volume of problem loans is sufficiently covered by reserves, in particular when taking into account its sizeable non-disclosed reserves.

The score for asset quality is B+, which is outstanding in the German banking market.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global local currency (GLC) deposit rating of Aa3 to Münchener Hyp.

The GLC rating is supported by MünchenerHyp's Baseline Risk Assessment of A2, as well as by the ratings of its underlying support providers:

- The creditworthiness of the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR) sector.

- Germany's Aaa local-currency deposit ceiling (LCDC).

The bank thus receives a two-notch uplift from its Baseline Risk Assessment, bringing the GLC rating to Aa3.

Based on MünchenerHyp's membership of the Association of Co-operative Banks Moody's assesses the probability of cooperative sector support for the bank in the event of a stress scenario as very high. The bank's membership of the FinanzVerbund provides MünchenerHyp with two forms of sector-specific support: the Garantiefonds (a support fund that is maintained by annual contributions from member banks) and the Garantie-Verbund (a further contractually defined support agreement, which invariably takes the form of a performance guarantee in favour of a co-operative bank in difficulty).

Additionally, the probability of systemic support is judged to be moderate. This is based on MünchenerHyp's relative small national market share but high importance to the German mortgage and Pfandbriefe market. Germany is characterised as a medium support country.

Notching Considerations

In line with Moody's notching guidelines published in April 2007, MünchenerHyp's dated subordinated debt is rated at A1, i.e. one notch below the bank's senior debt rating.

Foreign Currency Deposit Rating

Münchener Hyp's foreign currency deposit ratings are Aa3/Prime-1.

Foreign Currency Debt Rating

Münchener Hyp's foreign currency debt ratings are Aa3/Prime-1.

ABOUT MOODY'S BANK RATINGS

Bank Financial Strength Rating

Moody's Bank Financial Strength Ratings (BFSRs) represent Moody's opinion of a bank's intrinsic safety and soundness and, as such, exclude certain external credit risks and credit support elements that are addressed by Moody's Bank Deposit Ratings. BFSRs do not take into account the probability that the bank will receive such external support, nor do they address risks arising from sovereign actions that may interfere with a bank's ability to honor its domestic or foreign currency obligations. Factors considered in the assignment of BFSRs include bank-specific elements such as financial fundamentals, franchise value, and business and asset diversification. Although BFSRs exclude the external factors specified above, they do take into account other risk factors in the bank's operating environment, including the strength and prospective performance of the economy, as well as the structure and relative fragility of the financial system, and the quality of banking regulation and supervision.

Global Local Currency Deposit Rating

A deposit rating, as an opinion of relative credit risk, incorporates the BFSR as well as Moody's opinion of any external support. Specifically, Moody's Bank Deposit Ratings are opinions of a bank's ability to repay punctually its deposit obligations. As such, they are intended to incorporate those aspects of credit risk relevant to the prospective payment performance of rated banks with respect to deposit obligations, which includes: intrinsic financial strength, sovereign transfer risk (in the case of foreign currency deposit ratings), and both implicit and explicit external support elements. Moody's Bank Deposit Ratings do not take into account the benefit of deposit insurance schemes which make payments to depositors, but they do recognize the potential support from schemes that may provide assistance to banks directly.

According to Moody's joint default analysis (JDA) methodology, the global local currency deposit rating of a bank is determined by the incorporation of external elements of support into the bank's Baseline Risk Assessment. In calculating the Global Local Currency Deposit rating for a bank, the JDA methodology also factors in the rating of the support provider, in the form of the local currency deposit ceiling for a country, Moody's assessment of the probability of systemic support for the bank in the event of a stress situation and the degree of dependence between the issuer rating and the Local Currency Deposit Ceiling.

National Scale Rating

National scale ratings are intended primarily for use by domestic investors and are not comparable to Moody's globally applicable ratings; rather they address relative credit risk within a given country. A Aaa rating on Moody's National Scale indicates an issuer or issue with the strongest creditworthiness and the lowest likelihood of credit loss relative to other domestic issuers. National Scale Ratings, therefore, rank domestic issuers relative to each other and not relative to absolute default risks. National ratings isolate systemic risks; they do not address loss expectation associated with systemic events that could affect all issuers, even those that receive the highest

Factor: Operating Environment						B	Neutral
Economic Stability			x				
Integrity and Corruption		x					
Legal System	x						
Financial Factors (50%)						C	
Factor: Profitability						E+	Neutral
PPP % Avg RWA				0,56%			
Net Income % Avg RWA					0,12%		
Factor: Liquidity						C	Neutral
(Mkt funds-Liquid Assets) % Total Assets					33,52%		
Liquidity Management		x					
Factor: Capital Adequacy						C	Neutral
Tier 1 ratio (%)				6,80%			
Tangible Common Equity % RWA				4,84%			
Factor: Efficiency						B	Neutral
Cost/income ratio		51,67%					
Factor: Asset Quality						B+	Neutral
Problem Loans % Gross Loans	0,72%						
Problem Loans % (Equity + LLR)		19,12%					
Lowest Combined Score (15%)						D+	
Economic Insolvency Override						Neutral	
Aggregate Score						C	
Assigned BFSR						C+	

[1] - Where dashes are shown for a particular factor (or sub-factor), the score is based on non public information

[2] - A blank score under Earnings diversification or Corporate Governance indicates the risk is neutral

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