

Rating Action: Moody's downgrades MünchenerHyp to A2; outlook stable (Germany)

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BFSR downgraded to D+; Prime-1 ratings affirmed

Frankfurt am Main, September 09, 2011 – Moody's Investors Service has today downgraded Münchener Hypothekenbank eG's bank financial strength rating (BFSR) to D+ from C- (now mapping to Ba1 on the long-term rating scale from Baa2 previously). The downgrade of the BFSR triggered the downgrade of the senior debt and deposit ratings to A2 from A1.

Moody's has also affirmed MünchenerHyp's Prime-1 short-term rating and downgraded the Tier 1 instruments issued by GFW Capital GmbH and Isar Capital Funding I Limited Partnership to Baa3 (hyb) from Baa2 (hyb). The outlook on all the ratings is stable, from negative previously.

RATINGS RATIONALE

The downgrade of the BFSR was driven by several considerations, including (i) the bank's persistently weak profitability and internal capital generation, which leaves limited room for unexpected losses; combined with (ii) the bank's only adequate capitalisation in the context of its risk profile and its low quality of capital, which represents a challenge with regards to the upcoming Basel III requirements.

Furthermore, the bank remains exposed to ongoing asset-quality pressures at the current level from non-core portfolios such as international commercial real estate, as well as selected exposures within the bank's financial institutions and sovereign portfolio. Moody's believes that the challenges that MünchenerHyp faces are more consistent with a BFSR of D+, corresponding to Ba1 on the long-term rating scale.

In Moody's view, MünchenerHyp's weak risk-adjusted profitability represents a major rating constraint, leaving little room for unexpected losses. Combined with the possibility that weaker forms of capital might have to be replaced, the owners may have to take further capital measures. At the end of 2010, the bank's Tier 1 ratio stood at 6.4% and its core capital at EUR763 million, which included a sizable portion of hybrid Tier 1 capital instruments (EUR 341 million) according to audited 2010 financial statements. On a positive note, Moody's anticipates that MünchenerHyp is expected to qualify for substantial capital relief under the internal ratings-based approach, which is expected to result in a higher Tier 1 ratio going forward.

The stable outlook on the D+ BFSR is underpinned by MünchenerHyp's conservative risk profile in its core residential real-estate and domestic public-finance activities. Furthermore, it reflects Moody's expectation that MünchenerHyp will continue to improve its relative risk position through the reduction of its discontinued US commercial real-estate business, which was a key driver for higher problem loans. The stable outlook incorporates Moody's assumption that the bank will be able to manage the €1.5 billion total disclosed exposures related to sovereigns and banks in countries that are currently subject to credit deterioration.

The one notch downgrade of the long-term debt and deposit ratings to A2 follows the downgrade of the BFSR and incorporates Moody's view that MünchenerHyp will continue to benefit from the existing support mechanism available to members of the group of co-operative banks in Germany (the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken, BVR). Moreover, Moody's anticipates that the German cooperative sector -- and thereby indirectly MünchenerHyp -- would continue to benefit from a high probability of systemic support. Hence, MünchenerHyp's A2 long-term ratings with a stable outlook now benefit from a five notch rating uplift from four previously.

HYBRID RATINGS DOWNGRADED TO Baa3 (hyb); OUTLOOK STABLE

As per Moody's methodology for hybrid ratings, the assigned ratings for the capital notes and the fixed-rate capital securities issued by GFW Capital and Isar Capital Funding I are three notches below the A3 adjusted standalone credit strength, which reflects the D+ BFSR and incorporates four notches of co-operative support.

WHAT COULD CHANGE THE RATING UP/DOWN

Upward pressure on MünchenerHyp's standalone rating could result from (i) an improved quantity and quality of capital; (ii) rising and sustained profitability without compromising underwriting standards or risk appetite; and (iii) overall lower asset-quality pressures, in particular a shrinking of its portfolio of non-performing loans. A BFSR of D+, mapping into a higher Baa3 on the long-term scale, would not result in upward pressure on the long-term ratings.

Moody's would consider a downgrade of the BFSR if MünchenerHyp (i) experienced a further deterioration in non-performing loans; or (ii) suffered credit deterioration in its securities portfolio. The BFSR could be lowered if the bank faces difficulties in converting its existing Tier 1 instruments into stronger forms of capital. A lower BFSR could exert strong downward pressure on the long-term ratings.

PREVIOUS RATING ACTIONS AND PRINCIPAL METHODOLOGIES

Please see ratings tab on the issuer/entity page on Moody's.com for the last rating action and the rating history.

The methodologies used in this rating were Principal Methodology "Bank Financial Strength Ratings: Global Methodology" published in February 2007, and Principal Methodology "Incorporation of Joint-Default Analysis into Moody's Bank Ratings: A Refined Methodology", published in March 2007.

Headquartered in Munich, Germany, Münchener Hypothekenbank eG reported total assets of EUR35.4 billion and net income of EUR4.8 million as of the end of June 2011.

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