Fitch Ratings

Covered Bonds

Germany

Aareal Bank AG

Mortgage Pfandbriefe

Update

Ratings

Mortgage Pfandbriefe	AAA/Stable

Rating Rationale

IDR/Outlook	BBB+/Stable
D-Cap	4 notches (Moderate risk)
IDR Uplift	2 notches
Tested Rating on a PD Basis	'AA+'
Recovery Uplift	1 notch
Covered Bond Rating	'AAA'
'AAA' Breakeven OC (%)	24.0
OC Fitch Considers in its Analysis (%)	24.4

IDR – Long-Term Issuer Default Rating
PD – Probability of default
OC – Overcollateralisation

Discontinuity Analysis

Asset segregation	Low
Liquidity gap and systemic risk	Moderate
Systemic alternative management	Low
Cover pool-specific alternative management	Moderate
Privileged derivatives	Low

Key Data

	Dec 15
Asset type	Commercial Mortgages
Cover assets (EURbn)[a]	15.0
Pfandbriefe (EURbn)	11.7
Weighted-average life assets (years)	4.0
Weighted-average life Pfandbriefe (years)	3.3

[a] Excluding derivatives

Related Research

Fitch Affirms Aareal Bank's Mortgage Pfandbriefe at 'AAA'; Outlook Stable (May 2016)

Covered Bonds Surveillance Snapshot (April 2016)

Global Housing and Mortgage Outlook - 2016 (January 2016)

Fitch: D-Cap Unchanged for 18 German Covered Bond Programmes (December 2015)

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Key Rating Drivers

Rating Affirmed: The affirmed 'AAA' rating on Aareal Bank AG's (ARB, BBB+/Stable/F2) mortgage Pfandbriefe is based on ARB's Long-Term Issuer Default Rating (IDR) of 'BBB+', an unchanged IDR uplift of 2 and an unchanged Discontinuity Cap (D-Cap) of 4 (moderate risk). It also reflects the 24.4% over-collateralisation (OC) that Fitch Ratings takes into account, which provides more protection than the 24% 'AAA' breakeven OC.

Higher Stresses for Non-Domestic Assets: The slightly wider credit loss of 36.2% (up from 34.9%) is the main constituent of the breakeven OC. The increase is mainly due to application of the recently published updated foreign-currency stresses.

In addition, 16.7% of mortgage cover assets are in countries with a Country Ceiling (CC) below 'AAA'. Therefore under Fitch's sovereign risk criteria the agency has stressed recoveries for currency redenomination risk from eurozone assets with a CC below 'AAA'. This potential unhedged currency risk accounts for 4.4% of expected losses.

Increased Asset Disposal Loss: The asset disposal loss component increased to 5.3% from 3.5% a year ago. This increase is mainly due to a modelling assumptions change. In its current cash flow analysis, Fitch tested the point at which recourse against the cover pool is enforced at up to six quarters after the pool cut-off date, rather than up to four quarters previously.

Commingling Loss Reflected: As the issuer is rated below 'A' and 'F1', we assumed a commingling loss to occur just before issuer default. These assumptions, together with the high default rate assumption and the front-loaded default distribution applied lead to an increased need for forced asset sales to ensure timely payment of all outstanding Pfandbriefe after the recourse against the cover pool is enforced.

Improved Cash Flow Valuation: Initial open interest and currency positions are significantly mitigated by the inclusion of privileged derivatives in the cover pool. Combined with the well-matched profile, this led to the cash flow valuation component remaining the smallest at -1.8% (0% previously), reflecting the positive excess spread of the programme.

Programme Highlights

Cover Pool Composition: Portfolio composition and asset-liability mismatches are stable compared with 12 months ago. Office, retail and industrial exposure, hotel, logistics and multifamily properties are included in the commercial real estate (CRE) pool. The CRE properties are widely spread geographically, with the largest exposures (above EUR1bn) in Germany, France, the UK and US, each of which represent about 16% of the CRE assets. The remaining 37% of assets are relatively evenly spread across a further 14 countries.

Rating Sensitivity Analysis: The programme's 'AAA' rating would be vulnerable to downgrade if any of the following occurred: the IDR is downgraded by two notches or more to 'BBB-' or lower; the combined number of notches represented by the IDR uplift and the D-Cap is reduced to 4 or lower; or the OC that Fitch considers in its analysis drops below Fitch's 'AAA' breakeven level of 24%.

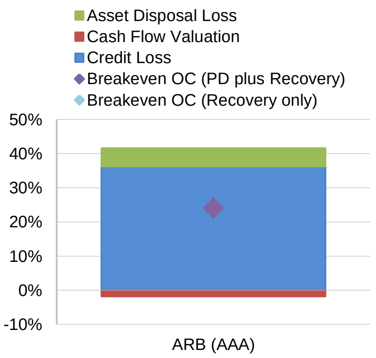
Criteria Variations: See page 3 of this report for a detailed explanation on the criteria variations applied in the analysis for Aareal Bank AG's mortgage covered bonds.

Cover Pool Characteristics: December 2015

Current principal balance (EURbn)[a]	**15.0**
- Thereof mortgage assets (EURbn)	13.4
- Thereof substitute assets (EURbn)	1.6
Number of borrowers	808
Number of loans	1,613
Number of properties	2,525
Borrower concentration (%)	
Top 20	19.8
Top 5	7.2
Top 3	4.7
Rate type	
Floating assets (%)	60.2
Floating pfandbriefe (%)	50.5
Repayment type (%)	
Instalment	10.6
Bullet	84.8
Annuity	4.6

[a] Excluding derivatives
Source: Aareal/Fitch

Breakeven OC Components



Source: Fitch

Related Criteria

Criteria for Interest Rate Stresses in Structured Finance Transactions and Covered Bonds (May 2016)

Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds - Excel File (May 2016)

Covered Bonds Rating Criteria (March 2016)

Fitch's Foreign Currency Stress Assumptions for Residual Foreign Exchange Exposures in Covered Bonds - Excel File (March 2016)

Fitch's Mortgage Covered Bond Refinancing Stresses - Excel File (February 2016)

Criteria for the Analysis of Commercial Real Estate Loans Securing Covered Bonds (December 2015)

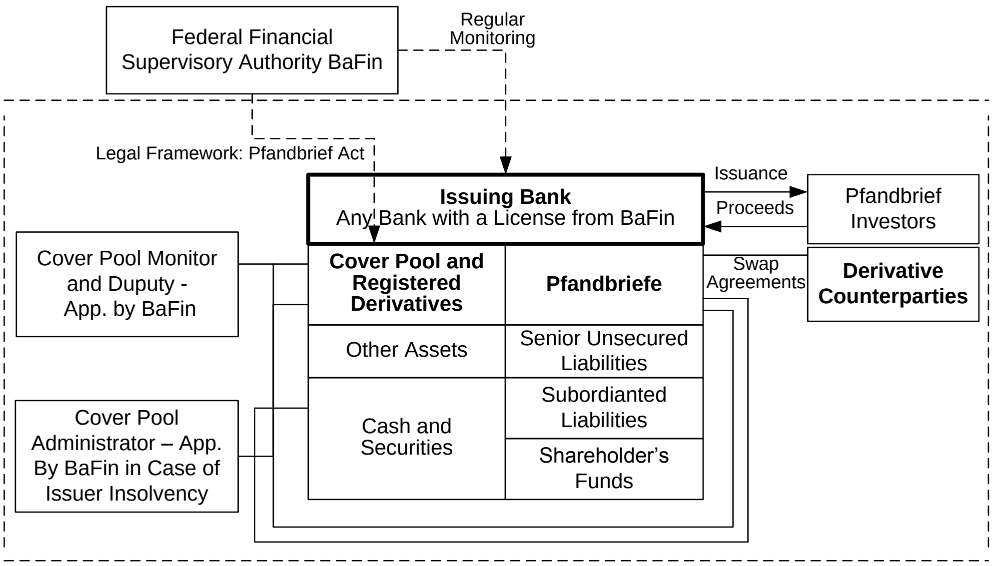
Covered Bonds Rating Criteria – Mortgage Liquidity and Refinancing Stress Addendum (September 2015)

Criteria for Sovereign Risk in Developed Markets for Structured Finance and Covered Bonds (February 2015)

Counterparty Criteria for Structured Finance and Covered Bonds (May 2014)

Counterparty Criteria for Structured Finance and Covered Bonds: Derivative Addendum (May 2014)

Diagram of a Pfandbrief Issuance



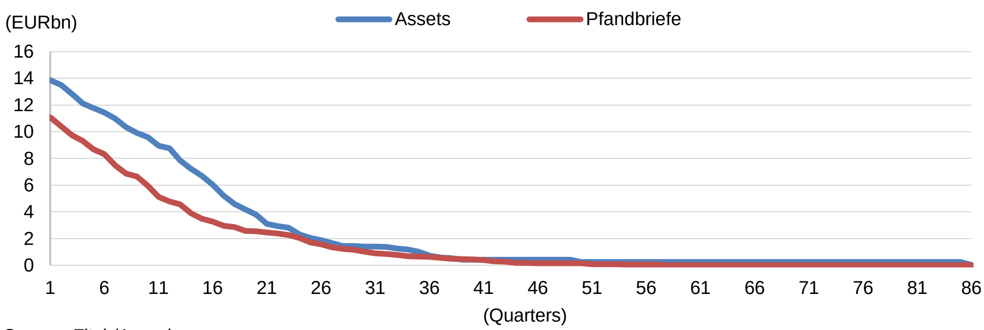
Source: Fitch

Fitch Default Model Output (%)

Rating level	'AAA'	'AA+'	'AA'
WA frequency of foreclosure (WAFF)	92.8	90.6	89.2
WA recovery rate (WARR)	71.3	81.3	86.6

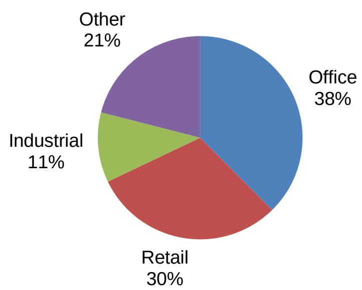
Source: Fitch

Amortisation Profile
(As of Dec 15)



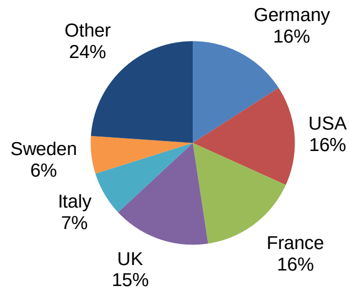
Source: Fitch/Aareal

Commercial Real Estate - Property Type
(% of commercial real estate assets)



Source: Fitch/Aareal

Commercial Real Estate - Property Location
(% of commercial real estate assets)



Source: Fitch/Aareal

Criteria Variations

Fitch applied variations from *Covered Bonds Rating Criteria - Mortgage Liquidity and Refinancing Stress Addendum*, published 23 September 2015, for cases where no specific mortgage refinancing stress assumptions for commercial real estate assets were available. For cover assets located in Austria, Belgium, Canada, Czech Republic, Finland, France, Iceland, Netherlands, Slovakia, Switzerland, the UK, and the US, amounting to 54% of the cover pool, refinancing spread levels (RSL) between 450bp and 753bp were applied in a 'AAA' stress scenario.

It was also assumed that an appointed special administrator would first sell assets with a lower discount (ie lower RSL) if they were available in the cover pool at the time of the sale. However, in a recovery given default scenario calculation, the weighted-average RSL of all cover assets was used to calculate the stressed net present value of the entire cover pool. The variations are reflected in the asset disposal loss component of the breakeven OC for the rating and have no impact on the rating of Aareal's Pfandbriefe.

Fitch applied a variation from *Covered Bonds Rating Criteria*, published 11 March 2016, for one case where no specific foreign currency stress assumptions were available. For the euro-Czech koruna currency pair we applied the category 3 stress assumptions. The variation is reflected in the analysis and has no impact on the rating of Aareal's Pfandbriefe.

Fitch applied a variation from *Criteria for the Analysis of Commercial Real Estate Loans Securing Covered Bonds*, published 10 December 2015. In the absence of CMBS guidance assumptions, Fitch assumed market value declines in line with the assumptions for German multifamily properties for office, retail, industrial and multifamily properties in Austria, Belgium, Finland, Sweden and Switzerland for which Fitch is provided with rental information.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.