

Aareal Bank AG

Mortgage Pfandbriefe Update

Ratings/Outlook

Mortgage Pfandbriefe	AAA/Stable
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Rating Rationale

IDR/Outlook	BBB+/Stable
IDR uplift	2 notches
Payment continuity uplift	4 notches
Tested Rating on a probability of default basis	AA+
Recovery given default uplift	1 notch
Covered Bond Rating	AAA
OC Fitch considers in analysis (%)	28.5
AAA breakeven OC (%)	27.5

Key Data

	July 2017
Asset type	Mortgage
Cover assets (EURbn)	14.3
Pfandbriefe (EURbn)	10.7
Nominal OC (%)	33.7
WAL of assets (years)	3.4
WAL of liabilities (years)	4.3

Key Rating Drivers

No Buffer Against IDR Downgrade: The 'AAA' rating of the covered bonds is based on Aareal Bank AG's (Aareal) Long-Term Issuer Default Rating (IDR) of 'BBB+', an IDR uplift of two notches, a Payment Continuity Uplift (PCU) of four notches, a one-notch recovery uplift and the overcollateralisation (OC) Fitch relies upon of 28.5%, which provides more protection than the 'AAA' breakeven OC of 27.5%. The Outlook is Stable.

The rating follows Fitch Ratings' assessment of Aareal's mortgage Pfandbriefe programme after the transfer of Westdeutsche Immobilienbank's (WI) cover assets and outstanding mortgage Pfandbriefe to Aareal, which took place on 30 June 2017.

Credit Loss Decreased but Still High: The credit loss component dropped to 21.1% (24.5%) due to the improved credit quality of the US and Canadian commercial real estate (CRE) portfolio, which accounts for about 20% of the CRE portfolio. The inclusion of 5% residential mortgages further contributed to lower loss expectations.

Compressed Excess Spread: The cash flow valuation rose to 5.2% from 1.4% in the previous analysis. The increase mirrors the compression of the programme's excess spread following the Pfandbrief programme merger. WI's Pfandbriefe carry a higher weighted average (WA) coupon than Aareal's. Fitch expects this effect to diminish over the next 12 months as most of WI's Pfandbriefe will mature by the end of 2018.

Programme Highlights

Internationally Diversified Pool: Following the inclusion of WI's cover pool, the non-German exposure accounts for 76% (previously 85%). Furthermore, the WA loan-to-value (LTV) improved to 37% (previously: 38%). It remains more diversified than peers with notable exposures to the US (20%), France (14%) and the UK (13%). Aareal's CRE pool has also become more granular as the share of the top 10 financings has shrunk to 11.4% from 13.3%, which is in line with peers.

Highly Seasoned Residential Portfolio: The integrated residential portfolio is largely comparable with peers, as all properties are spread over Germany without significant concentrations. The WA seasoning of about 12 years significantly exceeds peers and yields the lowest WA LTV of only 36%.

Prepayment Scenario Limits Asset Sales: The asset disposal loss component of 1.1% underlines the well-matched asset and liability profile. The programme is vulnerable towards high prepayment scenarios, which limits the need to model asset sales but at the same time reduces available excess spread. This increases the cash flow valuation component.

Criteria Variations: See Page 3 of this report for a detailed explanation on the criteria variations applied in the analysis for Aareal's mortgage Pfandbriefe.

Related Research

[Fitch Affirms Aareal Bank AG's Mortgage Pfandbriefe at 'AAA' on WI's Pfandbriefe Transfer \(January 2018\)](#)

[Aareal Bank AG \(April 2017\)](#)

[Fitch 2018 Outlook: Covered Bonds \(December 2017\)](#)

[Covered Bonds Surveillance Snapshot \(October 2017\)](#)

['B' Portfolio Loss Rates for Covered Bonds \(September 2017\)](#)

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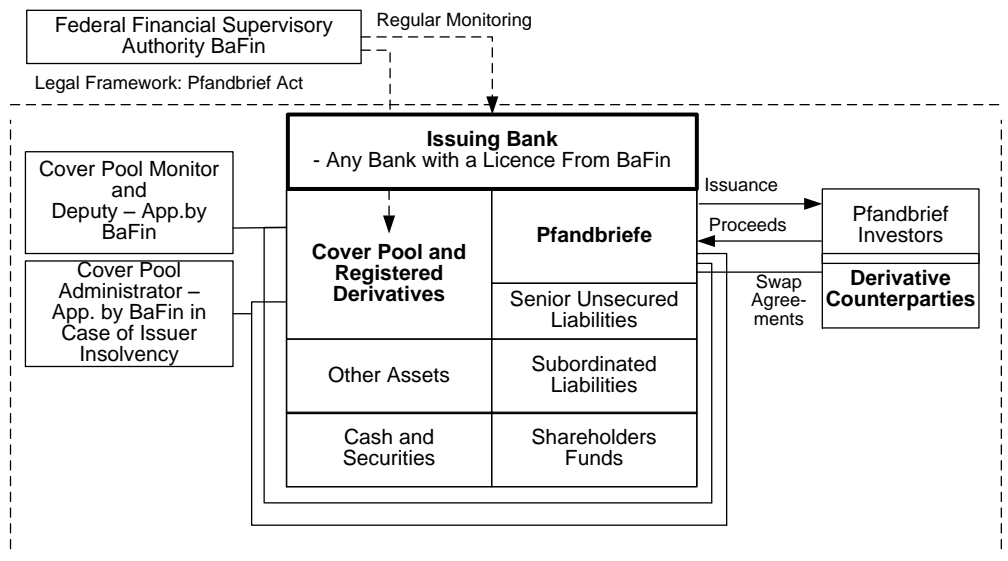
Cover Pool Characteristics: July 2017

Total balance (EURbn)	14.3
Commercial	12.0
Residential	0.8 ^a
Substitute assets	1.5
Number of loans	13,296
Number of borrowers	11,136
Number of properties	12,662
Interest rate type – CRE (%)	
Floating rate	59
Fixed rate	41
Repayment type – CRE (%)	
Bullet/interest only	83
Amortising	17
CRE – seasoning (years)	5.3
CRE – top 10 exposures (%)	11.4

Currency breakdown (EURbn) ^b		
	Assets	Pfandbriefe
EUR	13.0	9.9
USD	1.0	0.8
GBP	0.2	0.0

^a Includes loans secured by multifamily properties
^b Post-swap exposures above EUR100m
 Source: Fitch/Aareal

Diagram of a Pfandbrief Issuance



Source: Fitch

Fitch Default Model Output (%)

Rating level	AAA	AA+	AA
Rating Default Rate (RDR)	87.6	86.9	86.3
Rating Recovery Rate (RRR)	76.8	81.7	86.6

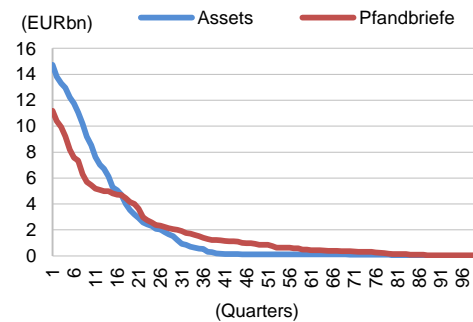
Source: Fitch

Related Criteria

- [Covered Bonds Rating Criteria \(December 2017\)](#)
- [Global Bank Rating Criteria \(November 2016\)](#)
- [Covered Bonds and CDOs Public Entities' Asset Analysis Rating Criteria \(December 2017\)](#)
- [Structured Finance and Covered Bonds Country Risk Rating Criteria \(September 2017\)](#)
- [Structured Finance and Covered Bonds Counterparty Rating Criteria \(May 2017\)](#)
- [Structured Finance and Covered Bonds Counterparty Rating Criteria: Derivative Addendum \(May 2017\)](#)
- [Fitch's Cover Asset Refinancing Spread Level \(RSL\) Assumptions – Excel File \(October 2017\)](#)
- [Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria \(February 2017\)](#)
- [Fitch's Interest Rate Stress Assumptions for Structured Finance and Covered Bonds – Excel File \(February 2017\)](#)
- [Fitch's Foreign-Currency Stress Assumptions for Residual Foreign-Exchange Exposures in Covered Bonds and Structured Finance – Excel File \(October 2017\)](#)
- [U.S. and Canadian Multiborrower CMBS Rating Criteria \(May 2017\)](#)
- [SME Balance Sheet Securitisation Rating Criteria \(March 2017\)](#)
- [Commercial Real Estate Loans Securing Covered Bonds Rating Criteria \(November 2017\)](#)

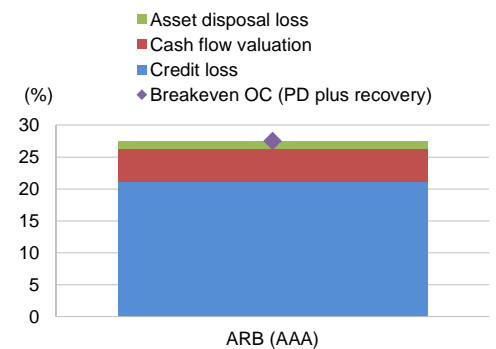
Amortisation Profile

(As of July 2017)



Source: Fitch/Aareal

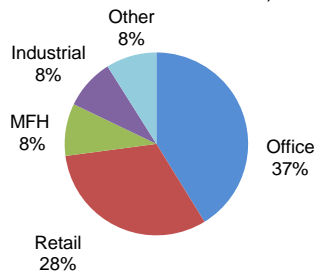
Breakeven OC Components



Source: Fitch

Commercial Real Estate - Property Type

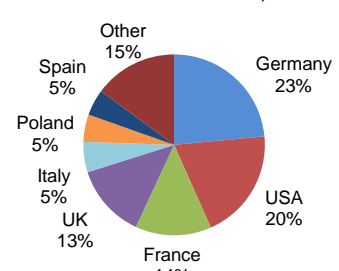
(% of commercial real estate assets)



Source: Fitch/Aareal

Commercial Real Estate - Property Location

(% of commercial real estate assets)



Source: Fitch/Aareal

Criteria Variations

Fitch has applied a variation to the "Covered Bonds Rating Criteria", published on 1 December 2017. Substitute assets that may vary in quantity and in nature are generally not included when calculating the refinancing spread levels for a specific programme. As Aareal commits to holding at least EUR700 million of such assets at any time, we included an amount up to this level included in the calculation of the refinancing spread levels. The application of this variation has not affected the programme's rating.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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