Moody's Investors Service

Credit Opinion: Bausparkasse Mainz AG

Global Credit Research - 30 Jul 2009

Mainz, Germany

Ratings

Category	**Moody's Rating**
Outlook	Stable
Bank Deposits	A3/P-2
Bank Financial Strength	C-

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Key Indicators

Bausparkasse Mainz AG

	[1]**2008**	**2007**	**2006**	**2005**	**2004**	**Avg.**
Total assets (EUR billion)	**2.49**	**2.43**	**2.46**	**2.43**	**2.42**	[2]**0.12**
Total capital (EUR billion)	**0.14**	**0.13**	**0.14**	**0.14**	**0.14**	[2]**1.88**
Return on average assets	**0.02**	**0.05**	**0.04**	**0.15**	**0.15**	**0.08**
Recurring earnings power [3]	**0.43**	**0.14**	**0.25**	**0.51**	**0.47**	**0.36**
Net interest margin	**1.34**	**1.37**	**1.58**	**1.78**	**1.67**	**1.55**
Cost/income ratio (%)	**74.46**	**92.44**	**87.24**	**76.61**	**77.49**	**81.65**
Problem loans % net loans	**--**	**1.44**	**0.24**	**0.21**	**0.19**	**0.52**
Tier 1 ratio (%)	**7.40**	**6.50**	**--**	**--**	**--**	**6.95**

[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 Bausparkasse Mainz ("BKM"), which translates into a Baseline Credit Assessment (BCA) of Baa1. The rating reflects BKM's: (i) defensible franchise in its niche market; (ii) good credit and liquidity management framework; (iii) acceptable capitalisation; and (iv) low credit risk. The rating is constrained by: (i) BKM's poor profitability, which results in a lack of internal capital-generation capacity; (ii) the possibility of a rise in risk charges, which could put more pressure on the bank's capital adequacy; and (iii) the bank's comparatively marginal operating efficiency.

BKM's long-term global local currency (GLC) deposit ratings are A3/Prime 2, based on the bank's intrinsic credit strength, which is reflected in its Baa1 BCA and Moody's assessment of a low probability of systemic support in the event of need.

Under Moody's joint default analysis (JDA) methodology, our support assessment grants BKM's GLC deposit rating a one notch uplift, to A3, from its Baa1 BCA.

The bank's debt rating is A3.

Credit Strengths

- Defensible franchise in the chosen niche market

- Adequate risk management framework and low credit risk overall, due to strict regulations and focus on residential real estate lending

- Controlling and simulation tools, together with the introduction of a more flexible tariff, which mitigate the effects of behavioural and market risk

Credit Challenges

- Poor profitability, which curtails the bank's ability to earn its cost of capital and/or to pay dividends, as well as its internal capital-generation capacity

- Adverse macroeconomic developments, which could put more pressure on profitability and asset quality

Rating Outlook

The outlook on the BFSR is stable, reflecting the bank's defensible franchise in its niche market.

What Could Change the Rating - Up

We see limited upside potential for the bank's ratings at this time. However, a stronger financial profile, reflected in recurring earnings power above 1%, might, if the current risk profile is maintained, have positive implications for the BFSR and the debt and deposit ratings.

What Could Change the Rating - Down

The C- BFSR could come under downward pressure if the bank's financial profile weakens, in particular if increased loan losses put undue strain on the bank's capital. The BFSR rating would also come under pressure if the bank's ability to earn its cost of capital remains constrained.

Any adverse change in the BFSR could exert pressure on BKM's GLC deposit rating.

Recent Results and Company Events

For the financial year 2008, BKM reported a moderate 2.5% increase in total assets to EUR 2.49 billion, from EUR 2.43 billion at year-end 2007. It was driven by a significant increase in liquid assets (EUR 101 million in 2008, from EUR 12 million in 2007) on the back of a surge in customer deposits (+28%), while the loan book declined by 2.7%.

The benefits of BKM's restructuring programme, aimed at streamlining its operations and improving its product sales, were reflected in a considerable reduction of personnel expenses to EUR 19 million (from EUR 26 million). The reduction boosted recurring earnings to EUR 11 million (EUR 3 million).

On the back of a substantial increase in risk charges - from EUR 2 million in 2007 to EUR 9 million in 2008 - net income decreased to EUR 0.6 million, from EUR 1.1 million in 2007 (although note that the 2008 figure contains allocations to undisclosed reserves of EUR 2.6 million).

At year-end 2008, the Tier 1 ratio stood at 7.4% (6.5% in 2007), reflecting a decline in risk-weighted assets due to lower Basel II risk-weightings (as the bank operates in the area of residential real estate).

The bank is not allowed to invest in structured credit products and was not active in sub-prime assets, showing a prudent investment style that is supported by tight regulation.

DETAILED RATING CONSIDERATIONS

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

Bank Financial Strength Rating

Moody's assigns a C- BFSR to BKM. As a point of reference, the assigned BFSR is in line with the outcome generated by Moody's bank financial strength rating scorecard. Moody's believes the C- rating is an appropriate measure of the bank's intrinsic financial strength, given its defensible franchise in its select niche market, its good risk management capability and low credit risk.

The rating is constrained by: (i) the bank's poor profitability, which curtails internal capital-generation capacity; (ii) the possibility of a rise in risk charges, which could put more pressure on the bank's capital adequacy; and (iii) the bank's comparatively low operating efficiency.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

BKM is a "Bausparkasse", a special financial institution providing housing-related savings and loan products. The bank's traditional loan product (Bauspardarlehen), on which depositors acquire a call option if they have saved a specific amount over a certain period of time, is subject to the conservative provisions of the contractual savings bank law (Bausparkassengesetz): (i) commercial real estate financing is limited to 3% of aggregate loans; and (ii) maximum loan exposure is limited to 15% of distributable deposits should the sum of savings and loans (granted at the beginning of the savings period) exceed EUR 225,000 on a borrower basis per year. Moody's recognises that BKM is not active in commercial real estate financing.

BKM has a very modest national market share (around 1%), but a sustainable share in its core operating niche. It is positioned as a provider of housing-related financial services and affordable housing (pre-fabricated houses in differing stages of completion) to a lower/middle-income target group. Moody's notes the institution's particularly strong foothold among its Turkish/Italian/Spanish/Portuguese clientele, which represents a dominant 40-50% market share in Germany.

Notwithstanding its very modest national market share, BKM is active throughout Germany (with predominant focus on the western regions). No activities are being conducted outside Germany. The institution contends with intense competition from other Bausparkassen and deposit-taking retail banks. Although it has historically derived much of its franchise strength from its ability to provide housing finance at low and stable rates of interest, the current low interest rate environment has resulted in even more intense competition with mortgage providers in the broadest sense. The bank also offers insurance products on behalf of its main shareholder (INTER-Versicherungsgruppe).

Although the bank has the benefit of a very granular retail customer base, we view its earnings stability as modest, given its low earnings-generation capacity, which is driven by poor profitability and a possible increase in risk charges on the back of the deteriorating macroeconomic environment in Germany.

Overall, the bank's franchise value warrants a C-, to which we assign a neutral trend.

Factor 2: Risk Positioning

Trend: Neutral

BKM has an adequate risk management framework in place, with which it identifies, monitors, limits and manages the various risks in its core residential real estate lending operations. Risks arising from the bank's operations are summarised in a monthly risk report and areas needing corrective action are identified. The bank also analyses the business risks inherent in sales, the development of contractual savings and loans, its profitability, liquidity and interest rate risk, the credit risk and other business/operational risks. Moody's believes these reports provide a sufficiently sophisticated tool to manage and monitor risk (i.e. liquidity risk or credit risk in the core residential real estate activities).

The credit risk concentration (borrower and industry concentration) of BKM's loan book is low, as reflected by the institution's focus on residential real estate lending (accounting for 90% of total assets) and portfolio granularity. The securities portfolio accounts for a favourable 4.4% of total assets and mostly consists of highly rated financial institutions steered by adequate credit limit management. The inherent risk of the financial portfolio is further mitigated by the fact that no single borrower in the top 20 list has a rating below A3. Adjusting for borrowers at/above A3, however, borrower concentration is best reflected by a B score.

Industry concentration is also driven by financial institutions, and we take comfort from the very conservative investment guidelines for BKM's securities portfolio.

The bank's market risk is below 10% of Tier 1 capital and is predominantly driven by interest rate risk. The bank's strategy is to keep market risk low, also using hedges in the case of need. BKM is a non-trading institution, according to German regulations, and not allowed to invest in equity or hybrid capital, according to the Bausparkassengesetz (special banking act for the Bausparkassen).

Financial transparency is low, with BKM publishing no interim reports. According to Moody's definitions, the non-reporting of ratios that give a fair picture of a bank's risk profile, such as the number of problem loans and loan loss provisions, results in a weak score for quality of financial reporting.

Overall, the bank's risk positioning scores a C, with a neutral trend.

Factor 3: Regulatory Environment

All German banks are subject to the same score for the regulatory environment. This factor does not address bank-specific issues; instead, it evaluates whether or not regulatory bodies are independent and credible, whether they demonstrate enforcement power and whether they adhere to global standards of best practice for risk control. Please refer to Moody's Banking System Outlook for Germany, published in April 2009, for a detailed discussion about 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 German operating environment. Please refer to Moody's Banking System Outlook for Germany, published in April 2009, for a detailed discussion about the operating environment.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Weakening

In Moody's opinion, BKM's earnings are poor, yet somehow acceptable in view of their generally stable character, the institution's low risk profile and low event risk. However, its very modest earnings-generation capacity also reduces the bank's capacity to strengthen its existing franchise, and to withstand the negative impact of competitive challenges and the risks intrinsic to its business model. Moody's notes positively that, in 2008, the bank benefited from the outcome of the restructuring programme, initiated in 2007. As a result, total operating expenses declined to EUR 31 million (2007: EUR 41 million), mainly driven by a considerable reduction in personnel expenses. While this led to a boost in pre-provision income, the improvement was offset by an increase in risk charges and net income was duly unchanged for the financial year 2008. However this is after a contribution of EUR 2.6 million to undisclosed reserves was made.

In 2009, we expect the low interest rate environment and somewhat higher funding costs to prompt a decline in the bank's credit volume and to offset the positive effects of restructuring, given that the mortgage products from Bausparkassen are designed to work best in a higher-interest-rate environment by offering comparatively lower-interest-rate mortgage financing. In a low-interest-rate environment, the comparative advantage for a mortgage provider (in the broader sense) fades away and leads to intensified competition. A deteriorating macroeconomic environment could also put more pressure on new business, as fewer customers will be prepared to invest in residential real estate.

The assessment above is reflected by an E+ score for profitability, with a weakening trend.

Factor 6: Liquidity

Trend: Neutral

In general, BKM relies on customer deposits, which accounts for EUR 1.3 billion or 57% of total funding, and on inter-bank financing (German promotional banks followed by German cooperative banks and insurance companies), which currently accounts for EUR 1 billion or 41%.

There is some concentration within interbank funding, as 40% relates to just five counterparts. Nevertheless, although interbank funding is more credit-sensitive, particularly as it is largely sourced via brokers, we take comfort from the fact that it is largely (62%) long-term in nature and relates to promissory notes (Schuldscheindarlehen).

Additionally, Moody's notes positively that the bank has been successful in attracting more deposit-based funding, particularly via the internet. In 2008, internet-based deposit funding rose considerably to EUR 641 million, from EUR 341 million in 2007, leading to an increase in total customer deposits of 28% to EUR 1.3 billion.

Overall, we consider BKM's liquidity adequate, as it relies on rather stable funding sources.

BKM scores C for liquidity.

Factor 7: Capital Adequacy

Trend: Neutral

Capitalisation levels are moderate, as reflected by the institution's total capital ratio of 10.1% (2007: 9.3%) and Tier 1 capital of 7.4% at year-end 2008. The increase in the Tier 1 ratio to 7.4% (2007: 6.5%) mainly relates to a decrease in risk-weighted assets due to the implementation of Basel II, along with the benefit of a very granular retail customer base. Internal capital generation is constrained by poor profitability. Nevertheless, modest capitalisation levels are mitigated by the institution's low risk profile and defensible niche market position. Additionally, we acknowledge the high quality of the bank's Tier 1 capital, given that it has no hybrid capital.

The C+ score reflects the bank's satisfactory capital adequacy, and we add a neutral trend.

Factor 8: Efficiency

Trend: Neutral

BKM has a relatively high cost base given its small size and lack of economies of scale. It is less efficient than some of its German peers, but a comparison is difficult as many of them are part of a larger group, where many general expenses (e.g. marketing, head office costs) are borne by the parent. In 2008, the cost/income ratio stood at 75%, down from 92% in 2007 and reflecting the benefits of the cost-cutting programme. It was then at its lowest level of the preceding five years, albeit just slightly below the figure in 2005.

The E score for efficiency reflects the average cost/income ratio of the past three years.

Factor 9: Asset Quality

Trend: Weakening

BKM's loan book consists of Bauspardarlehen (10%), early draw-downs (63%) ("Vor- und Zwischenfinanzierungen") and other residential real estate loans (27%). The bank's securities portfolio consists mostly of financial institutions and we view its credit risk as low, given the highly rated portfolio. The credit risk of BKM's loan book is also low, as reflected by the institution's focus on residential mortgage lending (accounting for close to 90% of total assets) and portfolio granularity. However, we note that the bank has a subordinated claim on around two thirds of the residential mortgage portfolio (second lien), i.e. it is financing the 60-80% Loan-to-Value (LtV) bucket. The inherent risks, however, are mitigated by the fact that Bausparkassen have historically entailed low credit risk, as customers normally have to prove their payment discipline by first building a deposit base.

Problem loans account for 1.8% of customer loans and appear to be low. However, in 2008, provisioning requirements increased to roughly EUR 6 million (from EUR 4 million). Given the expected increase in unemployment in Germany, Moody's cautions that risk charges could rise further in 2009 and beyond.

The average ratios of the three years to 2008 give a C score for asset quality, to which we add a slightly weakening trend.

Global Local Currency Deposit Rating (Joint Default Analysis)

Moody's assigns a global local currency (GLC) deposit rating of A3 to BKM. The rating is supported by two main elements. They are:

(i) BKM's BCA of Baa1; and

(ii) The low probability of systemic support from Germany

Moody's assessment of a low level of systemic support is based on BKM's role as a small player in a niche market, and its limited importance for the national banking system.

Germany is considered a medium support country. The German banking market is highly fragmented, but Moody's acknowledges the country's favourable track record of systemic support for financial institutions in times of financial distress.

Foreign Currency Deposit Rating

BKM's foreign currency deposit rating is A3.

Foreign Currency Debt Rating

BKM's senior unsecured foreign currency debt rating is A3.

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 ratings on the National Scale.

Foreign Currency Deposit Rating

Moody's ratings on foreign currency bank obligations derive from the bank's local currency rating for the same class of obligation. The implementation of JDA for banks can lead to high local currency ratings for certain banks, which could also produce high foreign currency ratings. Nevertheless, it should be noted that foreign currency deposit ratings are in all cases constrained by the country ceiling for foreign currency bank deposits. This may result in the assignment of a different, and typically lower, rating for the foreign currency deposits relative to the bank's rating for local currency obligations.

Foreign Currency Debt Rating

Foreign currency debt ratings are derived from the bank's local currency debt rating. In a similar way to foreign currency deposit ratings, foreign currency debt ratings may also be constrained by the country ceiling for foreign currency bonds and notes; however, in some cases the ratings on foreign currency debt obligations may be allowed to pierce the foreign currency ceiling. A particular mix of rating factors are taken into consideration in order to assess whether a foreign currency bond rating pierces the country ceiling. They include the issuer's global local currency rating, the foreign currency government bond rating, the country ceiling for bonds and the debt's eligibility to pierce that ceiling.

About Moody's Bank Financial Strength Scorecard

Moody's bank financial strength model (see scorecard below) is a strategic input in the assessment of the financial strength of a bank, used as a key tool by Moody's analysts to ensure consistency of approach across banks and regions. The model output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Factors

Bausparkasse Mainz AG

Rating Factors [1]	A	B	C	D	E	Total Score	Trend
Qualitative Factors (50%)						C	
Factor: Franchise Value						C-	Neutral
Market Share and Sustainability				x			
Geographical Diversification		x					
Earnings Stability				x			
Earnings Diversification [2]							
Factor: Risk Positioning						C	Neutral
Corporate Governance [2]							
- Ownership and Organizational Complexity							
- Key Man Risk							
- Insider and Related-Party Risks							
Controls and Risk Management		x					
- Risk Management			x				
- Controls	x						
Financial Reporting Transparency				x			
- Global Comparability				x			
- Frequency and Timeliness				x			
- Quality of Financial Information				x			
Credit Risk Concentration	--	--	--	--	--		
- Borrower Concentration	--	--	--	--	--		
- Industry Concentration	--	--	--	--	--		
Liquidity Management		x					
Market Risk Appetite		x					
Factor: Operating Environment						B	Neutral
Economic Stability			x				
Integrity and Corruption		x					
Legal System	x						
Financial Factors (50%)						D+	
Factor: Profitability						E+	Weakening
PPP % Avg RWA - Basel II				0,51%			
Net Income % Avg RWA - Basel II					0,06%		
Factor: Liquidity						C	Neutral
(Mkt funds-Liquid Assets) % Total Assets					38,91%		
Liquidity Management		x					
Factor: Capital Adequacy						C+	Neutral
Tier 1 ratio (%) - Basel II			7,33%				
Tangible Common Equity / RWA - Basel II		7,33%					
Factor: Efficiency						E	Neutral
Cost/income ratio					83,45%		
Factor: Asset Quality						C	Weakening
Problem Loans % Gross Loans	--	--	--	--	--		
Problem Loans % (Equity + LLR)	--	--	--	--	--		
Lowest Combined Score (15%)						E+	
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

Moody's Investors Service

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