

Credit Opinion: Bausparkasse Mainz AG

Bausparkasse Mainz AG

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]2007	2006	2005	2004	2003	Avg.
Total assets (EUR billion)	2.43	2.46	2.43	2.42	2.47	[2]0.49
Total capital (EUR billion)	0.13	0.14	0.14	0.14	0.12	[2]3.34
Return on average assets	0.05	0.04	0.15	0.15	0.14	0.11
Recurring earnings power [3]	0.14	0.25	0.51	0.47	0.54	0.38
Net interest margin	1.37	1.58	1.78	1.67	1.75	1.63
Cost/income ratio (%)	92.44	87.24	76.61	77.49	75.62	81.88
Problem loans % net loans	--	0.24	0.21	0.19	0.20	0.21
Tier 1 ratio (%)	--	0.00	0.00	0.00	0.00	0.00

[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 of Baa1. The rating reflects BKM's defensible franchise in its niche market, its good credit and liquidity management framework, low credit risk and profitability levels. The ratings also take into account BKM's low degree of funding diversification and the comparatively marginal operating efficiency of the bank, the latter which contributes to a modest level of capitalisation.

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

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

The debt rating is at the A3 level.

Credit Strengths

- Defensible franchise in its 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 mitigate the effects of behavioural and market risk

Credit Challenges

- High reliance on bank borrowings as a primary funding source

- Comparatively low operating efficiency

Rating Outlook

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

What Could Change the Rating - Up

We see limited upside potential for ratings at this time. However, a stronger financial profile reflected in recurring earnings power above 1% while maintaining the current risk profile might have positive implications for the BFSR as well as for the debt and deposit ratings.

What Could Change the Rating - Down

The C- BFSR could come under downward pressure in the event that the bank's financial profile weakens, in particular reflected in a cost/income ratio sustainably above 85%. Moody's will monitor the benefits gained from the restructuring programme very closely and will act accordingly.

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

Recent Results and Developments

For the financial year 2007, BKM reported a 1.3% decrease in total assets to EUR 2.43 billion from EUR 2.45 billion at year-end 2006. Net income as at 31 December 2007 amounted to EUR 1.1 million, a 4.5% year-on-year increase. In the first half of 2007, BKM launched a restructuring programme aimed at streamlining its operations and improving its product sales. The total capital ratio was stable and stood at 9.3 % as at year-end 2007 (vs. 9.2% at year-end 2006). As at year-end 2007 the Tier 1 ratio stood at 6.5% (6.2% in 2006). However, following the implementation of the new capital requirements framework for German banks (SolvV) the Tier 1 ratio increased to 7.9% reflecting the decline in risk weighted assets.

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 BKM's defensible franchise in its niche market, its good credit and liquidity management framework, low credit risk and stable profitability levels. The ratings also take into account BKM's low degree of funding diversification and the comparatively marginal operating efficiency of the bank, the latter which contributes to a modest level of capitalisation.

Key positive elements driving Moody's BFSR for BKM are its capitalisation and improved asset quality.

Key negative elements driving the BFSR are modest risk-weighted profitability in conjunction with a low efficiency ratio.

Qualitative Rating Factors (50%)

Factor 1: Franchise Value

Trend: Neutral

BKM has a sustainable market share in its core operating niche, having positioned itself as a provider of housing-

related financial services and affordable housing (pre-fabricated houses in differing stages of completion) to a rural lower- to middle-income target group. Moody's notes the institution's particularly strong foothold amongst its Turkish/Italian/Spanish/Portuguese clientele, where it has a dominant 40-50% market share in Germany

Notwithstanding its modest market share, BKM is active throughout Germany (with a more predominant focus on the western regions) having positioned itself as a niche provider of affordable housing and housing-related financial services. The institution contends with intense competition from other Bausparkassen and deposit-taking retail banks. Although BKM 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 more intense competition with mortgage providers in the broadest sense. The bank also offers insurance products on behalf of its main shareholders (INTER-Versicherungsgruppe) and entered into a distribution agreement with a German subsidiary of Crédit Agricole (Creditplus-Bank AG). Earnings stability is high, as is normal for retail banks' franchises.

Overall, the franchise value factor warrants a C+.

Factor 2: Risk Positioning

Trend: Neutral

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

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

Overall, the risk positioning factor scores a 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 or not regulatory bodies are independent and credible, demonstrate enforcement powers and adhere to global standards of best practices for risk control. Please refer to Moody's Banking System Outlook for Germany, published in April 2008, to obtain a detailed discussion on the regulatory environment.

Factor 4: Operating Environment

Trend: Neutral

This factor is also common to all German banks. Please refer to Moody's Banking System Outlook for Germany, published in April 2008, to obtain a detailed discussion on the operating environment.

Quantitative Rating Factors (50%)

Factor 5: Profitability

Trend: Improving

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, withstand negative impacts arising from competitive challenges as well as risks intrinsic to its business model. An improvement in profitability could result from benefits gained from the restructuring programme.

The assessment stated above is reflected by an E score for profitability.

Factor 6: Liquidity

Trend: Neutral

In general, BKM relies substantially on inter-bank financing (German Landesbanken followed by German pension funds and insurance companies etc.), which currently accounts for approximately 60% of the institution's funding requirements. Although this funding source is to a large extent long-term in nature (58% of total funding has a maturity beyond one year), it is potentially more credit-sensitive, particularly as it is largely sourced via brokers. However, the low event and transition risk associated with BKM's credit portfolio and the availability of committed back-up liquidity lines in the amount of EUR 189.4 million serve to allay these concerns to a degree. BKM also maintains a small portfolio of repo-eligible securities, which provide an additional source of liquidity. Additionally, Moody's notes that the bank has been successful in attracting more deposit-based-funding, particularly via the internet. Further diversification could also be achieved should BKM consider the Pfandbrief as an effective funding mechanism or if the bank decides to participate in KfW's True Sale securitisation programme.

We have adjusted the liquidity ratio by reducing market funds by the amount of outstanding Schuldscheine (long term funding) to determine the true exposure to rating-sensitive capital-market funding.

While BKM scores C on liquidity on an unadjusted basis, the adjustments stated above lead to a better liquidity ratio - and hence an adjusted C+ score for the liquidity factor.

Factor 7: Capital Adequacy

Trend: Neutral

Capitalisation levels are moderate, reflected by the institution's total capital ratio of 9.3%, as at year-end 2007. Internal capital generation is constrained by the low profitability and the necessity to make dividend payouts to the institution's shareholder base. Nevertheless, modest capitalisation levels are mitigated by the institution's low risk profile and niche market position. Additionally, we acknowledge the high quality of Tier 1 capital, given the fact the bank has no hybrid capital.

The C+ score reflects the bank's satisfactory capital adequacy.

Factor 8: Efficiency

Trend: Improving

BKM has a relatively high cost base, given its small size and the lack of economies of scale. Although the efficiency is lower than at some of its German peers, this is a difficult comparison as many of its peers are part of a larger group where many general expenses such as marketing, head office costs etc. are borne by the respective parents. Current cost reduction programs are aimed at reducing overhead costs and strengthen the distribution channel's flexibility.

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

Factor 9: Asset Quality

Trend: Neutral

The credit risk of BKM's loan book is low reflected by the institution's focus on residential real estate lending (accounting for close to 100% of total assets) and portfolio granularity. Non-performing loans and provisioning requirements are also relatively contained. BKM's loan book consists of Bauspardarlehen, early drawdowns and other real estate loans. The bank's traditional product (Bauspardarlehen, amounting to 12% of total loans) -- 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 225000 on a borrower basis per year. Despite the high 80% Loan-to-Value (LTV) limit and the subordinated claim which the bank has on these mortgages, Bauspardarlehen have historically entailed low credit risk, with customers normally having to prove their payment discipline in preceding years by building a deposit base.

The average ratios of the three years to 2007 lead to a B score for asset quality.

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 three main elements. They are:

- (i) BKM's Baseline Credit Assessment of Baa1; and
- (ii) The low probability of systemic support from Germany

Moody's assessment of those support probabilities results from BKM's role as small player in a niche market and therefore its limited importance for the national banking system.

Germany is considered a medium support country. Whereas the German banking market is highly fragmented, Moody's acknowledges the favourable track record for systemic support to 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	Improving
PPP % Avg RWA					0.48%		
Net Income % Avg RWA					0.14%		
Factor: Liquidity						C	Neutral
(Mkt funds-Liquid Assets) % Total Assets					47.81%		

Liquidity Management			x				
Factor: Capital Adequacy						C+	Neutral
Tier 1 ratio (%)			6.33%				
Tangible Common Equity % RWA			6.33%				
Factor: Efficiency						E	Improving
Cost/income ratio					85.43%		
Factor: Asset Quality						B	Neutral
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

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