

Analysts

Michaela Hessmert
Melanie Kiene, CIIA

Homepage

www.deutsche-hypo.de

Ratings*

	Rating	Ausblick
Fitch	-	-
Moody's	Baa3	Negative
S&P	-	-

*Senior Unsecured Rating
Source: Bloomberg, NORD/LB
Fixed Income Research

Deutsche Hypothekbank Actien-Gesellschaft (Deutsche Hypo) is a Pfandbrief bank which specialises in financing commercial real estate. It is a wholly-owned strategic investment of NORD/LB and is part of the protection system of the Sparkassen - Finanzgruppe. NORD/LB has agreed through a letter of comfort to offset any loss incurred by Deutsche Hypo. A control and profit transfer agreement has also been agreed between NORD/LB and Deutsche Hypo. It is the NORD/LB Group's centre of expertise in its core area of business, namely commercial property finance, as well as in the issue of mortgage Pfandbriefe. Apart from Germany, its target markets include the Netherlands, the UK, France, Poland and Spain. Public sector lending (sovereigns) is only conducted as part of the management of the cover pool and liquidity. In the first six month of 2017, new real estate business amounted to EUR 2.2bn (previous year: EUR 1.8bn). Of this figure, 38% or so was attributable to financing abroad. The bank is concentrating on high quality properties and is less volume-driven in its operations. This is reflected in the constant level maintained by the total property finance portfolio of EUR 12.4bn (average of last five years: EUR 12.1bn). The proportion of non performing loans went down from 1.5% to 0.8% of total exposure in the 2016 financial year.

Balance Sheet Summary

(mm EUR)	2014Y	2015Y	2016Y	2017H1
Net Loans to Customers	17,558	16,632	16,246	16,182
Total Securities	9,321	7,089	6,760	6,023
Total Deposits	9,120	8,732	7,117	7,496
Tier 1 Common Capital				
Total Assets	30,055	26,944	25,203	24,443
Total Risk-weighted Assets				

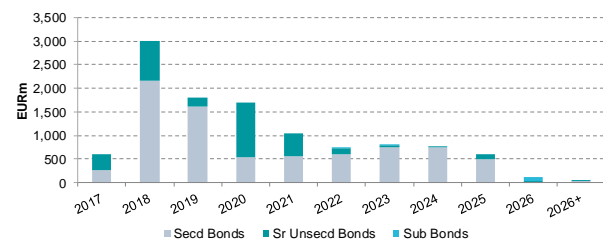
Income Statement Summary

(mm EUR)	2014Y	2015Y	2016Y	2017H1
Net Interest Income	222	225	202	99
Net Fee & Commission Income	4	0	4	0
Net Trading Income				
Operating Expense	84	89	82	54
Loans and Credit Commitments Impairment	62	41	67	19
Pre-tax Profit	40	70	113	36

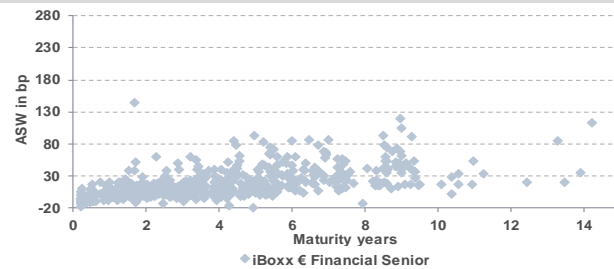
Company Ratios

In %	2014Y	2015Y	2016Y	2017H1
Net Interest Margin	0.73	0.79	0.78	0.80
ROAE	0.00	0.00	0.00	0.00
Cost-to-Income	36.47	38.65	39.45	50.03
Liquidity Coverage Ratio	NA	101.40	147.70	132.00
IFRS Tier 1 Leverage Ratio	NA	NA	NA	NA
Core Tier 1 Ratio	NA	NA	NA	NA
Gross Impaired Loans/Loans at Amortised Cost	1.84	1.47	1.16	NA

Redemption Profile

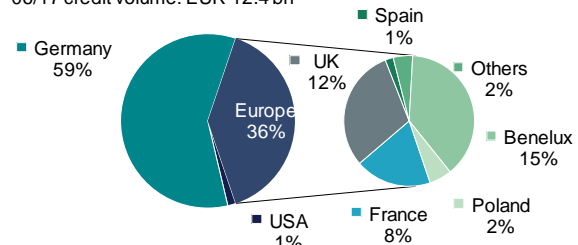


Senior Unsecured Bonds



Portfolio / Regions

06/17 credit volume: EUR 12.4 bn



As of: 01.11.2017; Source: Bloomberg, SNL, NORD/LB Fixed Income Research

Covered bonds

Deutsche Hypo establishes Green Pfandbrief

Analyst:

Matthias Melms, CIIA, CCrA

In 2015, Berlin Hyp became the first issuer to launch a green programme for Pfandbriefe (Green Pfandbrief). Deutsche Hypo has now followed suit with its own programme. That this type of programme has not yet become more common on the covered bond market is in our view partly due to the great complexity of this segment. Although issuers including Münchener Hypothekbank and Spain’s Kuxtabank have already placed such bonds on the market, their focus is strongly geared towards social criteria (environmentally sustainable governance; ESG).

So far, activity in the area of green covered bonds has been rather subdued

Framework based on Green Bond Principles

For the issuance of green bonds, Deutsche Hypo established its own framework, which is based on the Green Bond Principles set out by the International Capital Market Association (ICMA), with membership intended immediately after issuing its first green bond. As green bonds, the bank issues both senior unsecured bonds and Green Pfandbriefe which meet all the requirements of the German Pfandbrief Act. Senior unsecured bonds that are issued as green bonds are equal to other bonds in this asset class (pari passu), which may include bonds in benchmark format and private placements.

Green bonds are matched by a corresponding green portfolio

All bonds that are issued within the framework of green bonds are matched by an adequate volume of suitable green buildings. Funding by way of green bonds may only be carried out to the minimum extent that the bank has green buildings in its portfolio. Temporary residual amounts can be invested on a temporary/adequate basis. The proceeds of these bonds are used exclusively for the funding and refinancing of energy-efficient property, with financing geared towards the construction, project development, acquisition or energy-efficient renovation of buildings.

Energy efficiency of a property is reviewed in a multi-stage process

The energy efficiency of a property is reviewed by means of a multi-stage process under the green bond framework, with the criteria for the selection determined by a Green Building Commission, which also sets out the Green Bond Minimum Standards (GBMS). An asset is categorised as a green building if the applicable GBMS are fulfilled at the time of inclusion of the financing in the green bond portfolio. Energy efficiency is currently ascertained on the basis of maximum energy demand or consumption (heat) in kWh/(m²*a) by asset class. Alternatively, a certificate can be issued to attest to the efficiency of a building and that it thereby qualifies for the green portfolio. A further exclusion characteristic for the green portfolio is the type of use of the property or the main tenant’s area of activity. Properties belonging to customers from business areas considered to be controversial may not be financed. This criterion is also a strict additional condition of Deutsche Hypo’s business strategy and is embedded in Deutsche Hypo’s sustainability programme. An additional condition for the use of green buildings is that the financed real estate is only leased to uncontroversial main tenants. The property will be excluded from the portfolio of suitable green buildings should it become known that a main tenant operates in a controversial business.

Overview of criteria for the green portfolio

Energy pass with a maximum final energy demand or consumption (heat) in kWh/(m²*a) by asset class:

Guideline value	Type of property
50 kWh/(m ² *a)	for new residential properties
75 kWh/(m ² *a)	for old residential properties
30 kWh/(m ² *a)	for logistics buildings
70 kWh/(m ² *a)	for retail buildings (shopping centres, department stores)
95 kWh/(m ² *a)	for other retail buildings
95 kWh/(m ² *a)	for hotel buildings (up to 3 star hotels)
105 kWh/(m ² *a)	for hotel buildings (4 to 5 star hotels)
110 kWh/(m ² *a)	for production and storage buildings (with heating)
110 kWh/(m ² *a)	for office buildings without air conditioning
135 kWh/(m ² *a)	for office buildings with air conditioning

Alternatively, the following certifications allow assets to qualify:

Certificate	Category
LEED	Silver or above
BREEAM	Gold or above
DGNB	Silver or above (for certificates given after 1 July 2015: Gold or above)
HQE	Basic or above

Source: Deutsche Hypo, NORD/LB Fixed Income Research

Yearly reporting available

Each year, Deutsche Hypo will publish a green bond report on its website (www.deutsche-hypo.de). Among other details, the report contains information about the current volume of the green building portfolio, the CO₂ reduction of all green buildings compared with the relevant average and the characterisation of the green buildings according to property certifications, location, sustainability aspects, etc. Deutsche Hypo publishes this data on an aggregated basis. As at 18 October 2017, the portfolio volume amounted to EUR 1,211m, of which EUR 691.3m was reserved for Green Pfandbrief issuance. Broken down by asset class, the portfolio predominantly includes retail buildings (shopping centres) and office buildings with air conditioning (both 40%). Germany accounted for 81% of the portfolio, followed by France (8%), Poland (8%) and the UK (3%).

Second party opinion from oekom

oekom research published a second party opinion to Deutsche Hypo, confirming that the framework for green bonds is in line with the Green Bond Principles. In addition, the quality of the assets underlying the green bond portfolio is confirmed in view of a wide range of parameters, such as sustainability. According to oekom, the issuer shows good sustainable development, which is in our view also reflected in the corporate rating of C+ assigned by oekom. This puts Deutsche Hypo at number 4 of the 52 companies which oekom assesses in Financials/Mortgage & Public Sector Finance sector.

Deutsche Hypo has two cover pools

Deutsche Hypo has existing programmes for both public sector Pfandbriefe (Öpfe) and mortgage Pfandbriefe (Hypfe). As the centre of expertise for commercial property finance, the focus in the NORD/LB Group is increasingly on the issuance of Hypfe. As at the end of the second quarter of 2017, the respective programme had an outstanding mortgage Pfandbrief volume of EUR 8,040m. With concurrently available cover assets of EUR 8,810m, nominal overcollateralisation is 9.6%. At 18.2%, the net present value overcollateralisation is therefore higher. At the end of June, the Öpfe programme had an outstanding volume of EUR 4,847m, while the corresponding cover pool comprised cover assets in the amount of EUR 6,467m. This puts nominal overcollateralisation at 33.4%. A net present value of 30.9% is achieved.

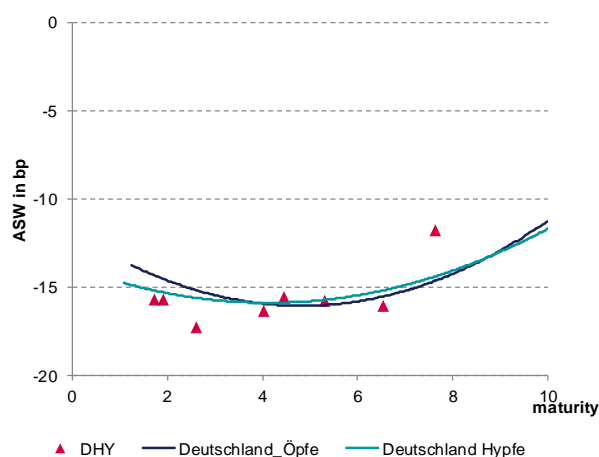
Programme figures (30 June 2017)		
	Hypfe	Öpfe
Volume outstanding	EUR 8,040m	EUR 4,847m
Cover pool volume	EUR 8,810m	EUR 6,467m
Overcollateralisation (nominal value/net present value)	9.6%/18.2%	33.4%/30.9%
Debtor type	76.1% commercial	52.9% regional
Country	55.8% DE	57.9% DE
Number of debtors	803	114
Number of loans/bonds	985	261
Ø LTV (original value/market value)	57.6%/41.8%	n/a
Share of fixed rate (cover pool/CBs)	67.1%/94.2%	82.1%/91.1%
WAL (cover pool/CBs)	3.8/5.0y	6.9y/7.5y
CB rating (Fitch/Moody's/S&P)	-/Aa1/-	-/Aa2/-

Source: issuer, Moody's, NORD/LB Fixed Income Research

Hypfe pool

Collateral for mortgage Pfandbriefe amounting to EUR 8,810m primarily comprises loans originating in Germany (55.8%), followed by property in the Netherlands (16.1%) and the UK (11.4%). With regard to type of use, the focus of the cover pool is on commercially used properties, at 76.1% of the overall cover pool. Residential real estate constitutes 16%, with the remainder being due to substitute cover (7.9%). The main types of use within commercial property are offices (32.9%) and retail properties (31.2%). The average loan-to-value ratio of the properties is 57.6%. In relation to the current market value, the ratio drops to 41.8%.

Spread landscape – Germany



Source: Bloomberg, NORD/LB Fixed Income Research

Öpfe pool

The public sector cover pool is also predominantly made up of German collateral (57.9%), followed by Italian (9.9%) and Austrian (9.5%). A breakdown by debtor type reveals a concentration on regional government authorities (44.7%), as well as other public sector debtors (35.1%) and central governments (19.9%). Local government authorities only accounted for a share of 0.3% of the cover pool.

Regulation and rating

While mortgage Pfandbriefe are classified as Aa1 by Moody's, Deutsche Hypo's public sector Pfandbriefe are assigned a rating of Aa2. The collateral score of the mortgage programme is 9.0% and that of the public sector Pfandbriefe is 6.2%. The TPI Leeway is one notch for mortgage Pfandbriefe and two notches for public sector Pfandbriefe. In our view, both programmes fulfil the necessary requirements of the LCR regulation in order to be eligible as Level 1 assets for benchmark issuances as well as the criteria of the ECB's purchase programme (CBPP3). The risk weight of the public sector and mortgage-backed Pfandbriefe is 10%.

Conclusion

By establishing a programme to issue green bonds, Deutsche Hypo has joined Berlin Hyp in being a Pfandbrief issuer with a programme for financing energy-efficient buildings and therefore made covered bonds an option for green investors. While we regard covered bonds as the ideal asset class for financing green buildings and enabling investors to make 100% green investments, we also think that statutory regulations in jurisdictions such as Germany do not provide for a second cover pool in the same asset class. For this reason, it is all the more reasonable that issuers such as Deutsche Hypo, Berlin Hyp, but also Münchener Hypothekenbank are seeking solutions for combining covered bonds and green investments.

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