Rating Report
Bausparkasse Wüstenrot AG
Austrian Mortgage-Covered Bonds

www.scoperatings.com

RATINGS

Cut-off date	Eligible Cover pool	Main cover asset type	Covered bonds*	Rating
28 Dec 2016	EUR 254m	Mortgage loans	EUR 2.0m	AA+/Stable

* Hypothekenpfandbriefe (HyPF) – Austrian mortgage-covered bonds

Scope's covered bond ratings constitute an opinion about relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity. See Scope's website for the Covered Bond Rating Definitions.

Covered bond rating:

Covered bond rating (long-term):	AA+
Outlook:	Stable
Last rating action date:	New

Covered bond rating-uplift above issuer rating (notches):

Wüstenrot Mortgage-covered bonds	
Legal framework	**2**
Resolution regime	**2**
Fundamental factors	**4**[1]
Cover pool analysis	**7**[2]
Used credit differentiation	**7**[3]

[1]Floor for the additional cover pool elevation; [2]Wüstenrot's covered bonds can be rated up to seven notches above the issuer rating; [3]All notches are used to achieve the current rating.

Issuer Credit-Strength Rating:

Long-term:	N/D*
Outlook:	N/D*
Last rating action date	New
ICSR and covered bond rating:	Monitored

- N/D: not disclosed; Scope assigned a private monitored issuer rating to the bank. The issuer solicited the assigned rating and has taken part in the rating process.

Covered bond analysts

Karlo Fuchs
Lead analyst
+49 30 27891 134
k.fuchs@scoperatings.com

Bank analyst

Michaela Seimen Howat
Lead analyst
+44 203 457 0445
m.seimenhowat@scoperatings.com

Rating rationale

Scope Ratings (Scope) has assigned AA+ with Stable Outlook to the Austrian mortgage-covered bonds issued by Bausparkasse Wüstenrot AG (Wüstenrot). The rating is based on our private rating of the bank, further enhanced by i) fundamental credit support factors, which provide a credit support of four notches above the bank´s issuer rating; and ii) the low-credit-risk cover pool, which further enhances the rating by 3 notches, by supporting a seven notches above the bank´s issuer rating.

Wüstenrot is the oldest and the only independent Bausparkasse (building society) in Austria. Scope's bank credit analysis reflects the prudent and conservative management of capital and liquidity, which also is rooted in the bank's independent position. Its low-risk profile provides resilience during periods of low profitability, and helps address challenges for the bank's business model from the lower-for-longer interest environment and the changing client behaviour this generates. The bank is one of the first Austrian Bausparkassen to start issuing covered bonds in order to diversify its funding which is currently predominantly funded by Bauspar contract saving deposits. Since receiving a covered bond issuance licence in December 2013, the bank has started to build up its cover pool and to date has only issued one retained covered bond.

Fundamental credit support analysis

Scope has established that the rating differentiation arising from fundamental credit support is four notches above the bank's issuer rating. The two notches of uplift are driven by the agency's analysis of the Austrian covered bond legal framework, which meets all provisions relevant to establishing and maintaining a high-quality cover pool that remains available after the issuer's potential insolvency. Scope notes that under its methodology the covered bond framework just meets the minimum standards, as the framework remains relatively vague on best practice regarding liquidity or risk management.

The covered bonds also benefit from an additional credit differentiation of two notches, based on an issuer- and country-specific assessment of the benefits of the resolution regime and the systemic importance of covered bonds. The differentiation primarily reflects the preferential treatment of covered bonds when a regulator intervenes in the issuer and Scope's assessment that regulators would likely maintain the issuer as a going concern.

Cover pool support analysis

The bank's cover pool exhibits a low to moderate credit risk evidenced by a purely domestic and geographically well spread residential cover pool with a low eligible LTV of 53.4%. It only exhibits a low sensitivity to interest rate risk. The extremely high overcollateralisation avoids mismatch risk, and Scope understands that the overcollateralisation will remain sufficient to support the rating even when taking into account the bank's covered bond issuance plan for the next year. The covered bond rating is based on support provided by the cover pool, and a minimum overcollateralisation of 7.5% will allow the covered bonds to benefit from the maximum three notch uplift above the fundamental-support-based credit differentiation.

Stable Outlook

The Stable Outlook on the covered bonds the stable credit performance of both the bank and its mortgage assets. Scope's outlook reflects its expectation that the issuer also applies its prudent risk-management strategies for the management of the covered bonds and will establish cover bond funding to diversify its current funding structure. The agency does not expect changes to Wüstenrot's willingness and ability to continuously provide sufficient overcollateralisation in order to support the very strong credit quality of its covered bonds.

Positive changes to the covered bond ratings could result from a visible improvement of the bank's profitability. Further, a higher visibility and market-driven, increased importance of covered bonds as an important funding product in Austria, coupled with an increased cohesiveness and cooperation between all relevant stakeholders, could prompt a positive revision of the fundamental support factors.

A decline in the bank's currently solid credit quality will directly translate into adjustments of the covered bond rating or outlook. Such rating changes could be driven by an increasing risk profile, deteriorating profitability and weakened prudential metrics. An excessive increase of the cover pool's risk could reduce the support the cover pool provides to the rating. As the fundamental support effectively provides a floor for the covered bond rating, any negative changes to the cover pool's risk profile would at most result in a maximum downgrade of up to three notches.

RATING DRIVERS AND MITIGANTS

Positive	Negative
The issuer. Longstanding history in housing finance and low-risk credit profile; prudent and conservative capital and liquidity management – helping to support periods of lower profitability	**The issuer.** Business model challenged by the lower-for-longer interest environment
Covered bond legal framework. Austrian covered bond laws address rating-relevant aspects, allowing us to grant the full legal framework uplift	**Covered bond legal framework.** N/A
Resolution regime assessment. Austrian covered bonds excluded from bail-in; issuer viewed as resolvable due to the sufficient level of bail-inable liabilities	**Resolution regime assessment:** Generally lower, only moderate importance of covered bonds in Austria; the issuer's current non-existent presence in the covered bond markets
Cover pool support. Extremely high overcollateralization, good asset quality cover pool and issuance plans which focus on long dated private placements mitigates short observed track record in cover pool and overcollateralisation management	**Cover pool support.** N/A

Contents

Positive rating-change drivers	Negative rating-change drivers
Issuer/group. Successful implementation of a cost-saving programme with increased improvement in profitability and flexibility; strategic partnership to help stabilise prudential metrics	**Issuer/group.** Changing risk profile with weakened credit quality; reputational risk from subsidiaries; decreasing market shares and reduced capital market access
Resolution regime assessment. Increased covered bond visibility for the issuer and Austrian covered bonds in general; more cohesive stakeholders in the Austrian covered bond market	**Resolution-regime assessment.** Significantly reduced capitalisation and/or market share which could remove the regulator's incentive to maintain the issuer as going concern
	Cover pool support. Significant deterioration of the cover pool's asset quality; new issuance activity (in particular in jumbo format) resulting in an excessive increase of the asset-liability mismatch, all of which are not mitigated

THE ISSUER

Wüstenrot's adequate credit quality is continuously monitored

Scope regularly monitors the credit quality of Wüstenrot, the only independent Bausparkasse in Austria.

The Bausparkassen sector in Austria is experiencing challenges, mainly due to the lower-for-longer interest environment and related dwindling profitability. Because Bausparkassen are bound by a specialised law and defined business models, these institutions lack the flexibility of other banking models to adjust services.

Nevertheless, Wüstenrot has been able to increase lending over the past years, in line with its very conservative risk strategy. The bank has a safe and well-diversified asset base, which has enabled it to operate profitably over the past decade, albeit at lower and partly stronger-fluctuating levels. Wüstenrot is currently updating its strategy and restructuring the group to exploit intra-group efficiencies.

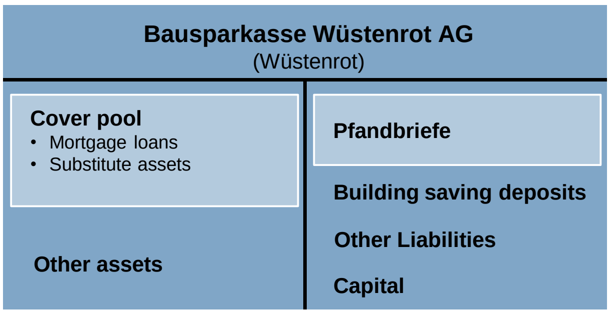
Compared to peers, Wüstenrot's independent structure results in a larger cost base and fewer opportunities for economies of scale. Furthermore, Wüstenrot does not have access to a larger capital- and liquidity-supporting group structure. We nevertheless regard positively that both the bank and overall group have a 'no dividend' policy, in order to organically strengthen capital positions for all entities within the group. With regard to the bank's capital-raising abilities, we note the potentially limited support from its majority owner.

For further details on our bank credit analysis see Appendix I.

COVERED BOND STRUCTURE

Wüstenrot's covered bonds are on-balance

Figure 1. On-balance sheet issuance structure



Wüstenrot is the regulated entity of a retail-focused financial conglomerate (see Appendix I). As a Bausparkasse focused on the promotion of residential mortgage lending and regular savings, Wüstenrot is subject to the specific regulations of the Austrian building savings act. This act significantly restricts business opportunities for Bausparkassen when compared to universal banks. In late 2013, Wüstenrot received the licence to issue covered bonds, allowing the bank to widen its refinancing opportunities. The issuance of covered bonds is governed by the Austrian covered bond act (see 'Legal Framework Analysis' for further details) and Austria's Financial Market Authority (FMA) has currently limited the issuance to 10% of Wüstenrot's balance sheet – which is a common restriction for Austrian Bausparkassen.

COVERED BOND RATING ANALYSIS

Covered bond ratings are cover pool-supported ratings

Wüstenrot's covered bond ratings are supported by the cover pool analysis and incorporate a maximum possible cover pool support of three notches. The covered bond rating is floored at four notches above our view on the bank's credit quality, reflecting the fundamental-support-based credit differentiation.

The ample available overcollateralisation mitigates credit, market and liquidity risks commensurate with the current credit quality of the covered bonds.

COVER POOL ANALYSIS

Wüstenrot's cover pool can substantially enhance the credit quality of the covered bonds, translating into a total credit differentiation of seven notches. Reflecting the current sound credit quality of the cover pool and taking into account the planned issuance structure, an overcollateralisation of 7.5% is, in our view, sufficient to support the uplift. Taking into account the issuance projections for 2017, overcollateralisation is expected to remain above 300%.

As for any covered bond rating, Scope´s methodology limits the maximum benefits from the cover pool to three notches above our fundamental support assessment. This reflects the dynamic nature of the cover pool and the fact that current overcollateralisation could be significantly and swiftly reduced by new issuances.

Start-up cover pool whose credit quality is representative of the stock of eligible exposures; cash flow structure to evolve with new issuances

Figure 2. Characteristics of the cover pool and covered bond structure

Reporting date	28 December 2016
Total cover pool/ Eligible assets (EUR m)	304/ 254
Covered bonds outstanding (EUR m)	2
Current overcollaterisation (OC) (Provided/min. regulatory OC)	>15,000% / 2.0%
Duration/WAM (cover pool - assets)	12.43 / 14.49
Duration/WAM (covered bond- liability)	6.93 / 7.92
Mismatch	N/M
OC to cover for credit risk at current uplift	6.80%
OC to support current rating/ OC to maintain upflift upon one-notch issuer rating downgrade	7.5% / 7.75%
Main cover asset type	Residential mortgages
Number of loans	2,672
Average loan size [EUR'000x]	113.74
Average whole loan LTV/ Eligible LTV	71.0% 53.3%
Top-10 exposures	1.82%
Top-20 exposures	3.03%
Geographic split (top 3)	Lower Austria (23.4%) Upper Austria (14.4%) Styria (14.2%)

Mortgage credit quality

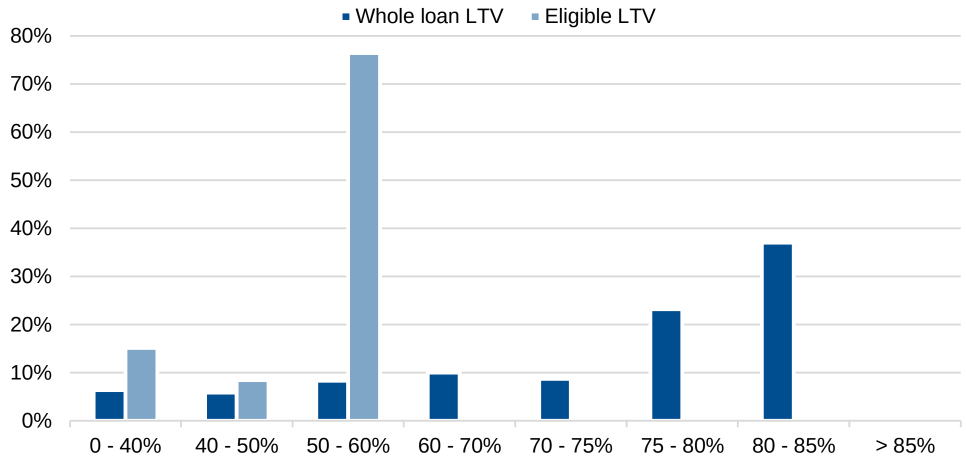
Stable and sound credit quality of the mortgage collateral

The credit quality of the granular and purely domestic cover pool is sound. It only comprises residential mortgage loans with an average loan size of EUR 113,000. The Austrian covered bond act stipulates a maximum loan-to-value (LTV) of 60% for the cover pool assets. In the case the borrower has taken out mortgage loans with higher LTVs, the whole mortgage loan is part of the cover pool.

Wüstenrot applies the same prudent underwriting criteria for mortgage loans granted for the cover pool as for those granted in the course of its Bausparkasse business. As a Bausparkasse, the issuer is generally not able to grant mortgage loans with a LTV in excess of 80%[1].

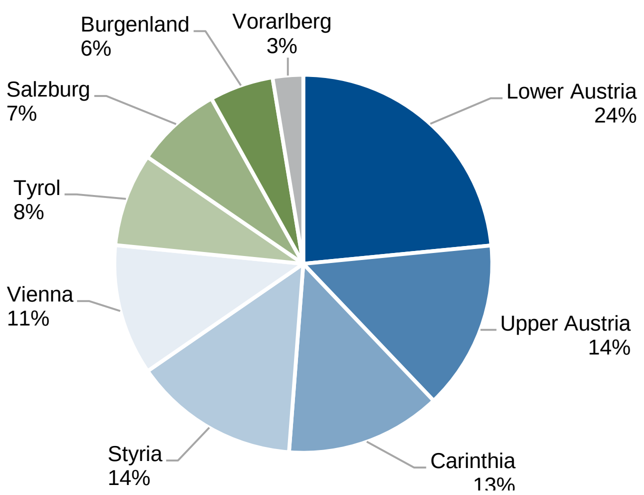
Most cover pool assets have just entered their amortisation phase, and the weighted average seasoning of the pool of 1.2 years is relatively low. This reflects the fact that the issuer only received its covered bond issuance license at the end of 2013 and has only started to document the valuations in line with the covered bond valuation requirements.

Figure 3. Cover pool by LTV



The cover pool's weighted average indexed whole loan LTV is 71.0%, evidencing the borrowers' moderate leverage levels. In addition, the corresponding 'eligible' LTV of only 53.3% indicates a high level of protection against credit losses in case the borrower defaults. There are no significant geographic concentrations and the cover pool is well split across Austria.

Figure 4. Geographic split by Austrian states



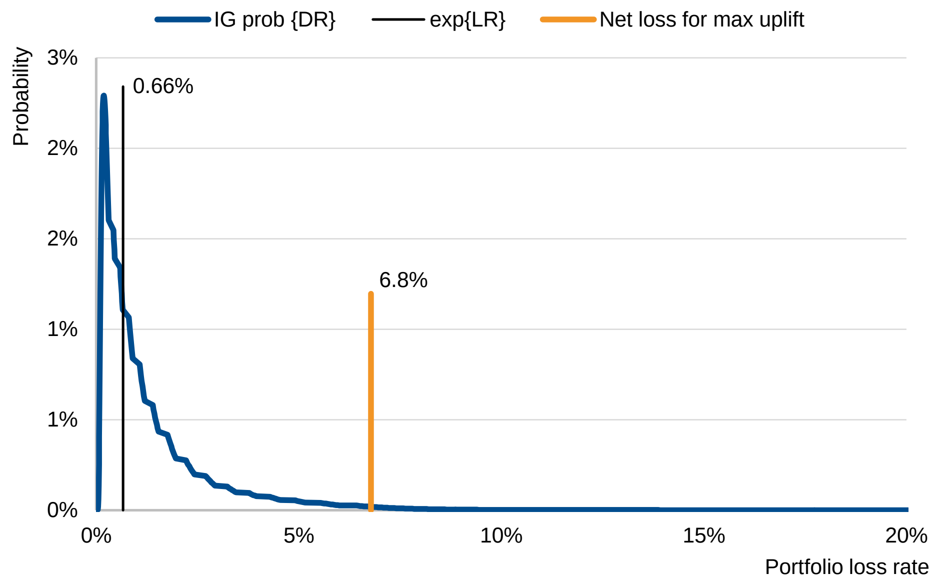
[1] LTVs higher than 80% can result from an indexation of the collateral, accrued interest and fees.

Scope derived pool default assumptions form the bank´s internal risk assessments

We have calculated a credit risk contribution of 6.8% for the cover pool. This stressed net credit loss assumption was derived by combining the pool default distribution with rating-conditional recovery assumptions. Scope analysed the default profile of the pool with an inverse Gaussian distribution whose key input parameters were derived from the internal loan by loan risk assessments from the bank. The backtesting information presented to us provided sufficient comfort to use these in the analysis.

Figure 5. Loss distribution for the mortgage portfolio

Credit risk contribution of about 6.8% to the supporting overcollateralisation



The applied default distribution is described by a mean lifetime default rate (DR) of 9.72% for the cover pool and a coefficient of variation of 60%. In the scenario needed to support the maximum achievable uplift, we have calculated a weighted average stressed recovery rate of 56%, which compares to our base case recovery assumption of 93% (see Appendix II for further details).

Cover asset origination and servicing

Wüstenrot began originating eligible mortgage cover assets only after receiving its license, but has a longstanding history in mortgage lending. The prudent underwriting standards for the loans granted for its Bausparkasse business and mortgage loans originated for the cover pool do not significantly differ. Further, the bank applies a positive selection for its cover pool when selecting new assets for the cover pool. Wüstenrot's monitoring processes and early delinquency management processes are efficient in dealing with weak obligors.

Delinquent loans or loan portions in excess of LTV limits can be kept in the cover pool. These loan parts are not eligible, but the covered bonds also benefits from the overcollateralisation from such loans, reflecting their senior secured status.

The cover pool does not comprise any delinquent or defaulted mortgage loans, as the issuer voluntarily removes already overdue mortgage loans from the cover pool.

Cash flow characteristics

Overcollateralisation of 7.5% is sufficient to support the full cover pool uplift

From a market risk perspective the cover pool is very resilient against stresses, and the overcollateralisation needed to support the highest rating uplift only amounts to 7.5%. The cover pool is still in a ramp-up phase, and only one bond was outstanding at the cut-off date. For the analysis we also have incorporated the bank's issuance projections for 2017.

Wüstenrot applies its prudent risk management strategy to the cash flow management of its cover pool. The current generous overcollateralisation avoids any shortfalls upon scheduled or currently planned covered bond maturities. The issuer has established an internal policy to always maintain a dedicated amount of liquid substitute assets to improve cover pool's inherent liquidity. This addresses the low secondary market liquidity of the mortgage collateral, mitigates the reduction of the available collateral upon a potential sale of cover pool assets, and demonstrates the general prudence of the issuer in managing risks.

Figure 6. Main cash flow characteristics as of December 2016

Provided overcollateralisation expected to remain above regulatory minimum requirements

Total assets Eur	Net present value EUR	WAM (Principal) in year	Duration in year	% fixed-interest-paying assets	% floating-interest-paying assets
303,916,771	**351,007,761**	14.51	12.44	74.6%	25.4%

Total liabilities Eur	Net present value EUR	WAM (Principal) in year	Duration in year	Fixed interest, % of CCY	Floating interest, % of CCY
2,000,000	**2,529,765**	7.92	6.97	100.00%	0.0%

Cash flow mismatch risk

Moderate interest and no foreign exchange risk

The expected distribution of new issuances and their long maturities limit mismatch risk. The covered bond programme is very resilient against other market risk stresses. There is no foreign exchange risk or limited interest rate risk, and the pool benefits from a high excess spread.

The majority of Wüstenrot’s mortgage loans are granted at fixed rates, a contrast to the typical Austrian mortgage loans that are granted as floating-rate loans. The majority of the fixed-rate mortgage loans are not fixed for life, but eventually convert to floating rates. Interest rate risk still remains moderate as the mortgage loans have embedded interest rate caps and floors that effectively hedge the structure against adverse rate movements.

Figure 7. Cover pool by interest rate type and fixing

Interest type	Weight
Floating mortgage	24.97%
Less than 5 year fixed/-floating mortgage	6.60%
Less than 10 year fixed/-floating mortgage	30.01%
Greater than 10 year/ fixed-floating mortgage	35.70%
Fixed mortgage	2.72%

We have tested the resilience of the covered bond structure against adverse rate developments using a deterministic set of scenarios with rising and falling interest rates (starting at different times) and complemented the stresses with a lower-for-longer interest rate scenario in which negative market rates persist. This lower-for-longer scenario is the most stressful for the cover pool, but its impact remains insignificant on the supporting overcollateralisation (see Appendix II for further details).

Substitute assets currently registered in the cover pool do not add credit risk and provide the cover pool with the ability to swiftly mitigate short-term liquidity needs.

Asset-liability mismatch risk

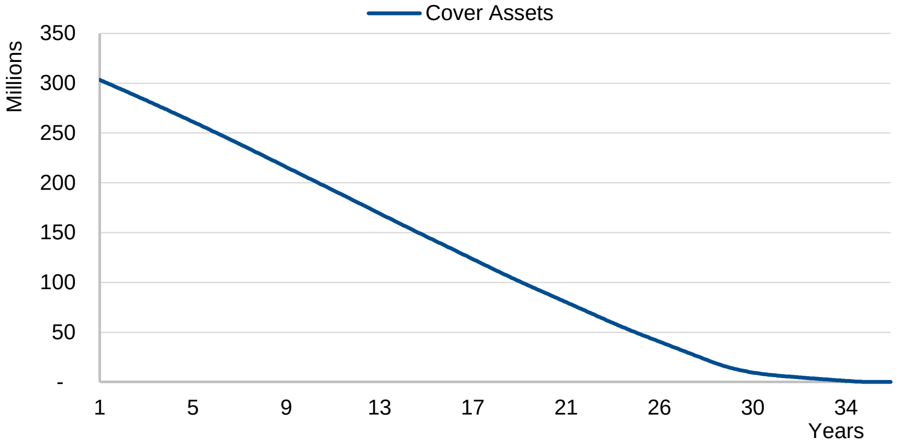
No asset sale would be needed in a run-down scenario of the cover pool, assuming the current overcollateralisation and planned issuance structure. Only upon scaling down the overcollateralisation, in order to determine the minimum overcollateralisation needed to support the cover pool uplift, do we identify the need to sell cover assets to meet covered bond redemptions on a timely basis.

To establish stressed proceeds in case of an asset sale we have discounted the remaining cover pool cash flows, adding the additional discount factor of a liquidity premium. We have used a liquidity premium of 150 bps based on the development of Austrian covered bond trading spreads.

Applying all credit and market risk stresses, we have iteratively reduced the overcollateralisation and established that an overcollateralisation of 7.5% will allow the mitigation of the identified stresses and support the full uplift under our methodology.

Current liability profile not representative but issuance plans do not result in material asset-liability mismatch risk

Figure 8. Asset and liability redemption profile



Overcollateralisation (OC)

Current credit quality of Wüstenrot allows the provision of the benefit to available overcollateralisation

Wüstenrot's covered bond ratings are cover pool-supported ratings and therefore hinge on the issuer's ability and willingness to provide overcollateralisation above the legal minimum.

As of 28 December 2016, Wüstenrot had only issued a 'test' issuance, resulting in an excessive and not representative overcollateralisation.

Our credit view of Wüstenrot allows us to fully consider available overcollateralisation for the analysis. In the case the issuer rating was downgraded, we would identify whether the issuer's capital market communication on its intended overcollateralisation is sufficiently robust. In the absence of this, we would establish a sustainable overcollateralisation level, against which we would compare the rating-supporting overcollateralisation to determine whether we can maintain the ratings.

If the issuer's credit quality deteriorated by one notch, and assuming the covered bond programme's credit and cash flow profiles remained unchanged, the covered bond rating would have to be downgraded by one notch as well. Available overcollateralisation would still allow for the same cover pool rating uplift as overcollateralisation would only slightly increase by 25 bps.

We are not aware of plans that would significantly change the risk profile or reduce available overcollateralisation to levels that would no longer support the current rating uplift.

Counterparty risk

Wüstenrot's covered bonds are exposed to its roles as originator, servicer, bank account provider and paying agent. There are no documented replacement mechanisms that would automatically shield the covered bonds from a credit deterioration of, for instance, the counterparties providing bank accounts. However, before a regulatory intervention we believe that the strong alignment of interests between the bank and covered bond holders will avoid a negative impact from such counterparty risk. As part of the risk management process, the bank regularly monitors its accounts to ensure that it can enter into remedial actions early on. We also take a positive view that most collections are done via direct debit, allowing for a relatively swift redirection of payments if needed.

In addition, we expect that a regulatory intervention in Wüstenrot would involve the use of available resolution tools, with the aim of maintaining this issuer. Scope does not expect the active management and servicing of the cover pool to be severely impacted in such a scenario.

FUNDAMENTAL CREDIT SUPPORT ANALYSIS

The Austrian covered bond framework (in particular the Pfandbriefgesetz relevant for Wüstenrot's Hypothekenpfandbriefe, or mortgage-covered bonds), combined with our credit-positive view on the resolution regime, allows us to assign the covered bonds a positive, fundamental-analysis-based credit differentiation of four notches above the bank's rating.

LEGAL FRAMEWORK ANALYSIS

Maximum two-notch rating uplift reflecting the sound legal framework

A credit differentiation of two notches is driven by the benefits arising from the Austrian legal covered bond framework. Our analysis for Austrian covered bonds confirms that the three frameworks in Austria meet the minimum criteria to assign the maximum credit differentiation under our methodology. The framework's provisions are robust enough to ensure the cover pool is segregated from the issuer's insolvency estate. The frameworks also provide regulations that allow a bond's payments to continue after an insolvency. In addition, they ensure that identified risks can be mitigated by overcollateralisation, which generally will remain available after a potential insolvency. Covered bonds also benefit from specific regulatory oversight. However, we recognise that these frameworks remain relatively vague on liquidity or risk management for covered bonds, which are seen as best practice in the market.

Austrian covered bond framework just meets the minimum standards, however

Currently, the Austrian covered bond frameworks just meet the minimum standards under our methodology. We believe ongoing industry efforts to improve and consolidate the existing three frameworks, combined with the European debate on covered bond harmonisation, will eventually reduce complexity and improve credit protection for covered bond investors. We currently do not expect framework developments to gain traction before the European Commission's covered bond harmonisation efforts have been finalised in mid- to late 2017.

For a more comprehensive assessment of the fundamental support factors relevant for Austrian covered bonds, see the related research.[2]

RESOLUTION REGIME ANALYSIS

Resolution-regime analysis supports additional credit differentiation

We have assigned an additional credit differentiation of two notches, reflecting the exclusion of Wüstenrot's covered bonds from bail-in in the hypothetical scenario of regulatory intervention in the bank. We have provided an additional notch of credit differentiation as we believe that regulators would, in a hypothetical resolution scenario, more likely restructure the issuer as a going concern using available resolution tools.

In the resolution framework assessment we analyse how likely a regulatory intervention on the issuer will preserve the credit quality of a covered bond and assess whether:

- Austrian covered bonds comply with the regulatory definitions to benefit from the preferential status;
- The issuer is bail-inable and regulators would use available tools to preserve the covered bond issuer;
- Mortgage-covered bonds in general and the issuers' covered bonds are systemically important in the domestic context; and
- An active domestic stakeholder group (issuers, regulators and investors) is working together to maintain confidence and a high credit quality of the covered bonds.

In line with the Bank Recovery and Resolution Directive, Austrian covered bonds are excluded from bail-in in the hypothetical scenario of regulatory intervention in the bank.

In addition, we believe that an additional credit differentiation can be provided as regulators would in a hypothetical resolution scenario more likely preserve the issuer as a going concern. The issuer has a sufficiently strong bail-inable liability side that will allow regulators to use available resolution tools.

Wüstenrot is one of the few independent providers of Bausparkasse products in Austria. This reflects the strong footing of building societies in Austria and the already existing oligopoly, we would expect this to classify as a critical function worth preserving compared to standard retail banking in the 'overbanked' Austrian retail market.

We have not provided additional, resolution-framework-based support to Wüstenrot's covered bonds. In general, Austria does not have a very high covered bond 'intensity',

[2] Covered Bond Framework Analysis – Analytical Considerations: Austria.

demonstrated by the two largest issuers already comprising more than 45% of total outstanding covered bonds. Wüstenrot's issuance volumes and representation in domestic and international investment portfolios to date (including planned issuances) do, in our view, not yet create an additional, covered bond-driven incentive for market stakeholders to provide support to the bank.

Generally for Austria we see the fundamental-resolution-based uplift to be constrained to three notches. Given Austria's low covered bond intensity, coupled with the lower predictability of support from stakeholders and regulators, we generally see a fundamental difference to countries with a more active issuance and support history.

The absence of strong proactive communication by regulators and support by industry stakeholders was evidenced during the prolonged uncertainty on the credit quality for covered bonds for two banks in workout. These banks were under close regulatory supervision, placed under moratorium, or were split into a 'good' and 'bad' bank; but covered bond investors did not get regular information on the impact of the outstanding covered bonds (HETA and Kommunalkredit). Such uncertainty on credit quality is, in our view, not commensurate with an additional fundamental support for Austrian covered bonds.

RATING STABILITY

Changes to the issuer assessment

Changes in our assessment of the bank will directly translate into cover pool rating changes

Upon an issuer downgrade or negative change on its outlook, the covered bond ratings would move in line with these changes. This reflects that, under our criteria, the maximum cover-pool-driven uplift can only be three notches above our assessment of fundamental support factors, and that additional collateral will not allow more than a three-notch rating differentiation above fundamental support factors. Similarly a positive credit development would result in an upgrade of the covered bonds.

Changes to overcollateralisation

ICSR downgrade will not significantly change the OC requirement

The rating is based on the support provided by the cover pool, thus relying on overcollateralisation. Current covered bond issuance is restricted to 10% of the balance sheet, which, combined with the bank's covered bond issuance strategy, does not indicate that the rating-supporting overcollateralisation will constrain the rating. This assumption also reflects that the issuer's underwriting criteria have remained stable and that the credit quality of the current cover pool is not materially different from additional available eligible assets or the bank's mortgage book.

We believe the issuer has a sufficient capacity to support the cover pool uplift.

SOVEREIGN RISK

Risk of institutional meltdown, legal insecurity or currency problems not material

Sovereign risk does not limit the ratings of Wüstenrot's mortgage covered bonds. We currently believe the risks of an institutional framework meltdown, legal insecurity or currency-convertibility problems, are remote.

DATA ADEQUACY

Detailed cover pool and performance data provided by the bank

We consider the data quality as adequate in light of the cover pool's high granularity.

Wüstenrot has provided Scope with public and confidential information on the cover pool composition, including asset performance data and information that allows us to establish a cash flow profile. We have received detailed loan-level data with the relevant credit characteristics of the mortgage segment.

We complemented the analysis of the cover pool performance information we received from the issuer with market data and made conservative assumptions (see Appendix II for further information). We ensured as far as possible that sources were reliable before drawing upon them, but did not verify each item of information independently.

Scope analysts visited Wüstenrot and interviewed key personnel to understand the banks' origination, monitoring and workout processes. We also discussed key trends relevant for the development of the cash flow profile, including issuance plans.

MONITORING

Ratings regularly monitored

Scope will monitor this transaction using information regularly provided by the issuer. The ratings will be monitored and reviewed at least once a year, or earlier if warranted by events.

APPLIED METHODOLOGY

To analyse the mortgage covered bonds, Scope applied the 'Covered Bond Rating Methodology' published 22 July 2016 and the principles of the 'Methodology for Counterparty Risk in Structured Finance', dated 12 August 2016. We also applied the principles as per our 'General Structured Finance Rating Methodology', dated 31 August 2016 for the asset and cash flow analysis. Our rating methodologies are available on our website www.scoperatings.com

APPENDIX I. WÜSTENROT ISSUER CREDIT ANALYSIS

Highlights

Bausparkasse Wüstenrot AG is the oldest and the only independent Bausparkasse (building society) in Austria – unlike its three national peers, which are associated with larger banking groups, namely Erste Bank, Raiffeisen group and BAWAG. Wüstenrot benefits from a wide range of clients across Austria, who are serviced via a nationwide network of Wüstenrot service centres and a larger number of full-time and part-time financial advisors. The building society also partners up with correspondent banks, as well as brokers for the distribution of its products.

Of the total population of 8.7m in Austria, around 5.4m individuals hold a so-called Bauspar contract, a Bausparkasse savings plan. As of December 2015, the market of outstanding mortgage loans (Bauspardarlehen), bridging loans (Zwischendarlehen) and other loans by Austrian Bausparkassen had a total size of around EUR 19bn. Within this financing segment, Wüstenrot ranks third behind Raiffeisenbausparkasse and S-Bausparkasse, although with a strong share of 23.9%. Nevertheless, the overall market share for Bausparkassen with regard to house financing loans in Austria and among all financial institutions is lower, at around 16%, of which Wüstenrot holds around 3.2%.

The Bausparkassen sector in Austria is experiencing challenges, mainly due to the lower-for-longer interest environment and related dwindling profitability. In addition, client preferences and behaviours are changing, forcing banks to innovate product offerings within their means and focus on increasing efficiencies. Because Bausparkassen are bound by a specialised law and defined business models, these institutions lack the flexibility of other banking models to adjust services. Nevertheless, Wüstenrot has been able to increase lending over the past years, in line with its very conservative risk strategy. The bank has a safe and well-diversified asset base, which has enabled it to operate profitably over the past decade, albeit at lower and partly stronger-fluctuating levels.

Besides this, Bausparkasse Wüstenrot benefits also from its set up within a financial conglomerate; the Wüstenrot group focuses on retail services and comprises next to the Bausparkassen business (the largest entity within the group) in addition a large insurance business. The main business focus of the group is on the Austrian market (c. 90% of deposits and c. 92% of loans), although the Bausparkasse as well as the insurance company have both established subsidiaries in CEE countries. Wüstenrot is currently updating its strategy and restructuring the group to exploit intra-group efficiencies.

Generally, Bausparkassen are considered niche players in a legally bound, monolined segment. This, in our view, makes the banks more vulnerable to adverse and/or sudden market developments, due to the lack of activities that can provide offsetting and alternative income sources. In the case of Wüstenrot, the bank might currently benefit from the integration within a larger group, however, while all entities are profitable, the group structure nevertheless exhibits, in our view, some vulnerability to financial contagions and reputational risks, which could arise from any business parts.

Compared to peers, Wüstenrot's independent structure results in a larger cost base and fewer opportunities for economies of scale. Furthermore, Wüstenrot does not have access to a larger capital- and liquidity-supporting group structure. We nevertheless regard positively that both the bank and overall group have a 'no dividend' policy, in order to organically strengthen capital positions for all entities within the group. With regard to the bank's capital-raising abilities, we note the potentially limited support from its majority owner. Regarding other shareholders, potential access to funds is even more limited.

Rating drivers (summary)

THE RATING DRIVERS, IN DECREASING ORDER OF IMPORTANCE, ARE:	
1.	Longstanding history and brand as a specialised housing-finance lender in Austria. Foreign subsidiaries and insurance business provide complementary brand value.
2.	Prudent and conservative management of capital and liquidity is rooted in the bank's independent position; these metrics provide some challenges for Wüstenrot's competitiveness.
3.	Low-risk profile should provide resilience during periods of low profitability.
4.	Currently lower-for-longer interest environment and changing client behaviour create challenges for business model.

Rating-change drivers

↑	Successful implementation of the cost-saving programme with visible improvement in profitability and flexibility could provide an uplift for the rating.
↑	Any strategic partnership with larger financial institutions could help to stabilise prudential metrics.
↓	Changing risk profile and weaker credit quality will directly impact ratings.
↓	Any risks arising from subsidiaries (insurance and foreign-based) could put downward pressure on ratings.
↓	A decreasing market share and/or diminishing profitability, as well as reduced capital market access, may weaken the bank's prudential metrics.

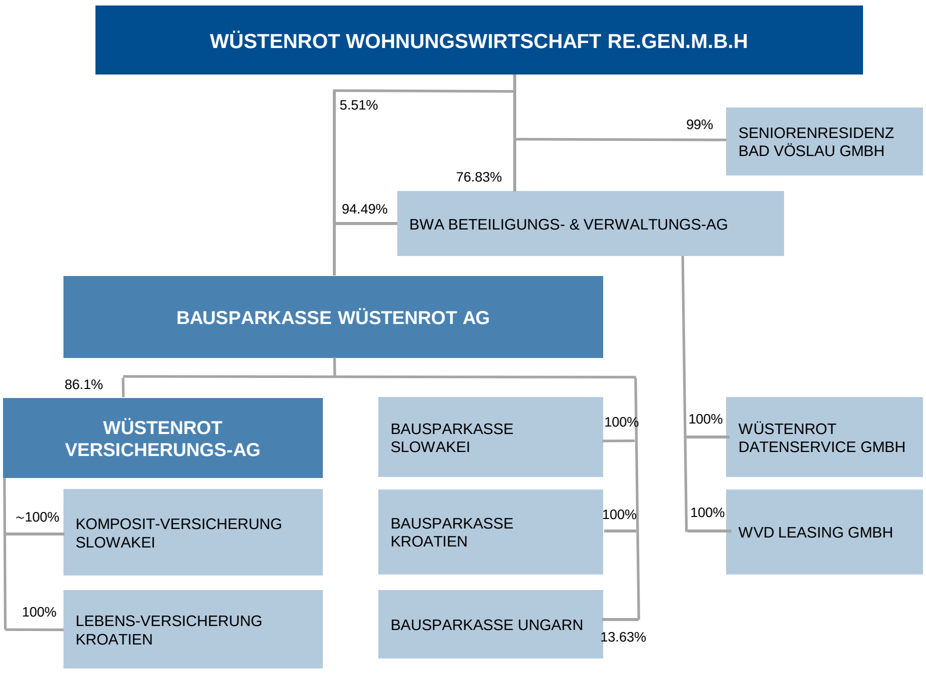
Overview of Wüstenrot group structure

The Austrian Wüstenrot group is a financial services group headquartered in Salzburg. Its main institutions are a Bausparkasse (Bausparkasse Wüstenrot AG) and a retail-focused insurance company (Wüstenrot Versicherungs-AG). The group's other entities include three building societies and two insurance companies, all based in Central and Eastern Europe (Figure 1).

The group offers residential real estate financing, financial precautionary planning, life and non-life insurance products (including health and mobility), as well as general insurance-based investment products. The products are highly complementary and target retail clients. The group also benefits from strong cross-selling opportunities via its own distribution network.

As of December 2015, Baupsarkasse Wüstenrot had around 684 employees in Austria and the insurance part had around 1,026 employees. The bank expects that during the process of further integration between the two business segments the number of employees could change over time due to transfers between the two entities.

Figure 1: Wüstenrot group structure



Source: Company Data, Scope Ratings

The bank's majority shareholder, Wüstenrot Wohnungswirtschaft reg. Gen. M.b.H., is a cooperative society, which was founded to promote and develop the housing industry, with the aim to provide affordable housing. The majority shareholder has a direct interest in the Bausparkasse of 5.51% and an additional overall indirect share of around 72.6% via the BWA Beteiligungs- und Verwaltungs-AG, a holding company (Figure 1 & Table 1).

The remaining shareholders (via BWA Beteiligungs- & Verwaltungs-AG) are various commercial banks in Austria, with which Wüstenrot partly has distribution agreements for its products.

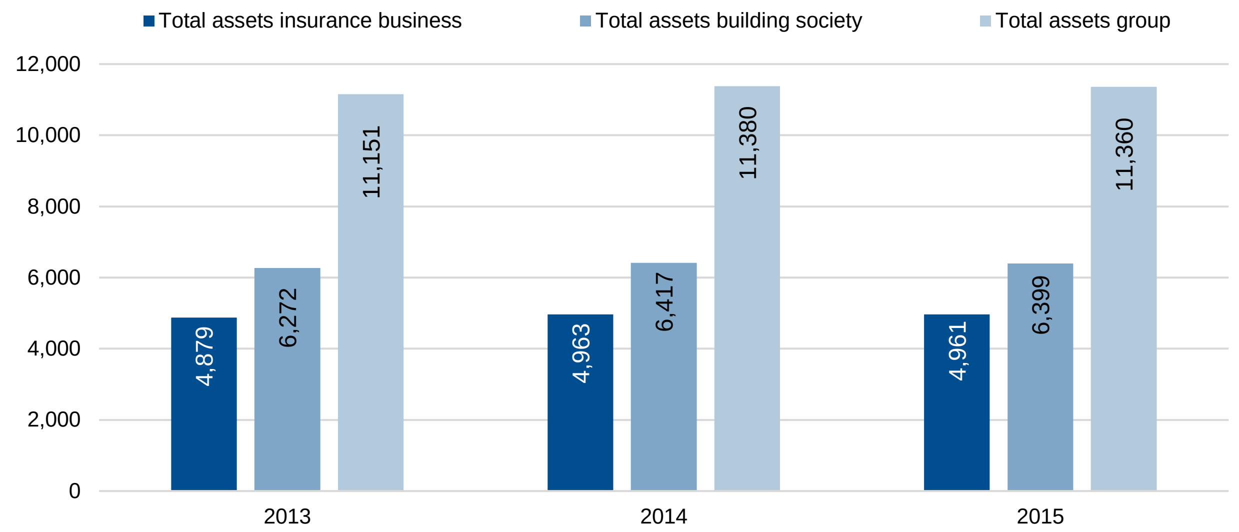
Table 1: Details on Wüstenrot shareholder structure – BWA Beteiligungs- und Verwaltungs-AG

Shares in the BWA Beteiligungs- und Verwaltungs-AG as of 01.07.2016	in %	in EUR
Wüstenrot Wohnungswirtschaft re.Gen.m.b.H., Salzburg	76,83	164.758.525,00
UniCredit Bank Austria AG, Wien	12,63	27.083.340,30
BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse AG, Wien	3,88	8.316.743,21
Oberbank AG, Linz	2,6	5.576.638,34
Other minority shares	4,06	8.700.076,15
	100	214.435.323,00

Source: Company data, Scope Ratings

Wüstenrot Bausparkasse is the largest entity within the group, with total assets averaging around EUR 6bn over the past years. The overall group has total assets of around EUR 11.5bn (Figure 2).

Figure 2: Development of total assets: Wüstenrot group

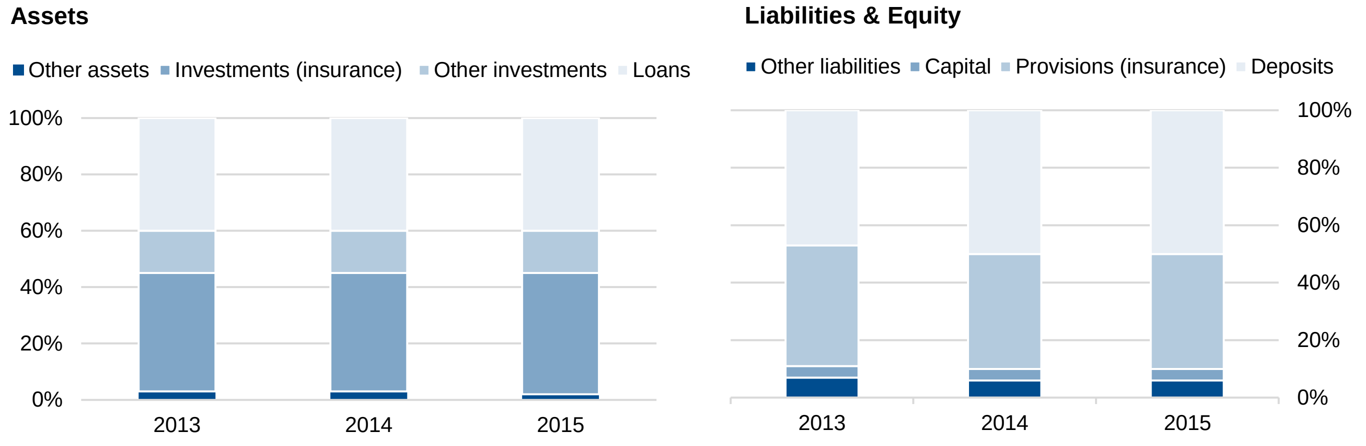


Source: Company data, Scope Ratings

Due to the dual business structure of the group (Bausparkasse savings and insurance), assets mainly comprise loans (banking) and investments (insurance), while liabilities strongly depend on deposits (banking) and provisions (insurance) (Figure 3).

The deposits and provisions are typically bound by contract, providing the group with some stability regarding its funding. Nevertheless, a lack of diversification of the funding profile raises concerns over the impact of reputational risks as well as current risks related to interest rates.

Figure 3: Asset and liability structure Wüstenrot groupd



Source: Company data, Scope Ratings

Wüstenrot Bausparkasse

Wüstenrot is a financial institution supervised nationally in Austria by FMA and OeNB.

Austrian building societies are subject to a specialised law, the Bausparkassengesetz, which defines the principles of mortgage lending. The main function of loans via building societies is to finance residential housing, but loans can also be used to a certain degree for education and for the care of the elderly or other individuals.

There are two types of loans available via Wüstenrot Bausparkasse

- Mortgage Loans (c. EUR 3.9bn as of year-end 2015)
- Other Loans - not backed by mortgages (c. EUR 345m as of year-end 2015)

To finance business activities, building societies in general can either bundle savings deposits, or issue covered bonds (currently max. 10% of total assets) or other securities.

Savings contracts via building societies appeal to Austrian retail clients because of the benefit of additional premium payments which are sponsored by the government. Bausparkasse savings loans are typically collateralised via its entry into the land registry or other eligible collateral. Building society loans based on a savings contract are restricted to EUR 180,000 per person, and the maximum loan-to-value (LTV) is 80%.

Wüstenrot's main business is focused on retail clients (c. EUR 4.3bn), whereas major residential building finance (Großwohnbau), related mainly to non-for-profit entities (c. 87%), comprised only around EUR 400m of the overall lending portfolio in 2016.

For the distribution of its products, Wüstenrot does not rely on an extensive branch network, but rather uses various distribution centres across Austria, a network of full-time and part-time financial sales consultants, mortgage brokers, as well as cooperating with various commercial banks. We particularly regard the network of financial sales consultants as a competitive advantage for Wüstenrot. It provides a close connection to the bank's clients, on a relatively low cost base.

Wüstenrot was the first Bausparkasse to establish a network in the CEE, where its growth strategy mirrors that of the home market and is based on organic growth. The bank fully owns both Wüstenrot stambena stedionca d.d. in Croatia and Wüstenrot stavebna sporteľna a.s. in Slovakia. It has a minority share (13.6%) of Hungarian Fundamenta Lakaskassza AG.

These entities have been profitable over the past years. The current 'no dividend' policy allows the institutions to build up intrinsic capital positions (Table 2).

Table 2: Key figures of CEE building society entities*

Country	Slovakia	Croatia	Hungary
Institution	Wüstenrot stavebná sporiteľňa, a.s., Bratislava	Wüstenrot stambena štedionica d.d., Zagreb	Fundamenta-Lakáskassza Bausparkasse Zrt. Budapest
As of	YE 2015	YE 2015	YE 2015
Year of establishment	1993	1998	1997
Ownership share of Wüstenrot	100%	100%	13.63%
Savings contract portfolio	118,725	120,446	661.434
Deposits (EUR m)	346.8	222	1,203.70
Loans (EUR m)	217.1	168.3	718.9
Equity ratio (%)	18.7	15.4	17.6
Employees	247	169	555
EBT (EUR m)	2.1	1	26
Total assets (EUR m)	370.2	223.2	1,344.20

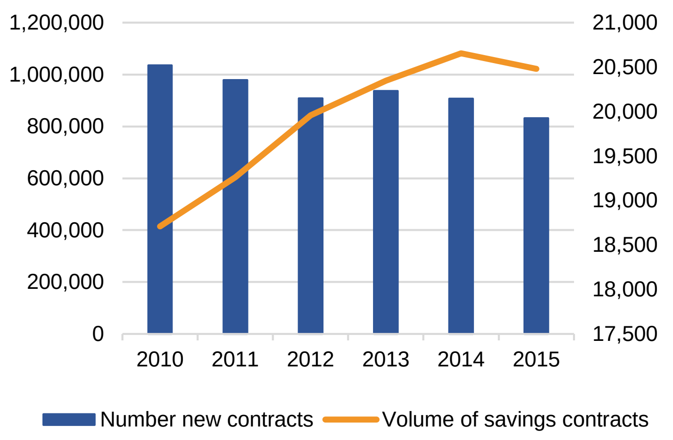
* Figures based on the local annual reports
Source: Company data, Scope Ratings

Recent events

Market for Bausparkasse savings is changing

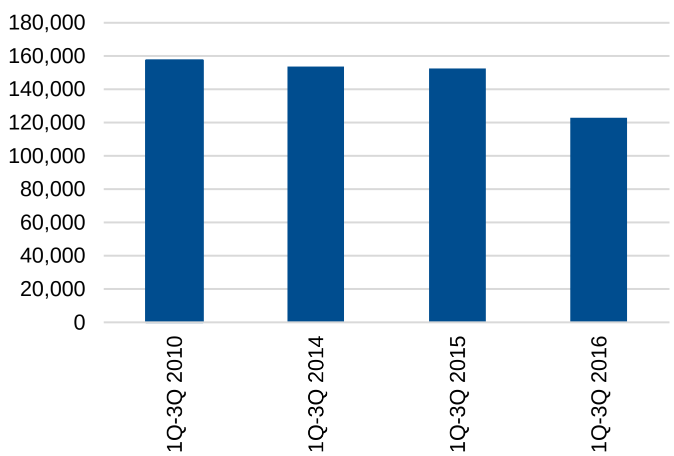
Since 2010, and as reported by the association for Austrian Bausparkassen (Arbeitsforum Österreichischer Bausparkassen), the Bausparkasse sector has experienced a near-continuous decrease in the number of new contracts (by roughly 20% (Figure 4)).

Figure 4: Number of new savings contracts with building societies (units) versus volume of outstanding savings contracts (EUR m)



Source: Company Data, Arbeitsforum der Österreichischen Bausparkassen (AÖB), Scope Ratings

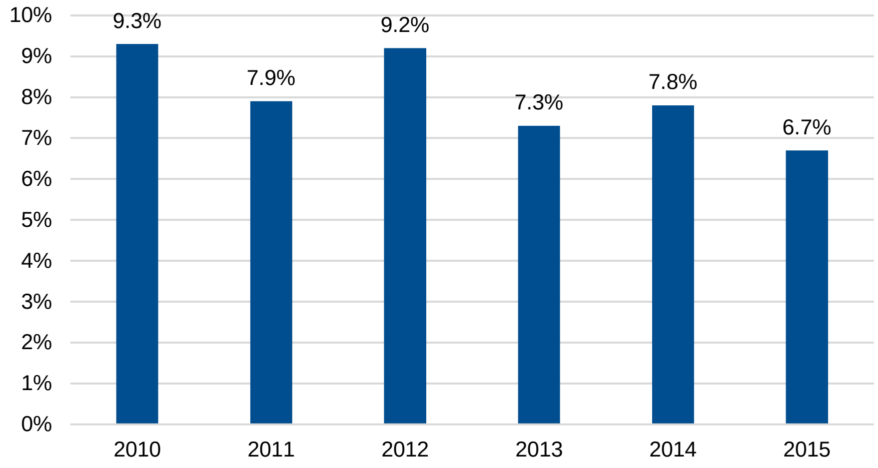
Figure 5: Number of new savings contracts with Wüstenrot (units)



Source: Company data, Scope Ratings

Part of the decrease can be potentially attributed to a changed environment with lower interest rates, which might have also resulted lower household savings (Figure 6). However, and as Figure 4 also reflects, we understand that savings have been partly redistributed towards older, previously existing savings contracts with higher interest rates. This would explain the strong increase in the actual volume of outstanding savings contracts, despite the shrinking number of new contracts.

Figure 6: Savings quota of private households in Austria (%)



Source: Company data, Arbeitsforum der Österreichischen Bausparkassen (AÖB), Scope Ratings

From a more general point of view, the 'traditional', monolined Bausparkassen business model is under pressure. New Bausparkassen savings contracts are less attractive for retail clients who intend to take out mortgage loans at some point, as alternatives in the market exist in the form of direct, low-interest mortgage loans. Hence, currently Bausparkassen cannot benefit from a steady stream of relatively cheap funding via newly signed saving contracts (Figure 4). In addition and to a degree, existing contracts are not converted into loans, but rather are used for ongoing savings due to the higher interest rate. This changed client / saver behaviour leads in some cases to Asset/Liability mismatches on Bausparkassens' balance sheets.

However, a certain difference should be noted here between the Austrian and German Bausparkassen market. Whereas in Germany Bausparen has been traditionally a mean to safeguard a cheaper interest rate for a future mortgage loan taken out via the Bausparkasse, in Austria Bausparen is incentivised by a state backed premium based on the savings. Given the latter, we understand that often Bauspar savings contracts are not necessarily converted into mortgage loans.

Wüstenrot furthermore also experienced a special trend with its clients where the number of regular, but small amount savers have declined and the number of savers which pay in larger, one off lump-sums to the savings accounts have increased. Such funds are actually regarded as longer term and hence should give the bank an advantage and some stability with regard to its Asset/Liability management.

We also observed in the market that currently relatively higher interest-bearing savings contracts represent a challenge for Bausparkassen and some banks are addressing this issue by cancelling older contracts which still bear more favourable rates for savers. It is uncertain whether the termination of such contracts is legal, and Bausparkassen are partly challenged to continue their relationship with clients to avoid reputational risks. Wüstenrot partly faced this issue as well, albeit on a more limited scale; only around 0.8% of deposits (EUR 44.2 m) fell under the category of such residual high-interest-bearing savings deposits. Those deposits carry an average interest rate of around 1.78%; whereas the average interest rates of all customer deposits in 2015 was about 1.19% and in 2016 around 1.05%.

In fact, due to the particular structure of the Austrian banking market, it seems that Bausparkasse Wüstenrot is still benefiting from a steady stream of client interest with regard to the establishment and maintenance of new savings contracts. However, for cost saving purposes, it should be in general in the interest of Bausparkassen to increase savings volumes rather than the number of savings contracts. As discussed above, Wüstenrot already follows a focus in this regard.

Rating drivers (details)

1. Longstanding history and brand as a specialised housing-finance lender in Austria. Foreign subsidiaries and insurance business provide complementary brand value.

Despite decreased interest rates over the past years, in Austria Bauspar contracts are still enshrined among classic investment and savings options for retail clients. This can be partly attributed to the attached government-sponsored premium benefits for savers. Hence, Bausparkassen typically benefit from high deposit levels, which function as their main and partly exclusive source of funding.

Wüstenrot is the oldest and only independent Bausparkasse in Austria. The bank has built a strong brand recognition and pursues a consistent, prudent lending business in residential housing. Since 2000, the bank's business has grown both organically and sustainably, although more slowly than general growth rates in the market (Figure 7).

Figure 7: Evolution of outstanding loans for the acquisition of housing (Based on amount borrowed; value in December 2000 = 100%)

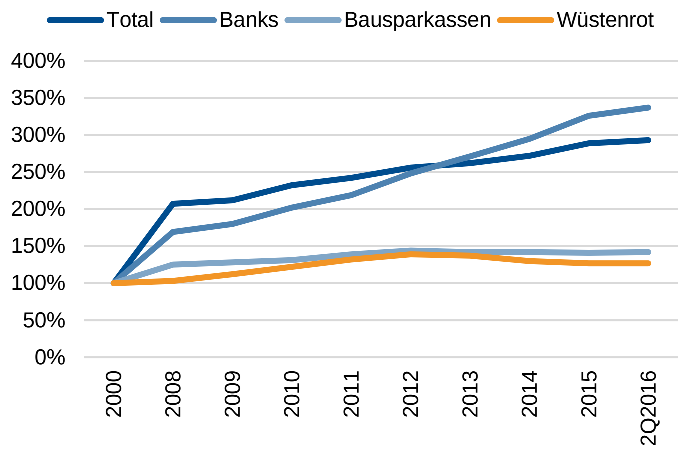
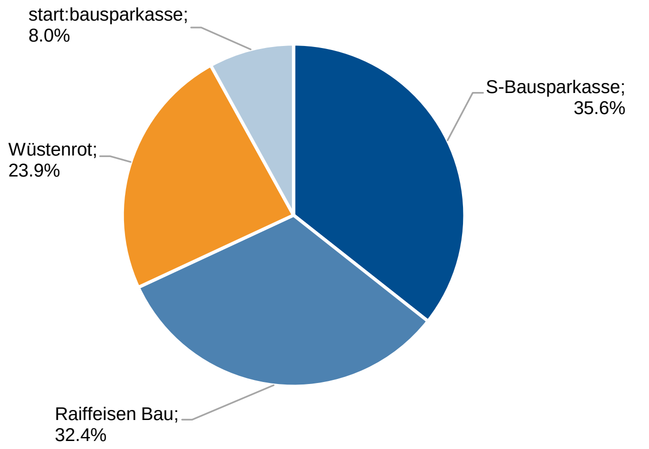


Figure 8: Bausparkassen market shares for loans (mortgage loans, bridge-financing and other loans) as of 12/2015 (%)

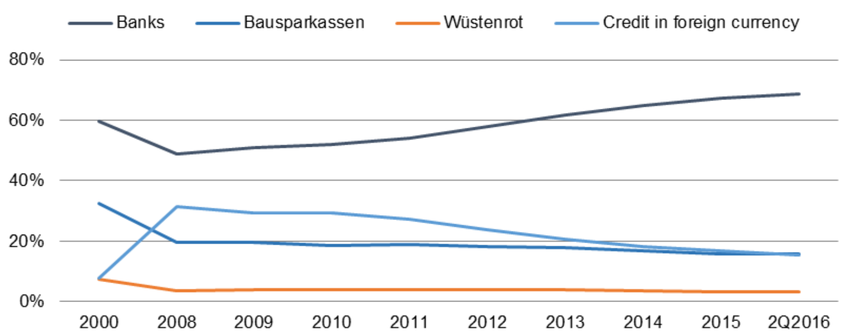


Source: Company data, Scope Ratings

From a market share perspective, Bausparkassen overall lost share in the housing finance segment over the past years (Figure 9). However, Wüstenrot has been able to keep its share relatively stable, albeit on a low scale. Within the Bausparkassen sector itself, Wüstenrot holds a still strong market share of around 24% (Figure 8).

The reason for the rather diverse developments in market shares is due to the fact that since the early 2000s commercial banks have continuously increased their role in housing finance. Certain developments have led to a liberalisation in this sector including for example the introduction of mortgage loans denominated in Swiss francs and Japanese yen. The popularity of these FX loans have stemmed from the much lower interest rates in Switzerland and Japan. As Wüstenrot did not offer FX loans as part of its product spectrum, the bank's growth rates remained subdued compared to its competitors who partly participated in the offerings of FX loans. Furthermore, Wüstenrot's relatively late introduction of granting a wider variety of loans without attached savings contracts also contributed to its slower growth.

Figure 9: Market shares based on the stock of credit for the acquisition of housing in Austria (%)



Source: OeNB, Scope Ratings

Due to a lack of affiliation with a large banking group, Wüstenrot does not have its own branded network of retail banking branches like its Bausparkassen peers. However, based on its distribution agreements with other banking groups, like for example BAWAG and Bank Austria, Wüstenrot should nevertheless have an extensive bank client reach across Austria. Besides this, the bank's main distribution channel consists of specialised sales consultants. The bank sees added value and a competitive advantage in this form of sales due to the close attachment to the client. According to statistics of the bank, this distribution channel generates market penetration of around 20% of the Austrian population.

Wüstenrot was the first bank to expand Bausparkasse operations to the CEE, which provides a relative competitive advantage and allows for an organic growth strategy.

2. **Prudent and conservative management of capital and liquidity is rooted in the bank's independent position; these metrics provide some challenges for Wüstenrot's competitiveness.**

Wüstenrot's common tier 1 equity (CET 1) ratio of 13.6% as of year-end 2015 (2014: 12.6%) and total capital ratio of 19% (18.2%) are strong compared to its national peers. We understand the Wüstenrot group currently has a 'no dividend' policy, and all the profits of each entity are retained to strengthen members' capital positions. However, low profitability will result in stable, rather than higher, capital ratios, which in turn will undermine any plans to strengthen growth. Nevertheless, the low-risk profile of the bank and strong collateralisation of its asset base are comforting aspects.

With regard to minimum requirements for own funds and eligible liabilities (MREL), we understand that national supervisors are yet to inform the bank about any specific needs to adjust its liability structure. The bank's low-risk profile, however, means it can rely solely on its own capital resources for the time being.

The funding of Wüstenrot mainly depends on retail deposits (c. 88% of total liabilities), with the majority linked to Bauspar contracts. This provides the bank with a relatively stable deposit base. Any cancelation of Bauspar contracts incurs penalty fees with the customer; therefore, early redemptions should be relatively limited.

Wüstenrot is in the process of redeveloping its funding strategy and adding covered bonds as an alternative funding source. However, by degree of the FMA, currently a maximum of 10% of Bausparkassens' total balance sheets can be diverted into this funding tool. We regard a more diversified funding structure as beneficial from a credit-risk perspective.

Wüstenrot's independent set-up is mainly challenged by its need to maintain a strong capital and liquidity profile, creating the pressure to strongly increase profitability. The bank's national competitors, on the other hand, benefit from the ability to revert back to group liquidity pools, to outsource some administrative functions, and access group members' branch networks (which are especially extensive in the Raiffeisen and savings bank sectors). Wüstenrot is currently in the process to implement a new strategy to make its overall group structure more efficient and, especially, to increase cross-selling between insurance and Bausparkasse businesses. Other major aims are to redevelop IT to broaden access to clients, make administrative processes leaner, and improve risk management.

The bank's liquidity profile looks adequate; its security portfolio also contains central-bank-eligible assets, which should help to counterbalance any larger short-term liquidity needs.

3. Low-risk profile should provide resilience during periods of low profitability.

We consider the credit risk of Bausparkasse Wüstenrot to be relatively low due to a main focus on residential mortgage lending.

The loan portfolio of Wüstenrot (c. EUR 4.3bn as of year-end 2015) is mainly composed of loans for residential housing. Loans for education and for the care of the elderly or other individuals are of minor significance, c. EUR 9m. The majority of loans (c. EUR 3.9bn) are composed of diversified residential mortgages in Austria. Such mortgage loans typically carry a loan-to-value (LTV) of between 60% and 80% and a maturity profile of 10-20 years. With Wüstenrot a typical housing loan has a value of around EUR 110,000.

Non-performing-loan levels have been consistently low over the past years, at around 0.84% in 2016 and with a max of up to 1.69% in 2009, which is very low compared to commercial banking peers. Any downside risk with regard to interest rates change should be limited due to a structure of capped interest rate contracts which contain fixed lower and upper level interest rate.

Residential real estate prices in Austria have increased considerably in the past years, although still from a comparatively low level. For example, the Stability Report 31 of the Austrian National Bank[3] states that in Vienna, where house prices have risen particularly strongly in recent years, only about 18% of households are owner-occupiers and only 6% of households have mortgage debt. It could be concluded that low home-ownership rates, in conjunction with a well-developed rental market with a high share of subsidised housing, limits the incentive and need for vulnerable households to own homes, and thus should limit associated systemic risks. The report further explains that the aggregate indebtedness of the household sector is comparatively low and has not increased in recent years. Also, the share of mortgage loans in Austria is low relative to both GDP and banks' tier 1 capital. Nevertheless, Bausparkassen would be at the forefront of any increased problems in this respect.

Wüstenrot holds an investment portfolio of around EUR 1.1bn as of 2016. The portfolio is geared towards Austrian exposures across sovereigns, financial institutions, corporates and money markets. However, Wüstenrot also has a strong exposure to financial institutions in the US. We understand that the bank is looking to downsize the portfolio and to refocus on the growth of its loan business.

4. Currently lower-for-longer interest environment and changing client behaviour create challenges for business model.

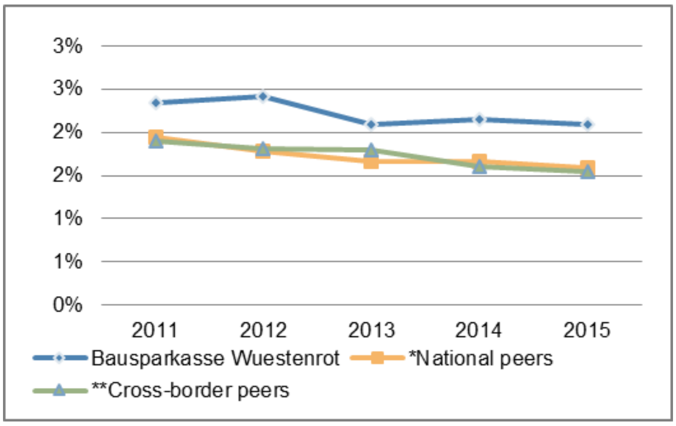
Over the past years, the lower-for-longer interest environment, as well as a changing and competitive mortgage lending market, have put pressure on the profitability of Bausparkassen. Wüstenrot has been able to steadily grow its loan business; nevertheless increased low / negative interest bearing cash positions and challenged retail deposit funding have to be met by a higher flexibility of Asset/Liability Management. Wüstenrot has shown a resilient, but nevertheless prudent strategy to respond to these challenges. Respectively, a shifting risk profile of the bank should be monitored over time.

Wüstenrot is continuously adjusting and improving its product portfolio to meet new demands, both for risk management purposes as well as for clients. The bank's competitive advantage is its fixed-interest-rate loan business. The majority of new loans carry a fixed interest rate with a long-term commitment of between 10 and twenty years. This gives the bank a more stable planning horizon; for clients, it provides an attractive investment alternative. The best part of fixed-rate loans are hedged by the bank, based on conservative interest-rate estimates. By contrast, in the whole of Austria, variable-rate loans represent the majority of all outstanding loans.

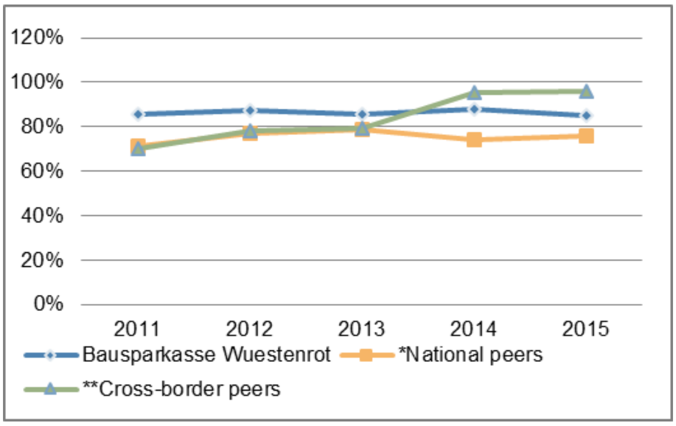
[3] See: https://www.oenb.at/en/Publications/Financial-Market/Financial-Stability-Report/2016/financial-stability-report-31.html

PEER COMPARISON – BAUSPARKASSE WÜSTENROT AG

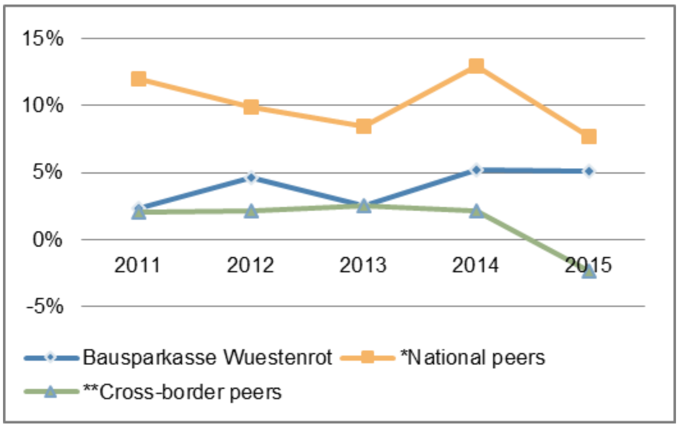
Net interest margin



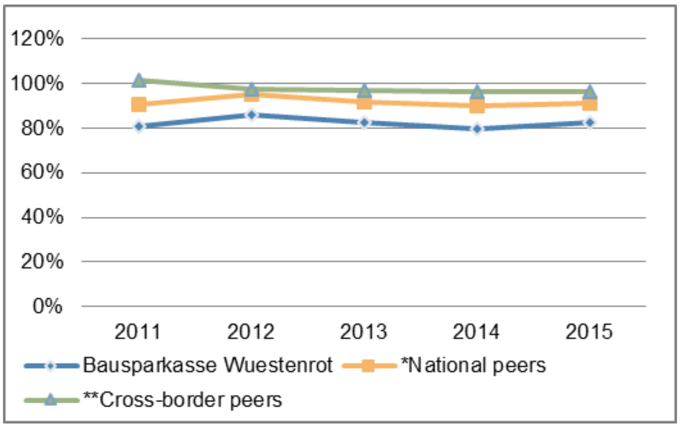
Cost-income ratio (%)



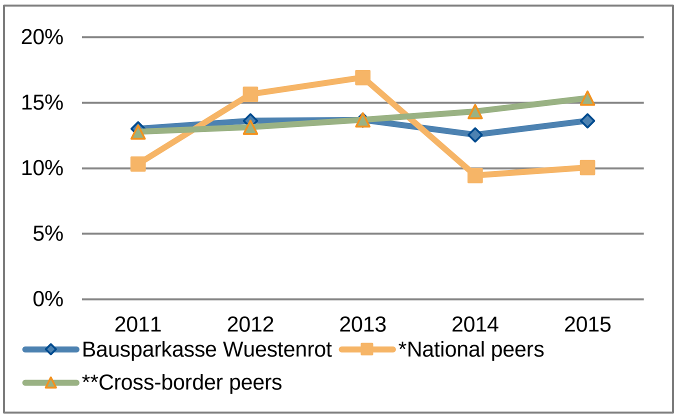
Return on average equity (%)



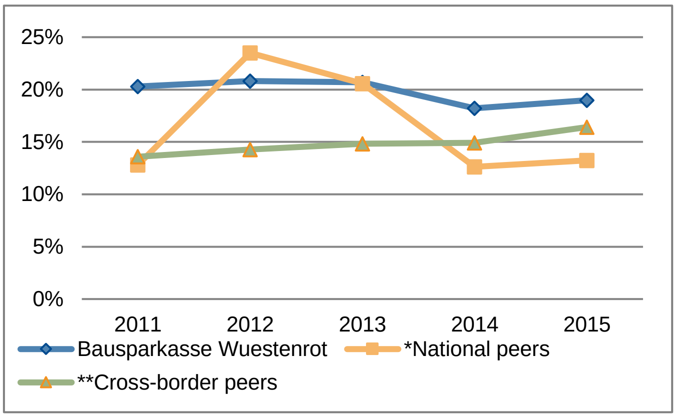
Loan-to-deposit ratio (%)



Common equity tier 1 ratio (transitional) (%)



Total capital ratio (transitional) (%)



Source: SNL, Scope Ratings
National peers: Raiffeisen Bausparkasse Gesellschaft mbH, Bausparkasse der österreichischen Sparkassen AG
**Cross-border peers based on business model: Alte Leipziger Bausparkasse AG, BHW Bausparkasse AG, Debeka Bausparkasse AG, Deutsche Bausparkasse Badenia, Deutscher Ring Bausparkasse, LBS Bausparkasse Südwest

SELECTED FINANCIAL INFORMATION – BAUSPARKASSE WÜSTENROT AG

	2011	2012	2013	2014	2015
Balance Sheet summary (EUR mn)					
Assets					
Cash and Interbank Assets	617.7	488.9	568.2	481.7	224.1
Total Securities	883.2	757.0	738.9	944.7	1,112.4
Derivatives	N/A	N/A	N/A	N/A	N/A
Net Loans to Customers	3,723.8	4,030.6	4,130.9	4,166.7	4,270.1
Other Assets	510.1	499.0	502.2	527.2	489.9
Total assets	**5,734.8**	**5,775.5**	**5,940.2**	**6,120.2**	**6,096.5**
Liabilities					
Interbank liabilities	85.0	75.5	59.7	58.0	114.7
Senior Debt	442.4	354.1	217.6	139.8	94.6
Derivatives	4.0	10.6	2.8	2.8	2.8
Deposits from Customers	4,595.5	4,697.0	5,013.2	5,243.3	5,188.2
Subordinated Debt + Non Equity Hybrids	136.3	136.3	136.3	136.3	134.5
Other Liabilities	84.5	96.7	94.7	102.0	100.8
Total Liabilities	**5,347.7**	**5,370.1**	**5,524.3**	**5,682.2**	**5,635.6**
Ordinary Equity	387.1	405.4	415.9	438.1	461.0
Equity Hybrids	N/A	N/A	N/A	N/A	N/A
Minority Interests	N/A	N/A	N/A	N/A	N/A
Total Liabilities and Equity	**5,734.8**	**5,775.5**	**5,940.2**	**6,120.2**	**6,096.5**
Core Tier 1 / Common Equity Tier 1 Capital	N/A	N/A	N/A	419.1	437.1
Income Statement summary (EUR mn)					
Net Interest Income	100.0	107.0	96.2	100.1	95.4
Net Fee & Commission Income	13.3	12.5	13.3	13.4	14.6
Net Trading Income	N/A	N/A	N/A	N/A	N/A
Other income	26.4	24.7	22.8	30.1	33.4
Operating Income	**139.7**	**144.2**	**132.2**	**143.7**	**143.4**
Operating Expense	119.6	126.2	113.4	126.0	122.0
Pre-provision Income	**20.1**	**18.0**	**18.8**	**17.7**	**21.4**
Loan Loss Provision charges	8.9	3.8	-0.3	-8.3	-3.8
Other Impairments	2.3	-4.0	8.6	3.9	2.5
Non-recurring items	N/A	N/A	N/A	N/A	N/A
Pre-tax Profit	**9.0**	**18.3**	**10.5**	**22.1**	**22.8**
Discontinued Operations	N/A	N/A	N/A	N/A	N/A
Income Tax Expense	-0.02	N/A	N/A	N/A	-0.08
Net Profit Attributable to Minority Interests	N/A	N/A	N/A	N/A	N/A
Net Profit Attributable to Parent	**9.0**	**18.3**	**10.5**	**22.1**	**22.9**

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information and were last updated in December 2016
See 'Methodologies Used for this Report' for further details

RATIOS – BAUSPARKASSE WÜSTENROT AG

	2011	2012	2013	2014	2015
Funding/Liquidity					
Gross loans % Total deposits	81.0%	85.8%	82.4%	79.5%	82.3%
Total deposits % Total funds	87.4%	89.2%	92.4%	94.0%	93.8%
Wholesale funds % Total funds	12.6%	10.8%	7.6%	6.0%	6.2%
Asset Mix, Quality and Growth					
Gross loans % Funded assets	65.0%	69.9%	69.6%	68.1%	70.1%
Gross loan growth (%)	8.9%	8.2%	2.5%	0.9%	2.5%
Funded assets growth (%)	0.6%	0.6%	3.0%	3.0%	-0.4%
Earnings					
Net interest income % Revenues	71.6%	74.2%	72.8%	69.7%	66.5%
Fees & commissions % Revenues	9.5%	8.7%	10.0%	9.3%	10.2%
Other income % Revenues	18.9%	17.1%	17.2%	21.0%	23.3%
Net interest margin (%)	2.3%	2.4%	2.1%	2.1%	2.1%
Pre-provision Income % Risk-weighted assets (RWAs)	0.7%	0.6%	0.7%	0.6%	0.7%
Loan loss provision charges % Pre-provision income	44.1%	21.2%	-1.8%	-46.9%	-17.9%
Loan loss provision charges % Gross loans (cost of risk)	0.2%	0.1%	0.0%	-0.2%	-0.1%
Cost income ratio (%)	85.6%	87.5%	85.8%	87.7%	85.1%
Net Interest Income / Loan loss charges (x)	11.3	28.0	-286.2	-12.1	-24.9
Return on average equity (ROAE) (%)	2.4%	4.6%	2.6%	5.2%	5.1%
Return on average funded assets (%)	0.2%	0.3%	0.2%	0.4%	0.4%
Retained earnings % Prior year's book equity	2.4%	4.7%	2.6%	5.3%	5.2%
Pre-tax return on common equity tier 1 capital	N/A	N/A	N/A	N/A	5.3%
Capital and Risk Protection [1]					
Common equity tier 1 ratio (%, Transitional)	N/A	N/A	N/A	12.6%	13.6%
Tier 1 capital ratio (%, Transitional)	13.0%	13.6%	13.7%	12.6%	13.6%
Total capital ratio (%, Transitional)	20.3%	20.8%	20.7%	18.2%	19.0%
Non-senior MREL estimate (%)	9.1%	9.4%	9.3%	9.4%	9.8%
Asset risk intensity (RWAs % total assets)	49.0%	48.7%	48.3%	54.5%	52.6%

Source: SNL Financial and Scope Ratings for historical figures. Scope's forecasts are based on publicly available information and were last updated in December 2016. See 'Methodologies Used for this Report' for further details

APPENDIX II. COVERED BOND MODELLING

Credit risk modelling – mortgage assets

Wüstenrot's mortgage pool is granular, thus we analysed it using a standard default-probability distribution law (inverse Gaussian). The approach relies on i) a measure of mean default probability, and ii) a corresponding volatility parameter. Recovery assumptions for the cover pool are considered during the cash flow analysis.

Scope calculated its lifetime default rate assumptions from the issuer's internal rating information, for which back-testing data was available. We derived a default-rate coefficient of variation[4] from information available from granular pools of residential mortgage loans in Germany and Austria.

Rating-distance-conditional market value declines

Scope calculates the recovery rates on secured exposures, such as mortgages, by analysing the value of the assigned security. In this analysis, the security value is the stressed value of the underlying residential real-estate properties. The recovery analysis considers the evolution to a long-run sustainable price level of the underlying properties, as well as fire-sale discounts during a foreclosure process. Consequently, our market value-decline (MVD) assumptions depend on the region where the collateral is located, as well as on market conditions.

Scope's framework for fundamental recovery analysis involves: i) estimating the current value of the property (typically by indexation); ii) estimating the distance from estimated price to long-term sustainable values; iii) haircutting the current value of the property by applying a rating-conditional MVD and a constant fire-sale discount; and iv) deducting foreclosure costs from the estimated, gross recovery proceeds. Steps 'ii)' and 'iii)' are embedded in the total MVD assumptions as calculated in the below section 'Austrian market-value-decline analysis'.

The recovery rates considered in the analysis reflect the outstanding notional of the loan as of closing. These recovery rates are thus conservative because deleveraging reduces the loan-to-value ratio and increases the expected recovery rates as time passes.

In our framework we adjust the security value to a long-term, sustainable value to estimate the recovery proceeds under rating conditional stresses. We reduce the current Austrian house price index to a sustainable value, adding an additional stress of 10% to determine the MVDs commensurate with the sought-for credit differentiation between the issuer and the covered bonds

The analysis also reflects the effect of a fire-sale discount whereas our base case market-value declines consider our forward-looking view on the current market conditions and values. Scope creates rating-conditional recovery differentiation by tiering the market indexation according to the rating distance it needs to support.

Austrian market-value-decline analysis

Scope analysed the current conditions of the Austrian property market to derive MVD assumptions specific to the respective Austrian federal states. We used highly aggregated data from the Austrian National Bank (OeNB) as we believe the portfolio provides a good representation of the properties in a region; a distribution over cities and towns, which is similar to that provided by the central bank.

We have analysed home prices for the period from March 2000 to Sept 2016. The MVD assumptions calculated by Scope for the highest stress scenarios seek to eliminate any overpricing compared to our estimation of the sustainable long-term value of a property (including an extra 10% stress) with the additional application of a fire-sale discount. The MVD assumptions also considers the inflation rates through the calculation of the sustainable values. The base case MVD assumptions reflect only the fire-sale discount.

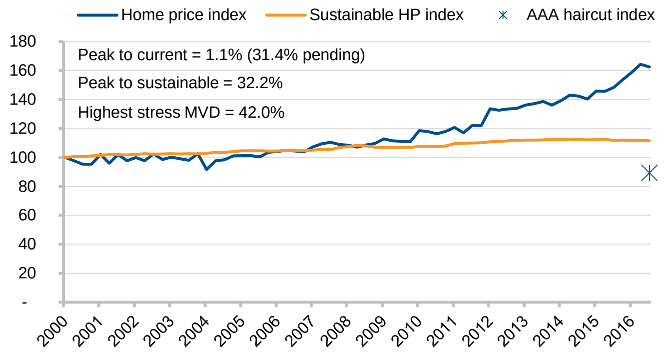
For the highest rating differentiation for Wüstenrot we have applied region-specific MVD stresses calculated by Scope for the different regions as a function of the rating-conditional stresses. The MVD assumptions are generally between 40.8% and 42%, and reflect regional differences in relation to property-price growth rates and the regional market's ability to correct inflated prices.

4 The coefficient of variation is defined as the standard deviation divided by the mean.

Figure 10 shows the market value decline assumptions in the context of market prices for the largest regions in the portfolio.

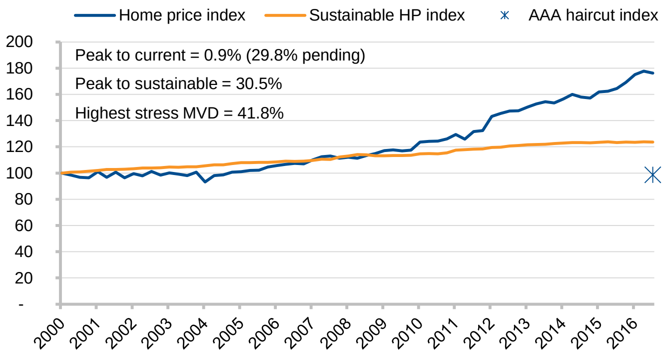
Figure 10. Total market-value-decline assumptions for the three most relevant regions in the portfolio

House Prices Rural (41.0% of total balance)



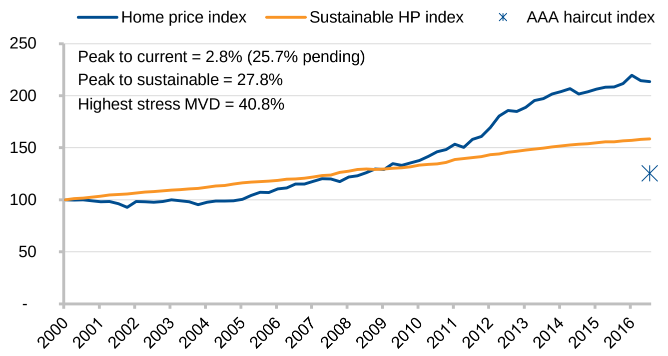
Source: Austrian National Bank and Scope

House Prices Average (40.5% of total balance)



Source: Austrian National Bank and Scope

House Prices Urban (18.5% of total balance)



Source: Austrian National Bank and Scope

Cash flow modelling

The main inputs for the cash flow simulation are the credit-related parameters of the cover pool, e.g. amortisation profile, default distributions, default timings, recoveries, and market-scenario parameters, e.g. stressed interest and foreign exchange rates, stressed refinancing assumptions.

Scope has applied the default distribution of the mortgage and the public-sector portfolio (for mortgages, an inverse Gaussian probability distribution; for public sector, a non-parametric default distribution from loan-by-loan default simulation) to our cash flow modelling of the covered bond programme to calculate the probability-weighted, i.e. expected, loss of each of the segments. In the analysis we also apply rating-conditional recovery-rate stresses as a function of the rating distance (D0 to D7) between the covered bonds and the issuer.

The modelling of the covered bonds' cash flow waterfall assumes that asset sales can cover liquidity shortfalls. Proceeds from asset sales are determined by calculating the present value, i.e. by discounting all future expected cash flows and adding a liquidity premium for the cover pool.

We discount future cash flows of the performing assets by applying the discount curve constructed from an expected forward curve through compounding. The net present value at period k with compounding interval $\Delta(t_j)$ is calculated as:

Figure 11. Net present value of the cover pool

$$\sum_{i>k} \prod_{j=k}^{i-1} \frac{1}{1 + r_{forward}(t_j)\Delta(t_j)} CF(t_i)$$

Interest rate stresses are applied consistently by shifting the discount curve parallel so that the day-zero forward of the discount curve matches the corresponding forward rate $r_{forward}(t_k)$.

Scope applies a set of increasing stress scenarios specific to the covered bond programme to the input parameters, and tests the cover pool's ability to service the covered bonds. The stress scenarios are rating-dependent changes in recovery rates, market parameters and liquidity premiums. We also tested the cover pool against different assumptions for constant prepayment rates (CPR). The structure 'passes' a certain rating level when the model result is at least commensurate with the target rating of a certain rating scenario.

The covered bond rating is anchored at Scope's view of the credit quality of the issuer, the Issuer Credit-Strength Rating (ICSR). Scope's methodology reflects this by considering stress scenarios which depend on the rating distance. The base case scenario is anchored at the ICSR, i.e. we allow the issuer to cover for rating scenarios up to its rating. The cover pool therefore only needs to support scenarios above this threshold. We translate the stresses commensurate with the potential uplift into a quantitative covered bond rating.

Additional modelling parameters

Based on the composition of the cover pool, we apply segment-specific recovery rates. We also base the relevant average liquidity premium on the cover pool's composition. The highest stress assumptions only apply in the scenario which, if passed, allows us to assign the maximum credit differentiation between the issuer and its covered bonds.[5]

Liquidity premium: We have applied on average 150bps as additional liquidity premium for the discounting of the Austrian residential mortgage assets. We determined the liquidity premium from historical trading spreads of other Austrian covered bonds.

Market risk stresses: We assumed deterministic interest rate and foreign exchange rate stresses in our cash flow modelling. We applied a common framework to establish the stresses, which equate to the maximum achievable rating uplift.

Interest rate stresses: We tested Wüstenrot's covered bonds against several scenarios of rising and falling interest rates. The rising interest rate scenarios increase from the current rate environment to a stressed interest rate of 10%. After two years they start to revert back to a long-term mean. The corresponding falling interest rate stresses drop after the first two years to a low of minus 1%. In contrast to the rising interest rate scenarios, we not only model interest rate developments that revert back to the mean after two years but also scenarios in which the interest rates remain at those negative rates. For both rising and falling interest rate scenarios we simulate interest rate patterns when rates start to deviate from current expectations at different starting points. The tested interest rate scenarios start to deviate between year 2 and year 10. Further, the tested patterns also include a scenario that reflects current interest rate expectations.

Foreign-exchange risk stress: Not relevant for Wüstenrot's cover pool, as all assets and liabilities are hedged in euros.

Prepayment rate assumption: For the rating determination, we tested both a very conservative 0% CPR assumption for all cover assets. Tested scenarios also include high prepayment assumptions for mortgage assets. Generally, higher CPRs benefit the cover pool analysis as it increases cash accumulation inter alia, reducing the need to monetise parts of the cover pool.

Servicing fee: We apply country- and asset-type-specific servicing fees, which the cover pool has to pay on an annual basis. For Wüstenrot's residential mortgage cover pool we applied an annual 25 bps servicing fee.

[5] The maximum credit differentiation between the rating of the issuer and its covered bond is typically determined by our fundamental assessment of the legal and resolution framework. Our methodology sets out that the maximum credit differentiation can only be three notches higher than this fundamental uplift. For Wüstenrot, we have determined a fundamental support of four notches. According to our methodology, the maximum achievable uplift is seven notches (4+3).

APPENDIX III. SUMMARY OF COVERED BOND CHARACTERISTICS

Reporting date	28 December 2016
Issuer name	Bausparkasse Wüstenrot AG
Country	Austria
Covered bond name	Hypothekenpfandbrief (Hypf) Austrian mortgage covered bonds issued under the PfandG
Covered bond legal framework	Austrian legal covered bond framework
Cover pool type	Residential Mortgages
ICSR	N/D
Current covered bond rating	AA+/Stable
Covered bond maturity type	Hard Bullets
Cover pool currency	EUR (100%)
Covered bonds currency	EUR (100%)
Fundamental cover pool support (notches)	4
Max. achievable covered bond uplift (notches)	7
Potential covered bond rating buffer	0
Cover pool/ Eligible assets [EUR mn]	303.92 / 253.97
Covered bonds [EUR mn]	2
Substitute assets [EUR mn]	0.15
Current overcollateralisation/ Legal minimum OC	>15,000% / 2.0%
OC to support current uplift	7.50%
OC to maintain upflift upon one-notch issuer rating downgrade	7.75%
WA Seasoning	1.19 years
Duration / WA Maturity of assets	12.43 / 14.49
Duration / WA Maturity of liabilities	6.93 / 7.92
Duration gap / WA Maturity gap	N/M
Number of loan exposures	2672
Average loan size (in EUR '000s)	113.74
Top-10 exposures	1.82%
Top-20 exposures	3.03%
Interest rate type	2.72% (Fixed) / 24.97% (Floating) / 72.30% (Fixed over a term)
WA whole loan LTV / Eligible LTV	71.04% / 53.38%
Geographic split (top 3)	Lower Austria (23.4%) Upper Austria (14.4%) Styria (14.2%)
Default measure	Inverse Gaussian
WA DR	9.72%
WA CoV	60.00%
WA recovery assumption (D0/D7)[1]	96.10% / 57.66%
Current share of loans > 6 month in arrears	0.00%
IR stresses (max./min.; CCY dependent)	-1% to 10%
FX stresses (max./min.; CCY dependent)	N/A
D7[1] Liquidity premium	150bps
Servicing fee (mortgage)	25bps

[1] D0 or D7 denote the stresses commensurate with the rating distanced between the ICSR and the covered bond ratings
[2] For the rating analysis and the calculation of the supporting OC we only have taken into account the "performing balance"

APPENDIX IV. REGULATORY AND LEGAL DISCLOSURES

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund and Dr. Sven Janssen.

The covered bond rating analysis has been prepared by Karlo Fuchs, Executive Director

Responsible for approving the covered bond rating: Guillaume Jolivet, Managing Director

The rating concerns a debt type of issuer which was evaluated for the first time by Scope Ratings AG. Scope had already assigned private ratings for the rated instruments in accordance with Regulation (EC) No 1060/2009 on rating agencies, as amended by Regulations (EU) No 513/2011 and (EU) No 462/2013.

Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings but with a mandate by Bausparkasse Wüstenrot AG (solicited). The issuer has participated in the rating process

As at the time of the analysis, neither Scope Ratings AG nor companies affiliated with it hold any interests in the rated entity or in companies directly or indirectly affiliated to it. Likewise, neither the rated entity nor companies directly or indirectly affiliated with it hold any interests in Scope Ratings AG or any companies affiliated to it. Neither the rating agency, the rating analysts who participated in this rating, nor any other persons who participated in the provision of the rating and/or its approval hold, either directly or indirectly, any shares in the rated entity or in third parties affiliated to it. Notwithstanding this, it is permitted for the above-mentioned persons to hold interests through shares in diversified undertakings for collective investment, including managed funds such as pension funds or life insurance companies, pursuant to EU Rating Regulation (EC) No 1060/2009. Neither Scope Ratings nor companies affiliated with it are involved in the brokering or distribution of capital investment products. In principle, there is a possibility that family relationships may exist between the personnel of Scope Ratings and that of the rated entity. However, no persons for whom a conflict of interests could exist due to family relationships or other close relationships will participate in the preparation or approval of a rating.

Key sources of Information for the rating

Website of the rated entity/issuer, Annual reports/quarterly reports of the rated entity/issuer as well as other public covered bond specific reports, programme documentation and terms and conditions of the covered bonds issued, current performance information as well as confidential information on the composition of the cover pool composition and related cash flow structures, data provided by external data providers, Interview with the rated entity, press reports, official publications and data series by the central bank and research from reputable market participants.

Scope Ratings considers the quality of the available information on the evaluated entity to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The main methodology applicable for the covered bond rating is: “Covered Bond Rating Methodology”, published 22. July 2016. We also applied the General Structured Finance Rating Methodology, published 31. August 2016 and the principles of the Methodology for Counterparty Risk in Structured Finance published 12. August 2016.

The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope’s default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency’s website.

Conditions of use / exclusion of liability

Rating issued by

Scope Ratings AG, Lennéstraße 5, 10785 Berlin