

Rating Action: Mortgage and Land Bank of Latvia - Covered Bonds

Moody's downgrades MLBL's Covered Bonds to A3

London, 07 April 2009 -- Moody's Investors Service has today downgraded the following rating of the Mortgage Covered Bonds issued by Mortgage and Land Bank of Latvia ("MLBL" or the "Issuer"):

- Downgraded to A3 from A2 on review for possible downgrade; previously on 9 January 2009 downgraded to A2 on review for possible downgrade from A1.

Today's downgrade was prompted by a combination of the weakening economic environment in Latvia and the exposure of the Covered Bondholders to both significant refinancing risk and a material level of foreign exchange denominated liabilities.

The difficulties for the Latvian economy have been highlighted by rating actions and opinions issued by Moody's sovereign rating group. On 6 April 2009 Moody's published a Special Comment "European Sovereigns Face Differentiated Refinancing Risk" in which Moody's identified Latvia as a country with "elevated" refinancing risk. The report identifies Latvia as a country in the most vulnerable category when it comes to "GRR1+" -- Government Refinancing Risk. Earlier in 2009, Moody's downgraded the Latvian government to Baa1 with negative outlook from A3. Moody's expects the economic recession to be severe in Latvia, with a contraction of real GDP of about 12% by early 2010.

Against this backdrop, and given the exposure of the covered bonds to both refinancing and foreign exchange risk Moody's believe any recovery against the cover pool following Issuer Default could be severely distressed.

The covered bond programme is exposed to both refinancing risk and foreign exchange rate risk. Specifically:

- Refinancing risk. The covered bonds issued are "bullet" bonds, and so, following an Issuer Default, the natural amortisation of the assets in the cover pool cannot be relied on to repay the covered bonds in a timely manner. This means that funds may need to be raised against the assets backing the covered bonds, possibly through the firesale of the assets in the cover pool. In the current volatile environment, Moody's expects that recoveries from such a sale would be highly stressed. The high level of the potential refinancing risk faced in Latvia may be reflected in the widening funding costs currently faced by the Latvian Government. The yield for 6-year Latvian government bonds has more than doubled in the past year to over 10% from around 5%.

- Foreign exchange risk. As at December 2008, around 60% of the Covered Bonds and almost 80% of the assets were denominated in foreign currency (mainly euros). While the Latvian currency is currently pegged to the euro, Latvia has not yet adopted the euro. It had originally planned to adopt the euro in January 2008. However, it is now expected that Latvia will not adopt the euro before 2012. Two potential risks in a weakened economy include: i) whether borrowers would continue to be able to make payments if the currency was devalued; and ii) if borrowers payments are converted into domestic currency, covered bondholders would be exposed to material unhedged foreign exchange rate risks.

Moody's initially analysed and monitors these transactions using the rating methodology for EMEA Covered Bond transactions as described in the Rating Methodology reports "Moody's Rating Approach to European Covered Bond", published in June 2005, "Timely Payment in Covered Bonds following Sponsor Bank Default", published in March 2008 and "Assessing Swaps as Hedges in the Covered Bond Market", published in September 2008.

The rating assigned by Moody's addresses the expected loss posed to investors. Moody's ratings address only the credit risks associated with the transaction. Other non-credit risks have not been addressed, but may have a significant effect on yield to investors.

Headquartered in Riga, Latvia, Mortgage and Land Bank of Latvia reported consolidated assets of LVL973 million (EUR1.4 billion) as per September 2008.

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