Risk, outlook and opportunities report

RISK REPORT

Continuous risk control and monitoring is essential to managing business development at MünchenerHyp. Risk management is therefore a high priority in terms of the overall management of the Bank.

The framework governing business activities is laid down in the business and risk strategy. The MünchenerHyp Board of Management as a whole is responsible for this strategy, which is reviewed regularly to ensure its objectives are being met, revised where necessary and submitted to the Supervisory Board for information purposes at least once a year.

The Supervisory Board's Risk Committee is informed of the Bank's risk profile at least once a quarter and additionally as necessary, so that it can exercise its supervisory function. This information is based on, among other things, reports on risk-bearing capacity and credit risks, operational risk reports and the risk report prepared in accordance with the German minimum requirements for risk management (MaRisk). The committee also receives numerous detailed reports from internal management, regarding funding and liquidity, for example.

Risk management is based firstly on the analysis and presentation of existing risks, and secondly on comparing these risks with the available risk coverage potential (risk-bearing capacity). There are also various other relevant analyses that need to be viewed as a whole to enable adequate management of the Bank. Extensive control procedures involving internal, process-dependent monitoring are implemented for this purpose. The Internal Audit department, which is independent of all processes, has an additional supervisory role in this respect.

When analysing and presenting the existing risks, a distinction is made between counterparty risks, market price risks, credit spread risks, liquidity risks, investment risks, model risks and operational risks. Additional risks, such as placement risk, reputational risk, business risk, etc. are each seen as elements of the above risks and are taken into account at the appropriate point in the respective calculations.

Counterparty risk

Counterparty risk (credit risk) is of major importance for MünchenerHyp. Counterparty risk is the risk that a counterparty will fail to meet its payment obligations towards the Bank, by paying late or by defaulting completely or in part.

The Credit Manual sets forth the credit approval procedures and process regulations for those units involved in the lending business and the permissible credit products. The business and risk strategy also contains more detailed explanations on the sub-strategies for target customers and target markets, as well as specifications for measuring and managing credit risks at individual transaction and portfolio level. Individual limits have been set for all types of lending, e.g. depending on the rating. Another factor is regional diversification, which is ensured by country limits.

In our mortgage business, we ensure that we grant senior loans predominantly with moderate loan-to-value ratios. The current loan-to-value ratios break down as follows:

TOTAL PORTFOLIO OF MORTGAGE AND OTHER LOANS
INCLUDING OPEN COMMITMENTS IN €

Mortgage lending value ratio	31 Dec. 19	% of total	31 Dec. 18	% of total
Up to 60 %	**15,344,320,091.37**	40.2%	14,720,901,589.27	42.8%
60.01% to 70%	**6,786,576,426.70**	17.8%	6,820,895,373.58	19.8%
70.01% to 80%	**7,316,381,368.42**	19.2%	6,960,099,522.16	20.2%
80.01% to 90%	**3,041,601,499.12**	8.0%	2,676,516,392.51	7.8%
90.01% to 100%	**2,516,947,130.12**	6.6%	1,795,904,046.61	5.2%
Over 100%	**3,077,883,878.42**	8.1%	1,412,897,435.12	4.1%
Without	**41,166,896.66**	0.1%	2,908,425.35	0.0%
Total	**38,124,877,290.81**	**100.0%**	**34,390,122,784.60**	**100.0%**

The regional breakdown within Germany is as follows:

TOTAL PORTFOLIO OF MORTGAGE AND OTHER LOANS IN GERMANY
INCLUDING OPEN COMMITMENTS IN €

Region	31 Dec. 19	% of total	31 Dec. 18	% of total
Baden-Wuerttemberg	3,199,417,955.96	8.4%	3,010,586,219.34	8.8%
Bavaria	6,914,757,962.13	18.1%	6,318,757,224.94	18.4%
Berlin	2,026,546,575.41	5.3%	1,671,039,470.92	4.9%
Brandenburg	608,610,025.74	1.6%	568,281,726.53	1.7%
Bremen	105,422,601.78	0.3%	99,892,194.27	0.3%
Hamburg	1,096,427,567.45	2.9%	954,465,248.40	2.8%
Hesse	2,589,198,469.12	6.8%	2,057,864,034.04	6.0%
Mecklenburg-Lower Pomerania	449,022,966.46	1.2%	408,844,173.55	1.2%
Lower Saxony	2,626,151,276.25	6.9%	2,304,961,954.58	6.7%
North Rhine-Westphalia	5,056,691,558.58	13.3%	4,872,993,885.28	14.2%
Rhineland-Palatinate	1,568,178,520.40	4.1%	1,394,665,008.86	4.1%
Saarland	391,827,023.46	1.0%	331,578,228.58	1.0%
Saxony	993,549,792.56	2.6%	925,694,734.24	2.7%
Saxony-Anhalt	562,668,859.46	1.5%	529,484,804.74	1.5%
Schleswig-Holstein	1,841,943,276.68	4.8%	1,786,195,963.33	5.2%
Thuringia	324,158,194.28	0.9%	312,876,008.63	0.9%
Total domestic	**30,354,572,625.72**	**79.6%**	**27,548,180,880.23**	**80.1%**

The international breakdown is as follows:

TOTAL PORTFOLIO OF MORTGAGE AND OTHER LOANS INTERNATIONAL
INCLUDING OPEN COMMITMENTS IN €

Country	31 Dec. 19	% of total	31 Dec. 18	% of total
Austria	169,854,589.87	0.4%	136,406,356.80	0.4%
France	550,861,295.11	1.4%	428,521,831.12	1.2%
United Kingdom	543,299,669.17	1.4%	506,310,386.23	1.5%
Spain	462,348,572.71	1.2%	305,926,931.31	0.9%
Luxembourg	64,900,000.00	0.2%	64,994,688.44	0.2%
Switzerland	4,761,198,571.64	12.5%	4,444,846,106.56	12.9%
The Netherlands	538,996,737.36	1.4%	421,798,450.39	1.2%
Belgium	38,141,763.09	0.1%	43,445,424.60	0.1%
USA	640,703,466.14	1.7%	489,691,728.92	1.4%
Total foreign	**7,770,304,665.09**	**20.4 %**	**6,841,941,904.37**	**19.9 %**
Total domestic and foreign	**38,124,877,290.81**	**100.0 %**	**34,390,122,784.60**	**100.0 %**

Credit risk management starts when the target business is selected with the drafting of loan terms and conditions. Regularly reviewed risk cost functions are used for this purpose. Depending on the type and risk level of the transaction, various rating and scoring procedures are used.

In property financing, a broadly diversified portfolio of mainly residential property finance and credit approval processes that have been tried and tested for years are reflected in a portfolio with a low credit risk. Our lending business with public-sector borrowers and banks is primarily focused on central and regional governments, public local authorities and Western European banks (covered bonds only). The regional focus is on Germany and Western Europe respectively. However, highly liquid sovereign bonds and other highly-rated securities will continue to be needed to a certain extent in order to guarantee compliance with CRR liquidity requirements.

Mortgage loans are checked for the need for a specific loan loss provision based on their rating, any payment arrears or other negative factors. Workout Management carries out more extensive specific loan loss provision monitoring, especially in non-retail business.

The Bank sets up a general loan loss provision as a precaution to cover latent credit risks. This general loan loss provision is calculated based on the letter from the German Federal Ministry of Finance dated 10 January 1994.

As the property market is highly stable, specific loan loss provisions for both in our residential property financing business and commercial property financing business are only established at a very low level. This is also reflected in an NPL ratio of 0.48 percent as of 31 December 2019.

Business relations with financial institutions are predominantly based on master agreements that allow the netting of receivables from and liabilities to the other institution. As a rule, collateral agreements are also concluded. Derivatives are settled via a central counterparty (CCP).

Specific and general loan loss provisions changed as follows in the year under review:

TOTAL LENDING BUSINESS
IN € MILLION

	Opening balance	Additions	Reversals	Utilisation	Exchange rate-related and other changes	Closing balance
Specific provisions	40.6	13.2	-32.0	-1.7	0.4	20.5
General provisions	13.0	0.0	0.0	0.0	0.0	13.0

Market price risks

Market price risks include the risks to the value of positions due to changes in market parameters, including interest rates, volatility and exchange rates. They are quantified as a potential present value loss using a present value model. This distinguishes between interest rate, option and currency risks.

In the case of the interest rate risk, a distinction is made between general and specific interest rate risks. General interest rate risk is the risk that the market value of investments or liabilities that depend on the general level of interest rates will be adversely affected if interest rates change.

Specific interest rate risk, also known as the credit spread risk, is also included under market price risk. The credit spread is defined as the difference in yield between a risk-free and a risky bond. Spread risks take account of the risk that the spread may change even without any change to the rating. The reasons for a change to yield spreads may include:

- varying opinions among market participants regarding positions;
- an actual change in the creditworthiness of the issuer not already reflected in its rating;
- macroeconomic aspects that influence creditworthiness categories.

The risks inherent in options include, among others: volatility risk (vega: the risk that the value of a derivative instrument will change due to increasing or decreasing volatility), time risk (theta: the risk that the value of a derivative instrument will change over time), rho risk (the risk of change to the value of the option if the risk-free interest rate changes) and gamma risk (the risk of a change to the option delta if the price of the underlying asset changes; the option delta describes the change in value of the option due to a change in price of the underlying asset). As options in capital market business are not contracted for the purposes of speculation, risk exposure is moderate. Almost all option positions arise implicitly as a result of borrower's option rights e.g. statutory termination rights under Section 489 of the German Civil Code (Bürgerliches Gesetzbuch – BGB) and are hedged where necessary. These risks are closely monitored in the daily risk report and are limited.

Currency risk is the risk that the market value of investments or liabilities that depend on exchange rates will be adversely affected due to changes in exchange rates. Foreign currency transactions of MünchenerHyp are hedged to the maximum possible extent against currency risks; only the margins included in interest payments are not hedged.

Stock risk is low for MünchenerHyp; it results from investments in companies in the Cooperative Financial Network. In addition, the Bank has invested in a mixed fund (as a special fund of Union Investment), in which a mix of shares is also possible. Responsibility for calculating risk ratios is transferred to the investment fund company; the results are reviewed for plausibility and then transferred to the Bank's systems.

In order to manage market price risks, the present value of all MünchenerHyp transactions is determined on a daily basis. All transactions are valued using the 'Summit' IT programme. Interest rate risk is managed based on the BPV vector (Base Point Value), which is calculated daily from the change in present value per maturity band that would occur if the mid-swap curve changed by one basis point. Sensitivities to exchange rates and in relation to rotations in the interest rate curve and changes to the base spread and volatilities are also determined.

Market risks are recorded and limited at MünchenerHyp using the value at risk (VaR) indicator. The VaR calculation takes account of both linear and non-linear risks by means of a historic simulation. The impact of extreme movements in risk factors is also measured here and for other types of risks using various stress scenarios.

The daily stress scenarios (others are tested with less frequency) are:

- Supervisory requirements: the yield curve is shifted up and down in parallel by 200 basis points for each currency separately. The poorer of the two results is taken into account.
- Parallel shifting: the current yield curve is shifted up and down completely by 50 basis points across all currencies at the same time. The poorer of the two results is taken into account.
- Sensitivities:
  - Exchange rates: all foreign currencies change by 10 percent.
  - Volatilities: all volatilities increase by 1 percent.
- Steepening / flattening: the yield curve is rotated in both directions in accordance with guideline BCBS 368.
- Historic simulation:
  - Terrorist attack in New York on 11 September 2001: changes in market prices between 10 September 2001 and 24 September 2001, i.e. the direct market reaction to the attack, are applied to the current level.
  - 2008 financial market crisis: changes in interest rates between 12 September 2008 (last banking day before the collapse of investment bank Lehman Brothers) and 10 October 2008 are applied to the current level.
  - Brexit: change in interest rates and exchange rates due to the Brexit referendum on 23 and 24 June 2016.

During 2019 the maximum VaR of the bank book (interest, currencies and volatilities) at a confidence level of 99 percent with a ten-day holding period was €62 million. The average figure was approximately €28 million.

Although MünchenerHyp is a trading book institution (for futures only), it has not concluded any trading transactions since 2011.

In order to manage credit spread risks, the present value of asset-side capital market transactions of MünchenerHyp is calculated and the credit spread risks determined on a daily basis. The credit spread VaR, credit spread sensitivities and various credit spread stress scenarios are calculated in the Summit valuation system.

Credit spread risks are recorded and limited at MünchenerHyp using the VaR figure. The VaR is calculated based on an historic simulation.

The current (daily) credit spread stress scenarios are:

- Parallel shifting: all credit spreads are shifted up and down by 100 basis points. The poorer of the two results is taken into account.
- Historic simulation of the collapse of the investment bank Lehman Brothers: the scenario assumes an immediate change in spreads based on the change that was measured in the period from one banking day before the collapse of Lehman Brothers to four weeks after this date.
- Flight to government bonds: this scenario simulates a highly visible risk aversion seen on the markets in the past. The spreads of risky security classes widen, while the spreads of safe sovereign bonds tighten.
- Euro crisis: this scenario replicates the change in spreads during the euro crisis between 1 October 2010 and 8 November 2011. During that period, in particular the spreads of poorly rated sovereign bonds increased sharply.

The credit spread VaR for the entire portfolio using a 99.9 percent confidence level and a holding period of one year stood at a maximum of €86 million in 2019, while the average figure was about €78 million.

Liquidity risk

Liquidity risk includes the following risks:

- Inability to honour payment obligations on time (liquidity risk in the narrower sense).
- Inability to procure sufficient liquidity when needed at anticipated conditions (refinancing risk).
- Inability to close out, extend or settle transactions without incurring a loss due to insufficient market depth or market disruptions (market liquidity risk).

MünchenerHyp distinguishes between short-term solvency measures and medium-term structural liquidity planning.

Short-term solvency measures

The purpose of short-term solvency measures is to ensure that the Bank is able on a daily basis to honour payment obligations in due form, in time and in full, even during stress situations (willingness to pay). Current supervisory requirements (MaRisk and CRD IV) regarding banks' liquidity reserves have been implemented.

MünchenerHyp classes itself as a capital market-oriented institution within the meaning of MaRisk and therefore also fulfils the requirements of BTR 3.2.

MaRisk distinguishes between five different scenarios, which have been implemented accordingly:
1) Base case: corresponds to normal management of the Bank.
2) Bank stress: the reputation of the institution deteriorates, for example due to large on-balance-sheet losses.
3) Market stress: short-term event affecting one part of the financial market. Examples of this include the terrorist attack on 11 September 2001 or the financial market/sovereign debt crisis.
4) Combined stress: simultaneous occurrence of bank and market stress.
5) Combined stress without countermeasures: it is assumed that it is no longer possible to obtain any liquidity at all.

According to MaRisk, the Bank must meet the liquidity requirements arising from scenarios 1 to 4 for a minimum of 30 days. Scenario 5 is the worst-case scenario for internal management purposes.

Depending on the scenario, various modelling assumptions have been deduced for all important cash flows, such as drawdowns of liquidity lines, drawdowns of loan commitments already made or changes to collateral. In addition, all securities were allocated to various liquidity classes in order to deduce the volume in each scenario that could be sold or placed in a securities repurchase agreement, and in what time frame, in order to generate additional liquidity. In all cases statutory restrictions, such as the 180-day rule in the Pfandbriefgesetz, were met at all times. The result is a day-by-day presentation of available liquidity over a three-year horizon in three currencies (euros, US dollars and Swiss francs). Positions in other currencies are negligible. Limits are set in the stress scenarios across various horizons as early warning indicators for each scenario.

In addition, the liquidity coverage ratio (LCR) and a forecast in accordance with CRD IV are calculated across all currencies at least once a week.

Medium-term structural liquidity planning

The purpose of structural liquidity planning is to ensure medium-term liquidity. The legal basis for this is both MaRisk BTR 3 and CRD IV on the net stable funding ratio (NSFR).

Medium-term liquidity management in accordance with MaRisk is based on short-term liquidity management in accordance with MaRisk, i.e. both use the same scenario definitions and modelling assumptions. Due to the longer observation period, however, additional modelling is taken into account that is not decisive for short-term liquidity management, such as new business planning or current expenses such as salaries and taxes.

Medium-term liquidity planning has the following key liquidity figures over time as profit or loss components:
- cumulative overall cash flow requirement;
- available uncovered and covered funding potential, including planned new business and extensions in accordance with Moody's over-collateralisation requirements;
- other detailed data for planning and management activities.

Liquidity risks are limited via the structural liquidity forecast and stress scenarios, based on available liquidity within a year.

In addition, the NSFR is computed monthly across all currencies in accordance with CRD IV. Forecasts are also created for monitoring purposes. However, as the supervisory authorities have not yet stipulated a binding minimum value for compliance with the NSFR and the values are stable at over 100 percent, active management of this key ratio is not yet necessary.

In order to reduce refinancing risks, MunchenerHyp strives to refinance loans with matching maturities where possible. The Bank continuously checks if its relevant refinancing sources (primarily, those within the Cooperative Financial Network) are still available. In order to limit market liquidity risk, in its business with the public sector and banks the Bank predominantly acquires ECB-eligible securities that can be used as collateral for ECB open market operations at any time.

In order to diversify its refinancing sources, the Bank has started to build up its deposit business. At the end of 2019, the portfolio volume was €258 million.

MünchenerHyp does not have any illiquid bonds, such as mortgage-backed securities (MBS) or similar securities, in its portfolio.

Investment risk

This describes the risk of potential losses if the price of investments falls below their carrying amount. This applies to long-term participations held by MünchenerHyp for strategic reasons in companies of the Cooperative Financial Network and, to a small extent, positions within its special mixed fund.

Operational risks

Operational risks are the risk of potential losses caused by human error, process or project management weaknesses, technical failures or negative external factors. Human error includes unlawful action, inappropriate selling practices, unauthorised actions and transactional errors and information and communications risks.

We minimise our operational risks by qualifying our employees, transparent processes, automation of standard workflows, written work instructions, comprehensive IT system function tests, appropriate contingency plans and preventive measures. Insurable risks are covered by insurance to the normal extent required by banks.

The materiality of all services outsourced by MünchenerHyp in connection with banking transactions and financial services or other standard banking services has been examined in a risk analysis. All outsourced services are monitored in accordance with ECB guidelines and included in the risk management process.

Risk-bearing capacity

The technical concepts and models used to calculate risk-bearing capacity are continually updated in accordance with supervisory requirements. MünchenerHyp calculates its risk-bearing capacity in accordance with the requirements of the ECB, based on both the normative and the economic approach.

Market risks, counterparty risks, operational risks, spread and migration risks, investment risks, property risks and model risks, which include other risks not specifically listed, are deducted. Risks are allocated to risk-coverage potential conservatively, disregarding any diversification effects between different types of risks.

The Bank maintained its risk-bearing capacity at all times throughout the year under review.

Use of financial instruments for hedging purposes

We engage in hedging activities – interest rate and currency derivatives – in order to further reduce our risks and to hedge our business activities. We do not use credit derivatives. Asset swaps are used as micro-hedges at the level of individual transactions. Structured underlying transactions, such as callable securities, are hedged accordingly with structured swaps. Exchange rate risks for commitments in foreign currency are hedged primarily by endeavouring to secure funding in matching currencies; any remaining transactions are hedged using (interest rate) cross-currency swaps.
At portfolio level, we prefer to use interest rate swaps and swaptions as hedging instruments. Bermuda options on interest rate swaps (swaptions) are used in addition to linear instruments to hedge embedded statutory termination rights or interest rate cap agreements.

Accounting-related internal control and risk management processes

The accounting-related internal control system is documented in organisational guidelines, process descriptions, accounting manuals and operating instructions. It comprises organisational security measures and ongoing automatic measures and controls that are integrated into work processes. The main controls are segregation of functions, the dual control principle, access restrictions, payment guidelines, the new product and new structure processes and balance confirmations. Non-process-specific audits are conducted primarily by Internal Audit.

The risk management methods described in the risk report provide ongoing qualitative and quantitative information on the financial situation of MünchenerHyp, such as performance development. Aspects of all types of risks are included in this assessment.

At MünchenerHyp there is close coordination between the risk control and financial reporting units. This process is monitored by the entire Board of Management.

The output from the risk management system is used as a basis for multi-year planning calculations, year-end projections and reconciliation procedures for the accounting figures calculated in the Bank's financial accounting process.

CORPORATE PLANNING

MünchenerHyp regularly analyses its business model based on the challenges that will face the Bank in future, and further develops its business and risk strategy on this basis. In order to achieve its strategic objectives, numerous measures have been defined across various areas of activity, which will be consistently implemented in the years ahead. The MaRisk-compliant strategic process, which also sets the parameters for the annual planning process, will play a crucial role in this. As part of this annual planning process, sales targets and centralised and decentralised components of administrative expenses are reconciled with the projected rolling multi-year income statement. All earnings and cost components and our risk-bearing capacity are monitored continually or projected on a rolling basis, so that the Bank can react promptly and appropriately to fluctuations in earnings or costs.

Planning also includes matters in relation to equity adequacy, to ensure the Bank complies with supervisory requirements.

OUTLOOK – OPPORTUNITIES AND RISKS

- » **Economic outlook remains subdued**
- » **Strong investor interest in commercial property still expected for 2020**
- » **MünchenerHyp intends to build on its market position in private and commercial property financing**

Economic development and financial markets

The prospects for a recovery in the global economy are uncertain. Although economic researchers do expect a slight increase in global gross domestic product in 2020, they also see continued risks, particularly with regard to trade and geopolitical tensions. In this context, the IMF lowered its forecast for global economic growth slightly at the start of 2020, to 3.3 percent, and to 3.4 percent for 2021. The IMF sees the signs of recovery in production and global trade as a support for the economy.

A slight economic upturn is also forecast for the eurozone. Economic growth is expected to increase by 1.3 percent in 2020 and by 1.4 percent the year after. The reason for this is the expectation that the economy in the eurozone will benefit from growing international demand.

The economic outlook for the German economy also remains subdued. Although sentiment indicators did improve slightly at the beginning of 2020, economic researchers agree that there will only be a moderate revival of economic growth. GDP growth forecasts are therefore 0.8 percent on average. The IMF predicts growth of 1.4 percent for 2021. In 2020, the economy will benefit from the positive effect of private and public consumption, as well as investment in construction. A slight upwards trend is forecast for industrial production. The outlook for the labour market is also cautious. A slowdown is expected in job creation and wage increases. Price development is expected to remain moderate, with a projected inflation rate of 1.4 percent for 2020. Due to the strong dependence of the German economy on exports, however, there are also significant economic risks for 2020, due to continued trade and geopolitical conflicts.

In view of the only slight improvement in economic prospects, the central banks will continue to pursue an expansionary monetary policy. It remains to be seen whether the strategic review announced by the ECB will lead to a change in monetary policy. Due to differing opinions within the ECB's Governing Council regarding negative interest rates and the asset purchase programme, most experts are predicting only minor adjustments.

Slightly weaker economic growth is expected in the USA. Some experts therefore expect to see further cuts in interest rates by the Federal Reserve. The Fed Chairman recently announced a pause in the interest rate-cutting cycle and a suspension of changes in the federal funds rate for the time being. Following recent poorer than expected economic data from the UK, the Bank of England may soon lower its base rates. The Bank of Japan and the Swiss National Bank are likely to take a wait-and-see approach. Ten-year Bunds are therefore likely to continue trading with negative yields, which are expected to range between minus 0.50 percent and 0.00 percent.

The foreign exchange markets have seen only minor fluctuations recently. Potential interest rate cuts by the Fed and weaker economic data in the USA could lead to an appreciation of the euro against the US dollar. Furthermore, the euro may benefit from a gradual stabilisation of industrial production and barely-existent potential for interest rate cuts in Europe. Further developments with Brexit and the structure of the forthcoming trade agreement between the United Kingdom and the EU are likely to have the greatest effect on the performance of sterling. In the event of interest cuts by the US Federal Reserve, the Swiss franc could benefit from its status as a "safe haven" and post slight gains in 2020.

On the covered bond markets, an increase in the issue volume of benchmark bonds denominated in euros is expected in 2020, to €146 billion. Once again, Germany and France are expected to account for the largest market shares. Cited reasons for the renewed increase in the issue volume include the relaunch of the ECB's purchase programme, new issuers entering the market and the continued high demand for property loans. The purchase programme should continue to bring favourable issue spreads and continued low interest rates.

Property and property financing markets

An anticipated gradual stabilisation in the global economic situation at the start of 2020, in spite of ongoing political uncertainties, is bolstering demand for property and property financing. Experts therefore expect to see continued strong investor interest in property in 2020, particularly in large cities and economically prosperous regions. This continues to bring more opportunities than risks for markets in which MünchenerHyp is active.

In terms of the German residential property market, the trend that has persisted for the past few years is expected to continue. Prices will remain on an upward trend, however the strong momentum of recent years is expected to slow to a certain extent. In addition, trends in purchase prices and rents will continue to vary from one region to another. Migration to the top seven cities, their surrounding areas and prospering business locations will continue, further reducing supply there due to high demand. This development is not without risks of regional overvaluations. Overall, however, experts still see no immediate risk of a nationwide property bubble developing.

The huge interest of institutional investors in German residential property also continues unabated, despite lower returns. However, the political discussion on limiting rent increases is causing some uncertainty among investors, as corresponding measures such as a rent cap will influence income and valuations.

If current conditions continue – high demand for residential property and low interest rates – strong demand for property financing is also expected in 2020. With prices continuing to rise, the proportion of property purchases financed by loans will increase.

Investors will continue to focus closely on German commercial property. The weaker economy is not expected to have any effects on the market or demand. Office property will remain the most significant asset class, while interest in retail property is expected to decline. Overall, experts anticipate the volume of transactions to remain at a high level, but not to exceed the level of 2019.

In the UK, it remains to be seen how much of an effect Brexit will have on the British economy and thus the labour market and demand for space. However, it can be assumed that the impact will be limited for the time being, due to the transitional arrangements. The mood of investors therefore brightened slightly at the beginning of 2020 for the first time. Notwithstanding the above, the UK retail trade will remain under pressure, particularly in regional markets. The radical change in shopping habits is impacting bricks & mortar trade, and, unlike in other European countries, bricks & mortar food retail trade is also affected in the UK.

Conditions for investors in the French property market are overwhelmingly positive. Major infrastructure projects are bringing new sub-markets in Greater Paris to the attention of office users and investors. Due to the shortage of space in the central business district of Paris, as well as attractive prospects in the surrounding areas, letting activity and rent increases will shift to peripheral office markets.

The economic forecast for the Netherlands remains positive, which also means sustained high demand for the property market. Migration to large cities will also continue in the Netherlands, leading to excess demand in both the residential segment and for office property. Falling vacancy rates and rental growth are expected.

Significant economic growth in Spain is having a positive effect on its commercial property market. Commercial properties in the office, retail, logistics and hotel segments are achieving significant rental growth and are recording falling vacancy rates due to sustained high user demand in the major cities. Investments in commercial properties are therefore particularly attractive to investors who are willing to pay high prices for commercial property.

An upturn in economic growth to 1.5 percent is forecast for Switzerland in 2020. The labour market also looks stable. With continued low interest rates, demand for property should thus remain high. According to expert estimates, the price trend for residential property will be moderate. A further increase in vacancies is expected on the rental housing market, as housing construction exceeds demand.

Strong demand for residential properties will continue in the larger cities in Austria. This creates a gulf between town and country, because it induces people to move closer to large cities to improve their prospects on the employment market. In contrast to Switzerland, the regional markets are not characterised by oversupply; instead, supply and demand are in balance.

In the USA, after the strong transaction volume in 2019, investors are expected to be somewhat more cautious in 2020, as the economic outlook is less favourable. On the other hand, institutional investors have high liquidity and are therefore under pressure to invest. This could lead to investors relaxing their investment criteria and paying comparatively high purchase prices for properties that do not conform to the low-risk core segment. Overall, however, the outlook remains positive, particularly for the office property market.

Development of business at Münchener Hypothekenbank

Building upon the very good new business result from 2019, our aim is to further expand MünchenerHyp's market position in private and commercial property financing.

The general situation described in the section above provides us with a good foundation and opportunities for this, because we assume that demand for residential and commercial properties in these markets will remain high. Our planning is also based on the assumption that demand for property and, consequently, property financing, will be boosted by low interest rates.

Under these conditions, we are confident that we will also be able to generate a high volume of new business in 2020, in line with the high level seen in the year under review. As we have been able to increase new business dramatically in each of the last two reporting years, we have now reached a level that we aim to consolidate or only moderately expand in 2020.

Private residential property financing in Germany remains the focus of our new business planning. Our key partners in this business segment are, and shall remain, the banks in the Cooperative Financial Network. These have a strong sales force and customer proximity, which continues to open up growth opportunities for them. We assume that they will therefore also be able to expand their market share in residential property financing in 2020, as they have in previous years. We aim to strengthen our market position as an expert in long-term property financing within the Cooperative Financial Network. To this end, we are planning again sales campaigns in the retail and individual business, to step up the joint market cultivation activities with our partner banks. We see potential and earnings opportunities particularly in the further development of higher-volume individual business with the cooperative banks. We will also further digitalise our processes, to make cooperation easier, more customer-focussed and more efficient. This includes in particular payment and portfolio processes. Our objective with this is to tackle competition within the Cooperative Financial Network and strengthen our position as an association partner.

In cooperation with independent financial service providers, we see good opportunities to continue our growth trend in this business segment, due to the favourable conditions currently governing our refinancing on the capital market, in comparison with refinancing via deposits. It is also important here to simplify the cooperation with our partners and to take a customer-orientated approach.

In our cooperation with PostFinance, we are planning new business at the previous year's level. We have based our planning on the assumption that the already intense competition in Switzerland will increase again. To support our activities, we will run another sales campaign in Switzerland.

In our financing business in Austria, which we launched in 2019, we are striving for a steady but cautious growth trend in 2020 and subsequent years. We also want to cooperate with the Volksbanks and Raiffeisenbanks close to the border.

In commercial property financing we want to continue the positive development of the year under review and further strengthen this business as the Bank's second core business area. We based our planning on the assumption of a sound business environment – even though protectionist tendencies and geopolitical tensions are creating uncertainties. In our view the latter are offset by two aspects that bring more stability to general business conditions: firstly, we assume that there will be very little change to the low interest level in the short to medium term, and secondly, we expect a high inflow of capital from investors into the property asset class, due to a lack of alternative forms of investment.

In our domestic business, we plan to maintain at least the level of new business attained in 2019. Investors still regard Germany as a "safe haven"; therefore, the demand for property investments will remain high. The challenge lies principally in undiminished strong competition on the financing market from traditional financial institutions and, increasingly, from alternative finance providers, such as debt funds.

In our international business, we see opportunities for growth in 2020. Especially in our longstanding markets of France, Benelux, Spain and, to a limited extent, the UK, we plan to continue to serve our national customers in these countries and to find local investors and globally positioned investors by having a stronger local focus. In addition, we are currently examining the possibility of entering the Scandinavian market.

We anticipate a high level of transaction activity on the syndication markets in 2020, as the trend towards ever-increasing volumes of financing continues. Only a few banks are prepared to leave excessively high financing volumes entirely on the balance sheet. In 2020, we therefore expect to see a stabilisation of the trend from 2019, with a growing secondary market volume at MünchenerHyp at the same time. On the one hand, we are ready to participate to a significant extent in third-party financing and, on the other, to surrender portions of our own financing to other banks. We will also continue to use our syndication programme with the Cooperative Financial Network.

The objective of our lending business with the public sector and banks will remain unchanged and primarily serve to manage liquidity and cover pools. For 2020, we expect stable development of our portfolio volume, as maturing securities will have to be replaced to manage liquidity.

We will also further expand our sustainability activities in 2020. In particular, we want to give our sustainable financing solutions an even stronger foothold in the market and expand our sustainable issuing activities.

For 2020, we are planning a refinancing requirement of between €7.0 billion and €8.0 billion, of which €6.0 billion to €6.5 billion will probably be raised on the capital market and the remainder on the money market. Similar to the previous year, we plan to issue two to three large-scale issues, with the additional potential to top up existing bonds. Due to its partnership with PostFinance in Switzerland, MünchenerHyp will continue to have a refinancing requirement in Swiss francs.

One large bond is maturing in financial year 2020 – a Mortgage Pfandbrief to the volume of €875 million – due for repayment in October.

Following the rating agency Moody's lowering of Germany's Macro Profile in its model in autumn 2019, further effects on the deposit rating for Senior Unsecured and MünchenerHyp's issuer rating cannot be ruled out, although we aim to control such effects with countermeasures.

We are aiming to achieve a moderate increase in net interest income generated from business operations in 2020. Stable trends on our key markets will again provide opportunities to expand our new business and thus our mortgage portfolios.

This will continue to have a positive impact on the Bank's earnings. On the other hand, increasing competition, persistently high regulatory pressure and increased investment and personnel costs have counteractive effects.

Based on the available information to date, we expect at most a slight increase in risk provisioning for the lending business.

In light of the favourable market environment forecast, we are confident that we will attain our targets for the 2020 financial year and succeed in further expanding our market position. We expect net income to be in line with the previous year's level.

Disclaimer regarding forward-looking statements

This annual report contains statements concerning our expectations and forecasts for the future. These forward-looking statements, in particular those regarding MünchenerHyp's business development and earnings performance, are based on planning assumptions and estimates and are subject to risks and uncertainties. Our business is exposed to a variety of factors, most of which are beyond our control. These mainly include economic developments, the state and further development of financial and capital markets in general and our refinancing conditions in particular, as well as unexpected defaults on the part of our borrowers. Actual results and developments may therefore differ from the assumptions that have been made today. Such statements are therefore only valid at the time this report was prepared.