Economic Report

GENERAL ECONOMIC CONDITIONS

» Global economic growth slowed once again
» Brisk issuing activity on the Pfandbrief and covered bond markets
» Property boom entered its tenth year
» Sales record on the German commercial property market

Economic development

The global economy lost more momentum in 2019 than was originally anticipated at the beginning of the year. Economic activity slowed to such an extent, particularly in the second half of the year, that in its January 2020 estimate the IMF assumed global GDP growth of just 2.9 percent for the year. The economy was especially influenced by continued weakness in industrial production and global trade. This slowdown in momentum was felt by both industrialised economies and emerging and developing economies. The weaker development of the US economy was particularly noticeable in industrialised economies.

Economic growth in the eurozone also slowed, with growth of just 1.2 percent achieved in 2019. Moderate economic growth in Germany and Italy in particular had a curbing effect. The eurozone's economy was mainly boosted by investment and government spending, whereas private consumption decreased.

At 0.6 percent, Germany experienced its lowest growth rate in five years. Consumption proved to be a mainstay of the economy. Investment also increased, however, especially investment in construction, which rose by 3.8 percent. The greatest impetus came from civil engineering and residential construction. On the other hand, industrial economic performance declined – with the exception of the construction industry.

The average inflation rate decreased to 1.4 percent. This is primarily attributable to energy and food prices, which only increased moderately overall. The labour market was quite stable, in spite of the economic slowdown. The number of people in employment increased by an annual average of around 400,000, to 45.3 million. Unemployment dipped again to an average of under 2.3 million, equating to 73,000 fewer unemployed than in the previous year. The unemployment rate decreased by 0.2 percentage points, to 5.0 percent.

Financial markets

In spite of the weak economy, the stock markets posted significant gains. This was predominantly attributable to a low price base at the start of the year, a lack of investment alternatives and the low interest rate policy of central banks. The latter largely responded to the weak economy and low inflation data with expansionary monetary policy measures.

Of particular note, the US Federal Reserve ("Fed") changed its interest rate policy and cut the federal funds rate three times during the year, by 0.25 percentage points each time, most recently to a range of 1.5 to 1.75 percent. The Fed stopped reducing its total assets on 1 August; this means that all maturing securities are currently reinvested in the market.

The ECB reduced its deposit rate by 0.1 percentage point in September, to minus 0.5 percent. The main refinancing rate remained unchanged at 0.0 percent. The ECB also reactivated its asset purchase programme. As a result, new purchases have totalled €20 billion a month since November 2019, in addition to the maturing securities.

Other central banks, such as the Bank of Japan and the Swiss National Bank, have not changed their interest policy and have kept key financing rates at their previous low levels. Despite

YIELD ON TEN-YEAR BUNDS 2019
IN %

Source: Bloomberg (closing rate)

higher inflation data the Bank of England also left its base rate unchanged at 0.75 percent, as the economic outlook was uncertain due to the Brexit discussions and the trade dispute between the EU and the USA.

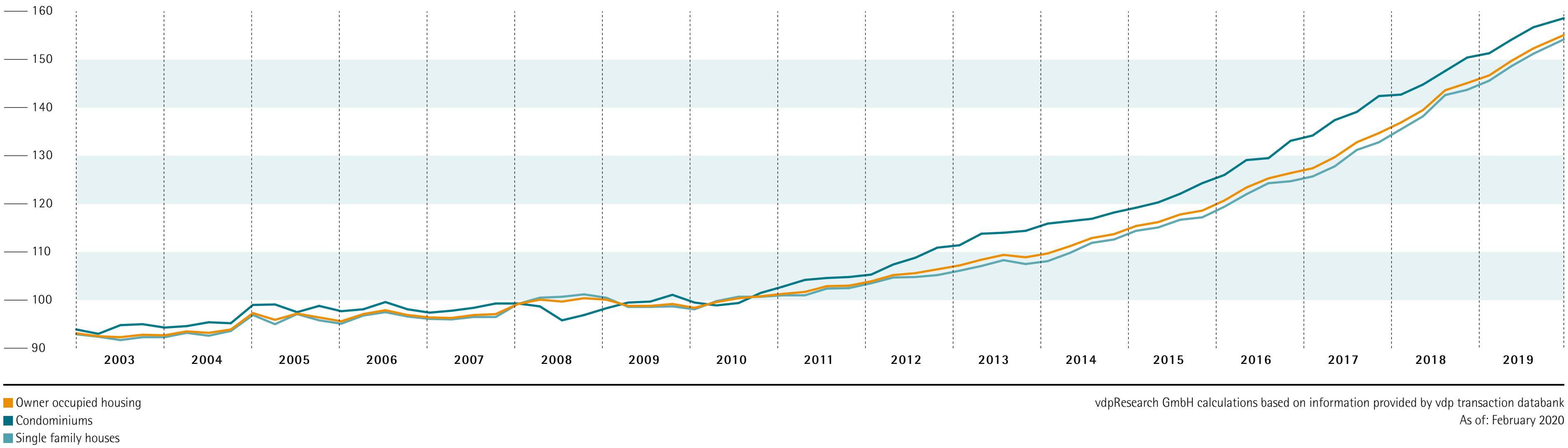
On the bond market, sluggish economic development and low inflation rates led to significantly declining yields during the year. Ten-year Bunds fell to a low of minus 0.74 percent at the start of September. Due to an easing of tension in the trade dispute between the USA and China, as well as the consensus on a Brexit agreement, by the end of the year the yield on 10-year Bunds increased again, to minus 0.185 percent.

On foreign exchange markets, the US dollar appreciated by and large, benefitting from the more robust state of the US economy in comparison with Europe and higher money market interest rates. At the end of the year, the euro was quoted at US$1.12, compared with US$1.15 at the start of the year. The Swiss franc also appreciated against the euro over the year, from CHF 1.13 to CHF 1.09 by the end of the year. Weaker economic data and political uncertainties in Europe put more pressure on the euro, while the Swiss franc benefitted from its status as a "safe haven". Sterling, meanwhile, came under pressure due to Brexit negotiations and the potential implications of Brexit for the UK's economic development, with the euro quoted at GBP 0.93 in mid-August.

The pound rose sharply at the end of the year following Boris Johnson's landslide victory and the clearer Brexit outlook, and at year-end was quoted at GBP 0.846 against the euro.

A significant widening of spreads on the covered bond market at the start of the year was reversed by another fall in interest rates. In the second half of the year, the primary market was increasingly characterised by negative yields. Longer maturities were therefore also placed in benchmark format in 2019, as these were generating positive yields. Furthermore, in spite of temporarily suspending its purchase programme, the ECB influenced the environment in the benchmark segment. In September, the ECB announced plans to resume its purchase

DEVELOPMENT OF PROPERTY PRICES IN GERMANY
YEAR 2010 = 100



vdpResearch GmbH calculations based on information provided by vdp transaction databank
As of: February 2020

programme for covered bonds from November, which it did from this point, increasing the ECB's share of primary market issues accordingly.

Overall, issuing activity on the primary market was once again very brisk. Benchmark covered bonds denominated in euros were issued to a volume of €135 billion. The issue volume was thus at the previous year's level. German issuers accounted for the largest share, followed by French issuers.

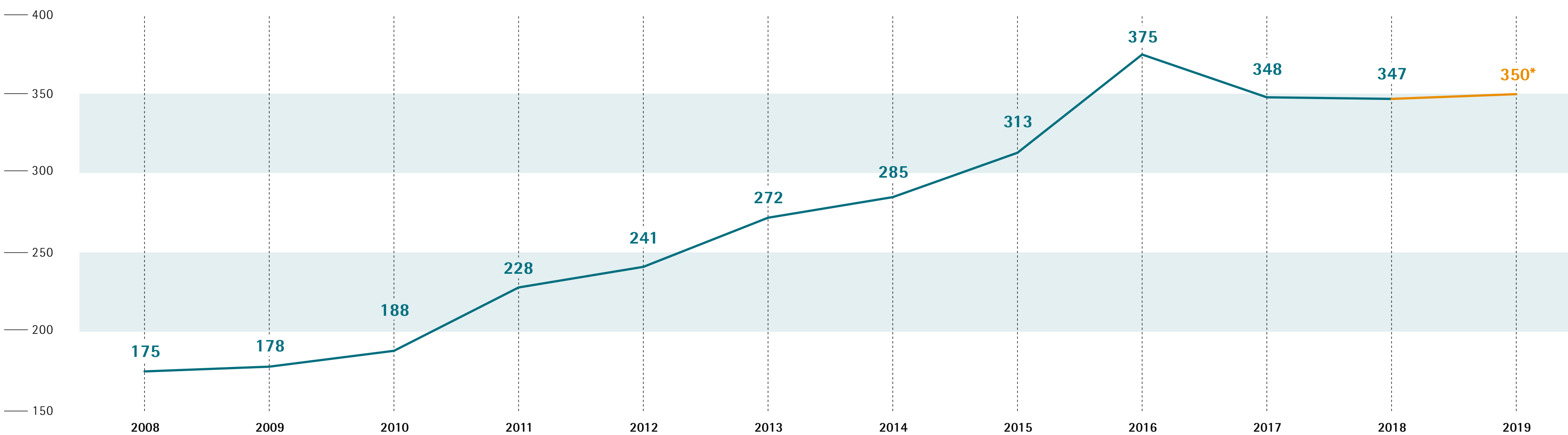
Property and property financing markets

Residential property – Germany

The upturn on the German housing market continued. Purchase prices and rents for houses and apartments increased significantly overall for the tenth year in succession. However, growth rates were lower compared with 2018. The Association of German Pfandbrief Banks (vdp) calculated an increase of 6.5 percent in its vdp property price index for 2019, compared with the previous year. The greatest price increase was calculated for single and two-family houses, which saw a rise of 7.0 percent. Multi-family house prices increased by 6.2 percent, while condominium prices rose by 5.9 percent. Price growth slowed continuously during the course of the year in Germany's seven largest cities, losing considerable momentum compared with the high growth rates of the previous year of around 10 percent, to rates of 3.9 percent for owner-occupied residential property and 4.2 percent for multi-family houses. Rental price growth also slowed, totalling 4.5 percent for multi-family houses across Germany, and 3.1 percent in the top seven cities, according to the calculations of vdpResearch.

The increase in prices for residential properties is still attributable to strong demand and a growing housing shortage in high-growth regions. More than 340,000 new housing units a year are needed in Germany between 2020 and 2021. In 2019, the construction industry reported the completion of around 300,000 new housing units. As a result, the construction backlog – in other words, permitted building projects that have not yet been reported as completed – has increased further, from more than 650,000 to over 693,000 housing units. One main reason for this is the high utilisation level of construction companies. This trend is also reflected in the level of building permits granted. In the first eleven months

RESIDENTIAL BUILDING PERMITS IN GERMANY 2008–2019
FIGURES IN 000



* Estimated.

Source: German Federal Statistical Office

of the year, a total of around 320,000 housing units were approved in Germany, which is just slightly higher than the previous year.

The German residential property market remained attractive to institutional investors. Ernst & Young calculated a transaction volume of €18.8 billion for residential property portfolios in 2019, which is €1.2 billion or 7 percent higher than the previous year. The institutional housing market continued to be dominated by domestic investors, who collectively accounted for more than 90 percent of turnover. Almost half of the transaction volume was attributable, in line with the previous year, to the top seven cities, with Berlin, at €4.2 billion, accounting for around a fifth of the total transaction volume.

Due to the continued strong demand for residential properties, new business in property financing once again increased. The vdp estimates an increase of around 5 percent for 2019, to around €240 billion. In addition to the high demand for apartments and houses, this is primarily attributable to the further rise in purchase prices. Thus, according to the findings of the vdp, the debt burden ratio of residential property financing increased to over 80 percent on average in 2019. The debt burden ratio – ratio of interest and principal payments to income – has also increased. This shows that interest rates, despite dropping to new lows in 2019, can no longer offset the increase in property prices.

Given the ongoing price dynamics on the residential property market, discussions on possible property market overvaluation and formation of price bubbles continued in 2019. In its most recent Financial Stability Review, the Deutsche Bundesbank warned again about recoverability risks for properties serving as collateral, which may arise from regional overvaluations of property. On the whole, however, the Bundesbank does not as yet see any "evidence of a spiral of sharply rising house prices and residential real estate loans combined with an erosion of lending standards which would jeopardise financial stability".

In order to counteract potential risks from low interest rates and high valuations on the property market, in July 2919 BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht – Federal Financial Supervisory Authority), upon the recommendation of the Financial Stability Committee, activated a countercyclical capital buffer, which the banks must fulfil by no later than July 2020. This countercyclical capital buffer must be met in addition to the existing capital requirements.

Residential property – international

Overall, European residential property markets performed positively in 2019. House prices increased in almost all EU member states, with only Italy recording a slight decline. Compared with the same period of the previous year, the upturn in prices slowed slightly in the first six months of 2019, although prices still grew by 4.2 percent in the second quarter of 2019 compared with the same quarter of the previous year, according to Eurostat.

The trend on the Swiss housing market was cautious. Although low interest rates and a resulting shortage of investment alternatives did create good demand for property, the vacancy rate increased to an average of 1.7 percent at the end of the second quarter of 2019, due to the continued high level of construction activity for rental properties. The country's highest vacancy rates were recorded in Ticino and Eastern Switzerland, and the lowest in the cantons of Geneva, Basel, Zug and the city of Zurich. Quoted rents therefore decreased further and, as a national average, were around 1 percent lower year-on-year at the end of the third quarter of 2019. There was only a slight increase in purchase prices for houses and apartments in 2019, as property prices have now risen to such a high level that fewer and fewer households can afford to buy their own home. This is particularly evident from the declining home ownership rate. Interest rates on the property financing market fell to new lows in the year under review. Many lenders in Switzerland also granted 10-year fixed-rate mortgages at interest rates of less than 1 percent. Demand was therefore particularly strong for mortgages with long fixed-interest periods. According to the Swiss National Bank, mortgage portfolios grew by around 3 percent overall, as in previous years. On the other hand, regulatory capital requirements increasingly posed an obstacle for private households.

In the third quarter of 2019 house prices in Austria increased by 6.2 percent compared with the previous year. Around 65,000 new homes were built in Austria in 2019, which roughly meets the demand for new housing space. Demand varies greatly from region to region. Prices for owner-occupied homes and condominiums in Vienna doubled over the last ten years, while prices in Austria as a whole increased by 80 percent in the same period. In Vienna in particular, excess demand is due to new high-rise apartment buildings.

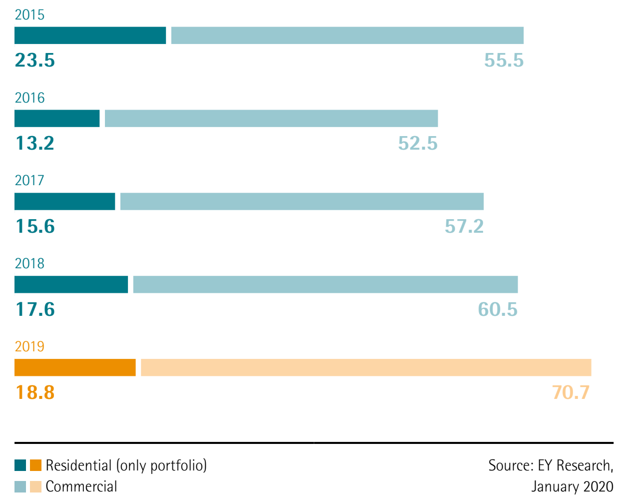
Commercial property – Germany

It was another record year for the German commercial property market, contrary to the expectations of many experts. According to Ernst & Young, the volume of transactions increased by 17 percent, to €70.7 billion. Continued low interest rates and high investment pressure ensured that demand remained strong. The significant increase in the volume of transactions is, however, primarily due to the increase in large-scale transactions and a dynamic, high-revenue final quarter.

More than 50 percent of the transaction volume is due to investments in office buildings, which have remained the most popular asset class. Office prime yields (net) declined to 2.9 percent, due to the strong investment pressure in property hotpoints. Office buildings in Berlin and Munich generated the lowest prime yields.

Just over 4 million square metres of office space was let in the top seven cities, an increase of 1.6 percent year-on-year. The highest office space turnover was achieved in Munich and Berlin. Berlin also had the lowest vacancy rate, of 1.8 percent. Vacancy rates were also down overall in Germany's biggest cities. The demand for office space was also boosted by further rises in employment figures.

DEVELOPMENT OF COMMERCIAL PROPERTY TRANSACTIONS IN GERMANY 2015–2019
IN € BILLION



Source: EY Research, January 2020

Decreasing vacancies combined with relatively little new construction activity resulted in a significant increase in new rental contracts for office space in 2019, with the highest rent increases recorded in Cologne, at 10.6 percent, and Berlin, at 8.8 percent. The relative shortage of space in city centres led to a shift in letting activities to sub-markets outside but in close proximity to city centres. As a result, premium rent prices in the major cities increased to a lesser extent in city centres than the average rent prices in other sub-markets.

Retail properties remained the second-largest asset class, with a share of 17 percent of the transaction volume, but at around €13 billion were only slightly above the investment volume of the previous year. This is primarily attributable to the impact from structural changes in the retail segment due, among other things, to tougher competition from online trading, as well as a stronger focus on the gastronomy and leisure segments. This was particularly evident from the net initial yields for shopping centres. Over the course of the year, prime yields for shopping centres in Germany increased by 40 basis points to 4.5 percent on a net basis. This is the only type of usage in Germany where investors became more cautious in 2019 and for which higher returns were recorded.

Commercial property – international

In 2019, institutional investors acquired commercial property throughout Europe with a volume of €281 billion. This corresponds to an increase of 2.6 percent year-on-year. Once again, this result was driven particularly by the high level of investment activity in Germany.

The continued dominance of office properties on the investment market is due to the very healthy state of office markets in many countries. Although turnover of office space declined slightly in Europe, by around 4 percent compared with the previous year, leased office space still totalled 9.6 million square meters. The reason for this development was a lack of suitable office space. Across Europe, only 5.6 percent of office space was vacant, which is the lowest vacancy rate since 2002. In light of this development, rental prices increased by 6.2 percent.

The volume of transactions in the UK decreased to around €36 billion in 2019. In comparison, in 2015, the year before the Brexit referendum, around twice as much was invested in commercial property in the UK. While uncertainties concerning the impact of Brexit were already having an adverse effect on the investment market for commercial property in the UK, so far the office rental market has shown no signs of a downturn. The vacancy rate in London continued to decline. A relative shortage of space, coupled with sustained high demand, was clearly reflected in prime rents, which increased by 14 percent in the City of London. An opposite trend is evident for retail properties, particularly in regional markets. The UK accounts for the largest e-commerce share of retail sales in Europe, which is now reflected in rising vacancy rates and a decline in retail rents for new lettings.

The French investment market proved to be robust, with a transaction volume of around €37 billion, and for the first time recorded a higher investment volume for commercial property than the British market. The office property market was also the most significant segment in France, with a share of over 64 percent of the investment volume. Three quarters of market activity was attributable to the Greater Paris area, which benefitted from a substantial increase in employment. Turnover in floor space during the first nine months of 2019 amounted to 1.7 million square metres, and the vacancy rate fell to 4.8 percent.

A positive economic trend also boosted the commercial property market in the Netherlands. A transaction volume of around €18.4 billion was achieved on the investment market, with the vast majority of investment coming from international investors. The focus was on office properties. Office space was in short supply due to the high level of demand. At the end of the year, the vacancy rate in the Amsterdam area decreased to 5.5 percent.

In Spain, a total of €14.3 billion was invested in commercial property in 2019, with Madrid alone accounting for 80 percent of this amount, and Barcelona for a further 17 percent. Office buildings was also the most important usage type in Spain, followed by multi-family houses and retail properties. Compared internationally, the Spanish retail sector is considered relatively resistant to online trading, because the shopping experience is considered more important there than in other countries. As a result, many investors in commercial property remained interested in Spanish cities, which promised stable rental income and future growth potential.

The US commercial investment market enjoyed a substantial inflow of capital. A total of around US$540 billion was invested in the first three quarters of 2019, 6.4 percent more than the prior-year period. The logistics and industrial property asset classes saw the largest increases, while the increase in transaction volume for office properties was much more moderate, due to investor reticence in view of the already well advanced cycle on the user market. Nevertheless, rental growth continued in all sub-markets of relevance to MünchenerHyp – Boston, Chicago, Los Angeles, New York, San Francisco, Seattle and Washington D.C. The vacancy rates in these top markets also decreased year-on-year. By contrast, around 14.2 percent of existing office space nationwide was vacant at the end of 2019.

BUSINESS DEVELOPMENT

» **New mortgage business develops dynamically and reaches new record volume of EUR 6.5 billion**
» **Entry into Austrian market with private property financing**
» **Great investor demand for benchmark mortgage Pfandbriefe from MünchenerHyp**
» **MünchenerHyp is the first foreign issuer of an Additional Tier 1 bond in Switzerland**

New mortgage business

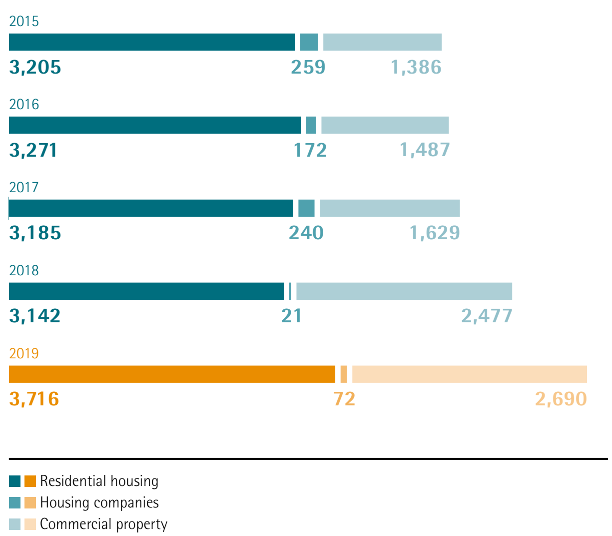
MünchenerHyp acquired by far the highest amount of new business in the Bank's history during the year under review. We increased the previous year's record result by 15 percent to €6.5 billion (2018: €5.6 billion). The volume of lending commitments thus significantly exceeded the forecast given in last year's annual report. We achieved double-digit growth rates in both the private residential property financing and the commercial property financing business areas.

New private residential property financing business increased by 18 percent, to €3.7 billion (previous year: €3.1 billion). Most of this growth was attributable to business with the cooperative banks within the German Cooperative Financial Network. We achieved a result of €2.8 billion, which equates to an increase of around €400 million, or 17 percent, year-on-year. Our cooperative partner banks have never before brokered such a high volume of financing on our behalf. Intensified market cultivation efforts, expansion of the higher-volume financing segment – select and individual business – and the introduction of digital processes had a positive impact on business development. Our sales campaigns were thus even more successful than in the previous year. Due to an increase in sales activities and improved internal processes, demand for our higher-volume financing up to €1 million increased by almost 50 percent. We also benefitted from strong demand for property financing driven by historic interest rate lows.

Sales of private property finance generated via independent financial service providers in Germany increased by 30 percent year-on-year, to €657 million.

In partnership with PostFinance in Switzerland, we increased new business slightly, as planned, with a new commitment volume of €290 million. The expansion of our product range was well received by Swiss customers. We now offer fixed interest rate periods of up to 15 years and forward periods up to 18 months before the end of the fixed interest period. This has enabled us to consolidate our position amid still very fierce competition on the Swiss finance market. This was also evident in the level of loan agreement extensions, which we increased by 12 percent, to €437 million.

MÜNCHENERHYP NEW MORTGAGE BUSINESS 2015–2019
COMMITMENTS IN € MILLION



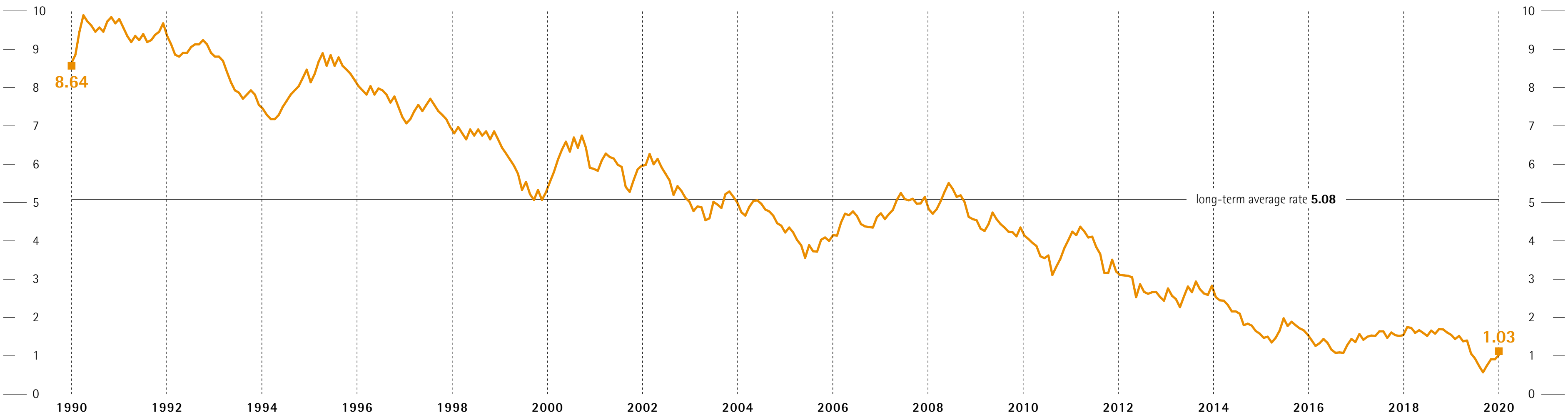
We entered the Austrian market in mid-2019, where our financing is aimed at private individuals resident in Austria and is secured by properties located in Austria. We sold our products through independent financial service providers who specialise in property finance advice. Initial contracts concluded during this market entry phase amounted to €8 million.

We have been very successful in commercial property financing. The volume of new business exceeded the €2 billion mark for the second time in succession since the financial market crisis. In total, we granted commercial property financing to the tune of €2.8 billion. This corresponds to an increase of 11 percent over the previous year's result of €2.5 billion and was achieved in spite of a high level of competition. Development of new business was also positive from an earnings perspective. This positive trend is attributable to a number of high-volume underwriting transactions, which were subsequently syndicated mainly in the Cooperative Financial Network.

Domestic business in particular contributed to this result, which grew by 40 percent, to €1.9 billion. This was mainly due to the financing we issued to our customers in Southern Germany. International business declined by 22 percent compared with the previous year, to €0.9 billion, with the USA (syndicated business only) once again accounting for the largest share, at 34 percent. Spain and the Netherlands were next in line, contributing around 25 percent each, followed by France, with around 10 percent.

High market prices resulting from the advanced price cycle were challenging for investors and financiers. From a risk perspective, we maintained our conservative financing approach,

MORTGAGE RATES MÜNCHENERHYP
TEN YEAR FIXED RATE | IN %



As of: 02.01.2020

focussing on traditional financing at completion. We consider the consistently high equity ratios in financing structures to be a positive aspect. In terms of the sustainable profitability of the financed properties, we paid particular attention to adequate, sustainable cash flows.

Capital markets business

Strict regulatory requirements and low asset spreads continued to dictate our strategy for investing in securities issued by the public sector and banks. LCR eligible securities continue to trade at expensive spread levels. In the current environment, purchasing sovereign and bank securities with strong credit ratings would result in net total asset costs and was therefore subject to major restrictions.

On a net basis, the portfolio volume was reduced by €0.4 billion, to €4.1 billion. New business in 2019 totalled €44.5 million, compared with €7 million in 2018.

Refinancing

The focus of refinancing in 2019 was once again on the issuance of Mortgage Pfandbriefe, in euros as previously, and in Swiss francs to a much greater extent.

Bonds issued in Swiss francs serve to refinance our property financing in Switzerland in the matching currency. Our total issue volume in Swiss francs was CHF 2.1 billion.

From this amount, we sold Mortgage Pfandbriefe with a total volume of around CHF 1.9 billion, making MünchenerHyp the largest foreign issuer of covered bonds in Switzerland in 2019.

Around CHF 870 million of this amount was placed via benchmark issues that had been newly issued or tapped, and around CHF 1 billion via private placements. In addition, a senior preferred note to the value of CHF 100 million was issued in October.

High-volume refinancing activities in euros started with a tap issue of an existing Mortgage Pfandbrief in February. To this end, the nominal volume of the bond maturing in November 2027 was increased by €250 million to €750 million. This transaction met with keen investor interest.

In April 2019, we very successfully issued a benchmark Mortgage Pfandbrief of €500 million with a 20-year term. This is the longest maturity ever issued in benchmark format on the Pfandbrief market. There was exceptionally strong investor demand for the issue. The order book was closed after one hour, at more than €3 billion. The coupon is 1.0 percent. The Pfandbrief was placed at a price of 7 basis points above the mid-swap rate.

At the beginning of the second half of the year, we issued another benchmark Mortgage Pfandbrief – also very successfully – with a volume of US$600 million and a term of three years and four months. The covered security has a coupon of 2.0 percent. The order book exceeded US$1.2 billion. The issue volume was spread over 31 individual orders from eleven countries. Almost 70 percent of investors were from outside Germany.

In August 2019, we issued a Mortgage Pfandbrief in the amount of €500 million with a short term of four years and a significantly negative yield. Demand for this issue was particularly high internationally, with the order book closing at almost €900 million. The coupon is 0.01 percent. The yield amounts to minus 0.567 percent. The issue was placed at a price of 2 basis points below the mid-swap rate.

In November 2019, MünchenerHyp became the first foreign issuer to issue an Additional Tier 1 bond in Swiss francs in Switzerland. This issue was a huge success and was significantly oversubscribed. The bond amounts to CHF 125 million and has a coupon of 3.125 percent. This is the lowest coupon for a publicly placed Additional Tier 1 bond of a German issuer. The term is indefinite. The bond may not be called until June 2025 at the earliest. More than 80 percent of the issue volume was subscribed in Switzerland. On the one hand, the bond serves as backing for the mortgage business in Switzerland. On the other, it optimises MünchenerHyp's equity structure with respect to the regulatory requirements for additional Tier 1 capital.

MünchenerHyp's total issue volume on the capital market in the year under review was around €6.1 billion. In the case of covered refinancing, Mortgage Pfandbriefe accounted for €4.8 billion, uncovered refinancing accounted for €1.2 billion and the Additional Tier 1 bond accounted for around €114 million (CHF 125 million). Once again, no Public Pfandbriefe were issued, in keeping with the Bank's business strategy.

NET ASSETS, FINANCIAL POSITION AND FINANCIAL PERFORMANCE

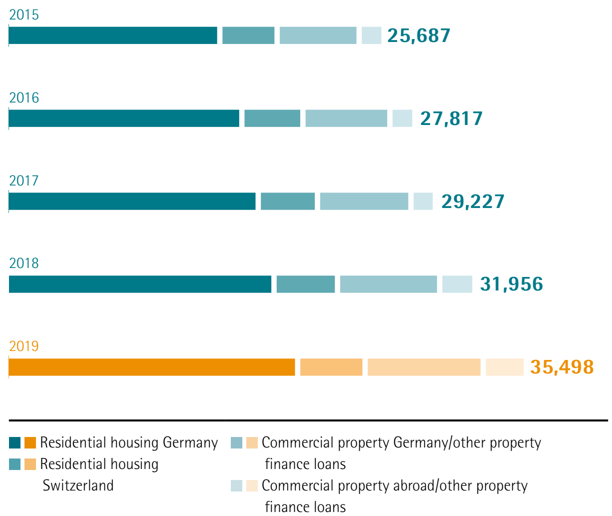
- **» Portfolio in mortgage financing increases to EUR 35.5 billion**
- **» MünchenerHyp remains well capitalised with Common Equity Tier 1 ratio of 19.8%**
- **» Net interest income rises to around EUR 300 million**
- **» Earnings from ordinary activities on a par with the previous year at EUR 73.6 million**

Balance sheet structure

Total assets increased to €42.9 billion at the end of financial year 2019, compared with €40.4 billion at 31 December 2018. This increase is once again due to continued strong new business.

During the course of the year, the mortgage loan portfolio grew by €3.5 billion, to €35.5 billion. Private residential property financing in Germany was once again the fastest growing segment, with growth of €1.6 billion.

PORTFOLIO DEVELOPMENT MÜNCHENERHYP 2015–2019
IN € MILLION



The private residential property financing portfolio is structured as follows: domestic – €19.7 billion (previous year: €18.1 billion); foreign – €4.7 billion (previous year: €4.4 billion). In addition to the financing business in Switzerland, this portfolio also includes financing in Austria for the first time. The commercial property financing portfolio totals €11.1 billion (previous year: €9.5 billion). Of this amount, €3.0 billion (previous year €2.4 billion) is attributable to financing outside Germany. The most important international market is the USA, with 21 percent (previous year: 19 percent), followed by the UK and France, with 18 percent each (previous year: 21 percent and 17 percent respectively), and the Netherlands, with 17 percent (previous year: 17 percent).

In line with our business and risk strategy, the portfolio of public-sector and bank loans and securities decreased from €4.5 billion to €4.1 billion, €2.0 billion of which was made up of securities and bonds.

At the end of 2019, the net sum of unrealised losses and unrealised gains in the securities portfolio amounted to plus €47 million (previous year: plus €41 million). These figures include unrealised losses of €0 million (previous year: €1 million) arising from securities issued by countries located on the periphery of the eurozone and banks domiciled in these countries. These securities had a total volume of €0.2 billion at the end of 2019 (previous year: €0.3 billion).

A detailed examination of all securities indicated that there are no permanent impairments. We have accounted for these bonds on a held-to-maturity basis. Write-downs to a lower fair value were not necessary.

The portfolio of long-term refinancing instruments increased by €1.7 billion to €36.4 billion. Mortgage Pfandbriefe accounted for €26.6 billion of this amount, Public Pfandbriefe for €2.2 billion and unsecured bonds for €7.5 billion. The total volume of refinancing instruments – including money market funds and customer deposits – increased from €37.9 billion in the previous year to €40.2 billion as of 31 December 2019.

The item "Other liabilities to customers" can be broken down as follows:

OTHER LIABILITIES TO CUSTOMERS
IN € 000

	Remaining term < one year	Remaining term > one year	Total
Other liabilities to customers as of 31 Dec. 19	**1,742,936**	**2,128,452**	**3,871,388**
Registered bonds	39,304	1,278,993	1,318,297
of which institutional investors	39,261	1,266,993	1,306,254
Promissory note loans on the liabilities side	624,521	807,959	1,432,480
of which institutional investors	244,130	605,459	849,589
Other	1,079,111	41,500	1,120,611
of which institutional investors	730,506	41,500	772,006

Subscribed capital grew by €39.9 million, to €1,072.5 million. Together with the issue of the Additional Tier 1 bond in the amount of CHF 125 million, regulatory equity capital totalled €1,573.2 million (previous year: €1,442.0 million).

Common Equity Tier 1 capital rose from €1,369.7 million in the previous year to €1,406.8 million. At 31 December 2019, the Common Equity Tier 1 capital ratio was 19.8 percent (previous year: 21.7 percent), the Tier 1 capital ratio was 21.4 percent (previous year: 21.7 percent) and the total capital ratio was 22.1 percent (previous year: 22.9 percent). The leverage ratio at 31 December 2019 was 3.6 percent (previous year: 3.4 percent).

Development of earnings

Net interest income[1] increased by €19.7 million, or 7.0 percent, to €299.8 million, in line with our forecast. The increase was driven mainly by the successful new business in the year under review and previous years.

Commission paid totalled €110.7 million, corresponding to an increase of €28.8 million or 35 percent year-on-year, and are the result of the extremely successful new business. Commission received rose to €15.4 million, resulting in net commission income[2] of minus €95.3 million, compared with minus €72.5 million in the previous year.

This resulted in net interest and net commission income[3] of €204.5 million, which corresponds to a decline of €3.1 million, or 1.5 percent.

General administrative expenses rose by €16.7 million, to €125.2 million. This included an increase to personnel expenses of €6.4 million, or 12.8 percent. In addition to increases under collective agreements, this was primarily due to necessary expansion of the workforce.

[1] Net interest income is calculated by adding Item 1 'Interest income' plus Item 3 'Current income' plus Item 4 'Income from profit-pooling, profit transfer and partial profit transfer agreements' agreements minus Item 2 'Interest expenses' as shown in the income statement.
[2] Net commission income is calculated by offsetting Item 5 'Commission received' and Item 6 'Commission paid' as shown in the income statement
[3] The net interest and commission result is the sum of net interest income and net commission income.

Other administrative expenses went up by €10.3 million, or 17.6 percent. In 2019 the Bank once again focused its investment on measures to optimise processes. There was another increase in regulatory costs.

Depreciation and write-downs of intangible and tangible assets rose by €1.0 million year-on-year, to €6.2 million.

Total administrative expenses[4] amounted to €131.3 million, compared with €113.6 million in the previous year. The cost-income ratio[5] was 64.2 percent.

The net sum of other operating expenses and income amounted to minus €4.3 million.

The operating result before risk provisions[6] decreased by 22.1 percent year-on-year, to €68.9 million.

The item 'Write-downs on and adjustments to claims and certain securities, and additions to provisions for possible loan losses', amounted to €4.6 million following the allocation to contingency reserves in accordance with Section 340f of the German Commercial Code (HGB). The credit risk situation remained unremarkable. The net result of changes in risk provisioning for loan losses in the lending business (including direct write-downs) amounted to €18.2 million (previous year: minus €1.2 million). This change is due in particular to the repayment in full of a loan that was previously in default. The income from the reversal of the specific loan loss provision created for this loan was used to sustainably strengthen reserves in accordance with Section 340f HGB.

Net income from the sale of promissory note loans and the redemption of registered securities and debt securities amounted to €4.2 million.

The item 'Income from reversals of write-downs on participating interests, shares in affiliated companies and securities treated as fixed assets' amounted to €0.1 million.

The result from ordinary business activities amounted to €73.6 million. After tax expenses of €37.9 million, the net income for the financial year amounted to €35.7 million, which is 27 percent lower year-on-year.

[4] Total administrative expenses are the sum total of Item 8 'General administrative expenses and Item 9 'Depreciation and write-downs of intangible and tangible assets' as shown in the income statement.
[5] Ratio of total administrative expenses to net interest and net commission income.
[6] Net result of items 1 to 10 in the income statement.

RATINGS, SUSTAINABILITY AND REGULATORY CONDITIONS

- » **MünchenerHyp Pfandbriefe retain best Aaa rating**
- » **Demand for sustainability loans in residential property financing increases**
- » **Leverage ratio of 3.6%**
- » **Regulatory minimum ratio for MünchenerHyp's Common Equity Tier 1 capital unchanged at 8.5%**

Ratings

In October 2019, rating agency Moody's changed Germany's Macro Profile from "Very Strong (-)" to "Strong (+)" in its model. This led to it taking rating actions on nine German banks, including MünchenerHyp: the deposit rating, the senior unsecured and the issuer rating remained unchanged at Aa3, but the outlook was changed to negative.

Moody's remains positive about the fact that MünchenerHyp has a strong reputation on the capital market as an issuer of Pfandbriefe, noting that it has an accordingly high level of refinancing strength, and also acknowledges the firm ties and corresponding support the Bank enjoys within the Cooperative Financial Network.

CURRENT RATINGS AT A GLANCE

	Rating
Public Pfandbriefe	Aaa
Mortgage Pfandbriefe	Aaa
Junior Senior Unsecured	A2
Senior Unsecured	Aa3*
Short-term liabilities	Prime-1
Long-term deposits	Aa3*

* Outlook: negative

To achieve the highest Aaa rating for Pfandbriefe, Moody's still requires compliance only with the legal requirement of 2 percent over-collateralisation. There is therefore no requirement for voluntary over-collateralisation.

Our long-term unsecured liabilities are rated AA- by the two other major rating agencies, Standard & Poor's and Fitch, via the combined rating of the Genossenschaftliche Finanz-Gruppe (Cooperative Financial Network).

Sustainability

In the year under review, we continuously expanded our commitment to sustainability and consistently pursued our strategic objective to establish sustainability firmly in the Bank's core business. Through our own sustainability loans for private customers (MünchenerHyp Green Loan and MünchenerHyp Family Loan), which emphasise environmental and social issues, we aim to create sustainable added value for our customers. In 2019, sustainable loans accounted for 20 percent of our new private customer business, which means that one in five new loans issued to private customers is now a sustainable loan.

We also further developed the sustainable refinancing of our property financing business. In 2019, our Green Bond Framework was expanded to include additional sustainable refinancing products, for example sustainable senior bonds and green commercial paper, and was again awarded a positive rating in a Second Party Opinion prepared by ISS ESG. The publication of an impact report on our green loan portfolio revealed, for the first time, the potential CO_2 emissions saved or prevented by our sustainable products.

Our commitment to sustainability continues to be rated 'positive' in the sustainability rating. We still hold the current highest grade of B- in the category "Financials/Mortgage & Public Sector Finance" at ISS ESG. Specifically, ISS ESG rates MünchenerHyp's environmental commitment at B- and its social commitment at B. MünchenerHyp therefore again ranks among the three top-rated banks in its peer group and retains its "Prime Status".

At the beginning of 2020, the agency imug raised MünchenerHyp's rating slightly within the rating category, although this did not result in a higher rating classification. The Bank's sustainability rating thus remains "positive"; Mortgage Pfandbriefe also have a "positive" rating, and Public Pfandbriefe have a rating of "very positive".

The Sustainalytics rating remained unchanged.

Development of sustainability ratings over the last two years at a glance:

THE DEVELOPMENT OF THE SUSTAINABILITY RATINGS SINCE 2018

		2018	2019/2020
ISS-ESG (previously ISS-oekom)		B–(Prime status)	B–(Prime status)
imug	Unsecured bonds:	positive (BB)	positive (BB)
	Mortgage Pfandbriefe:	positive (BBB)	positive (BBB)
	Public Pfandbriefe:	very positive (A)	very positive (A)
Sustainalytics		65 out of 100 points	65 out of 100 points

Separate non-financial report

We have been disclosing the responsibility we assume for our activity in various sustainability publications for many years. The statutory reporting obligation in accordance with the German CSR Directive Implementation Act (CSR-Richtlinie-Umsetzungsgesetz – CSR-RUG) is met with the publication of a non-financial report. The non-financial statement is published separately at the same time as the annual report on the Bank's website and in the electronic Federal Gazette (Bundesanzeiger).

Regulatory conditions

Basel III
MünchenerHyp calculates its capital requirements largely using the internal ratings based approach (IRBA). The ECB's Targeted Review of Internal Models (TRIM) confirmed the correct application of these models in compliance with the rules and that the systems are suitable.

The Liquidity Coverage Ratio (LCR) was maintained without issue throughout the year, with values significantly above 100 percent, and above 300 percent on average. The Net Stable Funding Ratio (NSFR) was also consistently above 100 percent.

Basel III also introduced a leverage ratio, which must be met. At the end of financial year 2019, MünchenerHyp reached a leverage ratio of 3.6 percent.

The "finalisation" of Basel III also includes a gradual introduction of an output floor of 72.5 percent to limit the effects of internal approaches compared with standard approaches. This means that banks with low risk weightings for their receivables, such as MünchenerHyp, will be adversely affected by the changes. The introduction of this floor will also impact on MünchenerHyp's capital ratios. Overall, we take a critical view of this new regulation, because it will make lending more expensive. These regulations have not yet been transposed into European law. Banking associations in Germany and other member states are committed to ensuring adequate implementation. The Bank is monitoring developments and, given the currently high Common Equity Tier 1 ratio of 19.8 percent, assumes that this regulatory change will be manageable.

We are closely following discussions about the publication of new national and international regulations by a central body, which will forward the new regulations to the relevant departments within the Bank, so that the departments can then implement these regulations within the scope of various measures and projects. The abundance of additional supervisory and regulatory requirements causes significant costs and poses a considerable challenge for our Bank's human and financial resources.

Single Supervisory Mechanism for EU banks
In 2019 the ECB once again conducted the annual Supervisory Review and Evaluation Process (SREP), comprising a detailed evaluation of the business model, internal governance and capital and liquidity adequacy. Any additional capital and liquidity requirements will be derived from that process. As part of the SREP, a mandatory minimum ratio in 2020 of 8.5 percent (previous year: 8.5 percent) was set for Common Equity Tier 1 capital for MünchenerHyp; no additional requirements were set for liquidity.

Minimum requirements for risk management (MaRisk)
German minimum requirements for risk management under MaRisk (Mindestanforderungen an das Risikomanagement) remained unchanged in the year under review.

Recovery and resolution plan
The recovery plan was updated and the information required for the resolution plan was sent to the resolution authority. There were no significant changes compared with the previous year.

IBOR reform
IBOR interest reference rates came under heavy criticism in the wake of the manipulation scandals a few years ago; at the same time, the abolition of the submission obligation for panel banks made it necessary to replace the LIBOR rates. Alternative risk-free rates (RFRs) are currently being developed and established; existing IBOR reference rates are to be replaced based on the new RFR benchmarks.

MünchenerHyp is affected both by the announced changes in relation to the interest rate benchmarks and by the Benchmarks Regulation. However, due to the highly specialised business model, there is much less of a need for change than for most other banks directly supervised by the ECB. The necessary adjustments are currently being prepared as part of a project and will be successively phased in by the end of 2021, as soon as final decisions have been taken by the supervisory bodies.

REGISTERED OFFICE, EXECUTIVE BODIES, COMMITTEES AND EMPLOYEES

Registered office

Münchener Hypothekenbank eG has its registered office in Munich. The Bank also has a branch in Berlin and 10 regional offices.

Executive bodies and committees

The following changes to MünchenerHyp's Supervisory Board and Board of Management took place in the year under review:

The Delegates Meeting elected HRH Anna, Duchess in Bavaria, entrepreneur, and Wolfgang Höbel, Spokesman of the Management Board of Volksbank Raiffeisenbank Dachau eG, as new members of MünchenerHyp's Supervisory Board.

At the end of the Delegates Meeting, the previous Chairman of the Supervisory Board, Wolfhard Binder, former Chairman of the Management Board of Raiffeisen-Volksbank Ebersberg eG, resigned from the Supervisory Board, after stepping down from his position on the Management Board at the end of 2018 due to his age. Dr Peter Ramsauer also retired from the Supervisory Board on a regular basis at the end of the Delegates Meeting for age reasons. The Supervisory Board thanked both men for their extraordinary dedication and commendable work for MünchenerHyp.

At its constituent meeting following the Delegates Meeting, the Supervisory Board elected its previous Deputy Chairman, Dr Hermann Starnecker, Spokesman of the Management Board of VR Bank Augsburg-Ostallgäu eG, as Chairman of the Supervisory Board of MünchenerHyp, and Gregor Scheller, Chairman of the Management Board of VR Bank Bamberg-Forchheim eG, as his Deputy.

At his own request, Michael Jung stepped down from the Board of Management of MünchenerHyp at the end of 2019 for health reasons. He had been a member of the Bank's Board of Management since 2011. Both the Supervisory Board and the Board of Management accept his decision with regret and would like to thank Michael Jung for his outstanding work for MünchenerHyp and wish him all the very best for his future.

Employees

The Bank continued to expand its workforce in the year under review. A total of 96 new employees were recruited to fill vacancies. A key focus of human resources work in the past year was therefore once again on the recruitment and integration of new employees. The number of new hires was also driven by 58 employees leaving the Bank. With an employee turnover rate of 6.8 percent – excluding retirements – the Bank remains slightly below the industry average.

Other focal points of human resources work were in the area of further training and professional development, as well as occupational health management provision.

The Bank employed 573 employees[7] (previous year: 550) and 15 apprenticed trainees (previous year: 12) on average over the year. The average length of service decreased from 10.9 to 10.4 years, due to the large number of new hires over the past two years.

Corporate governance statement in accordance with Section 289f HGB

In 2016, the Supervisory Board of MünchenerHyp stipulated a quota for the number of women on the Supervisory Board and Board of Management and for the two levels of management below the Board of Management. The target quota for the Supervisory Board and the two management levels below the Board of Management is 20 percent, and 33 percent for the Board of Management. In the year under review, the proportion of women on the first management level below the Board of Management was 17 percent, and on the second management level it was 14 percent; on the Supervisory Board, it was 17 percent and on the Board of Management, 0 percent. In 2017, the Nomination Committee of MünchenerHyp's Supervisory Board recommended that these target quotas should be achieved by the end of October 2021. Notwithstanding this, MünchenerHyp considers itself to be a modern company from a social, cultural and economic standpoint, where promoting the under-represented gender is a natural part of the management culture it practises.

[7] Number of employees in accordance with Section 267 (5) HGB; excludes apprenticed trainees, employees on parental leave, in early retirement or in partial retirement (non-working phase) and employees on leave of absence.