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 discussed with the Supervisory Board 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 ICAAP and ILAAP and on credit risks, operational risk reports and the risk report prepared in accordance with the German minimum requirements for risk management (MaRisk). The Risk 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 employed 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, participation 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 the mortgage business, we ensure that we grant senior loans predominantly with moderate loan-to-value ratios; in the commercial business, limits also apply with regard to DSCR and LTV. 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. 2020	Relative	31 Dec. 2019	Relative
Up to 60%	16,401,392,390.88	39.6%	15,344,320,091.37	40.2%
> 60% and <= 70%	7,042,011,598.28	17.0%	6,786,576,426.70	17.8%
> 70% and <= 80%	7,619,966,869.31	18.4%	7,316,381,368.42	19.2%
> 80% and <= 90%	3,423,715,652.17	8.3%	3,041,601,499.12	8.0%
> 90% and <= 100%	2,918,027,657.66	7.1%	2,516,947,130.12	6.6%
Over 100%	3,921,580,700.76	9.5%	3,077,883,878.42	8.1%
Without	52,169,575.59	0.1%	41,166,896.66	0.1%
Total	**41,378,864,444.65**	**100.0%**	**38,124,877,290.81**	**100.0%**

The regional breakdown within Germany and internationally is summarised below:

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

Region	31 Dec. 2020	Relative	31 Dec. 2019	Relative
Baden-Württemberg	3,459,145,234.81	8.4%	3,199,417,955.96	8.4%
Bavaria	7,698,948,641.11	18.6%	6,914,757,962.13	18.1%
Berlin	2,156,619,521.57	5.2%	2,026,546,575.41	5.3%
Brandenburg	614,702,291.86	1.5%	608,610,025.74	1.6%
Bremen	117,028,114.15	0.3%	105,422,601.78	0.3%
Hamburg	1,218,687,423.53	2.9%	1,096,427,567.45	2.9%
Hesse	3,015,553,722.32	7.3%	2,589,198,469.12	6.8%
Mecklenburg-West Pomerania	556,461,832.57	1.3%	449,022,966.46	1.2%
Lower Saxony	2,996,660,642.83	7.2%	2,626,151,276.25	6.9%
North Rhine-Westphalia	5,223,538,665.42	12.6%	5,056,691,558.58	13.3%
Rhineland-Palatinate	1,702,546,791.15	4.1%	1,568,178,520.40	4.1%
Saarland	424,211,558.98	1.0%	391,827,023.46	1.0%
Saxony	1,088,839,097.08	2.6%	993,549,792.56	2.6%
Saxony-Anhalt	634,003,054.63	1.5%	562,668,859.46	1.5%
Schleswig-Holstein	1,955,811,355.81	4.7%	1,841,943,276.68	4.8%
Thuringia	334,394,103.65	0.8%	324,158,194.28	0.9%
Total domestic	**33,197,152,051.47**	**80.2%**	**30,354,572,625.72**	**79.6%**

The international breakdown is as follows:

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

Country	31 Dec. 2020	Relative	31 Dec. 2019	Relative
Austria	181,484,755.12	0.4%	169,854,589.87	0.4%
France	441,156,481.80	1.1%	550,861,295.11	1.4%
United Kingdom	544,295,423.01	1.3%	543,299,669.17	1.4%
Spain	611,836,583.85	1.5%	462,348,572.71	1.2%
Luxembourg	64,900,000.00	0.2%	64,900,000.00	0.2%
Switzerland	4,803,985,406.13	11.6%	4,761,198,571.64	12.5%
Netherlands	701,825,145.19	1.7%	538,996,737.36	1.4%
Belgium	38,101,461.97	0.1%	38,141,763.09	0.1%
USA	794,127,136.11	1.9%	640,703,466.14	1.7%
Total foreign	**8,181,712,393.18**	**19.8%**	**7,770,304,665.09**	**20.4%**
Total domestic and foreign	**41,378,864,444.65**	**100.0%**	**38,124,877,290.81**	**100.0%**

Credit risk management starts when the target transaction 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. 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 (SLLP) monitoring, especially in non-retail business.

The Bank sets up a general loan loss provision as a precaution to cover latent credit risks. As in the past, this general loan loss provision is calculated based on the letter from the German Federal Ministry of Finance dated 10 January 1994. Due to the current situation, however, we no longer consider certain requirements imposed by the tax authorities to be appropriate. The flat-rate 40 percent reduction applied to average defaults over the past few years was no longer used; instead, a surcharge of 40 percent is applied to the average defaults over the past few years. The calculation also included the off-balance-sheet item "Irrevocable loan commitments".

As the property markets remain, mainly, very stable despite the COVID-19 pandemic, specific loan loss provisions continue to be recognised at only a very low level for both the residential property financing business and the commercial property financing business.

Business relations with financial institutions are based on master agreements that allow the netting of receivables from and liabilities to the other institution. Collateral agreements exist with all derivative counterparties. Derivative transactions, insofar as they are subject to clearing, 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 EUR MILLION

	Opening balance	Additions	Reversals	Utilisation	Exchange rate-related and other changes	Closing balance
Specific provisions	20.5	13.3	– 3.5	– 0.9	0.1	29.5
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 general 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). Options in capital market business are not contracted for the purposes of speculation. 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) or the right to make unscheduled repayments) and are hedged where necessary. These risks are carefully 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 almost exclusively from participations 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 input into 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' application. 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 an 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 and is limited.
  - In addition, six further stress tests (parallel shift up / down, steepening / flattening, parallel shift up / down in the short-term segment) are calculated. The poorest result is monitored as an early warning indicator for the limit. The stress tests are prescribed by EBA Guideline 2018 / 02.
- 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 percentage point.
  - Steepening / flattening: a moderate steepening / flattening of the yield curve is simulated, i.e. at the short end by up to + / – 10 basis points, at the long end by up to + / – 20 basis points, rotation around the 5-year grid point
- 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.

In the reporting year, the maximum VaR of the entire portfolio (interest, currencies and volatilities) at a confidence level of 99 percent with a ten-day holding period was EUR 56 million. The average figure was approximately EUR 33 million.

Although MünchenerHyp is a trading book institution (for futures only), it has not concluded any trading transactions since 2012.

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 indicator. 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 EUR 207 million in the reporting year, while the average figure was about EUR 170 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 (funding 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 German Pfandbrief Act (Pfandbriefgesetz – PfandBG), 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 safeguard 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 scenarios and modelling assumptions. Due to the longer observation period, however, additional modelling is taken into account that is not critical to short-term liquidity management, such as new business planning or current expenses such as salaries and taxes.

Medium-term liquidity planning has the following liquidity ratios over time as profit or loss components:

- cumulative overall cash flow requirement;
- available covered and uncovered 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. As the supervisory authority will not impose the mandatory minimum level of 100 percent for compliance with the NSFR until 30 June 2021, active management of this ratio has not yet been necessary.

In order to reduce refinancing risks, MünchenerHyp strives to refinance loans with matching maturities where possible. The Bank continuously checks if its relevant refinancing sources (above all, those within the Cooperative Financial Network) are still available. In order to limit market liquidity risk, in its business with governments 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 built up a modest deposit business. At the end of 2020, the portfolio volume was EUR 364 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, transactional errors and information and communication risks.

We minimise our operational risks by using skilled staff, transparent processes, automated standard workflows, written work instructions, comprehensive IT system function tests, appropriate contingency plans and preventive measures. Insurable risks are covered by insurance policies 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, known as ICAAP, 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 perspective.

Market risks, loan default risks, operational risks, spread and migration risks, refinancing 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 larger 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 ratios calculated in the Bank's financial reporting 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, some of which have already been implemented and which we will continue to implement consistently 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 capital adequacy, to ensure the Bank complies with supervisory requirements.

OUTLOOK – OPPORTUNITIES AND RISKS

Economic development and financial markets

The lockdown imposed in the winter of 2020/2021 has led to heightened concerns about the economy. At the end of January 2021, the IMF warned in its latest World Economic Outlook of the considerable uncertainty associated with economic forecasts and of diverging recovery paths, as the economic recovery is proceeding differently from country to country. At the same time, the IMF sees opportunities for the economy as a result of the vaccination programmes and the prospect of further stimulus packages in the world's major economies. All in all, the IMF expects the global economy to grow by 5.5 percent in 2021.

The economic forecast for the eurozone, however, is more subdued. The lockdown measures imposed to contain the current wave of the pandemic are putting more of a brake on the economic recovery than initially expected. As a result, the IMF has lowered its forecast for eurozone GDP growth in 2021 by one percentage point to 4.2 percent.

Increased risks are forecast for the German economy as a result of the lockdown. In its Annual Economic Report published at the end of January 2021, the German government now expects the economy to recover by only 3.0 percent in 2021, down from 4.4 percent previously. Industry is predicted to show robust development, whereas the service industry will continue to be hit very hard by the pandemic. The development of construction investment is seen in a more positive light, as this sector is not influenced quite as much by trends in other sectors of the economy. The German government expects construction investment to increase by a total of 1.9 percent in 2021 thanks to financing conditions that remain favourable, as well as high demand for homes. Residential construction is expected to grow by 2.7 percent as a result. The German government still expects to see more significant adverse effects on the labour market, predicting an unemployment rate of 5.8 percent for 2021 (2020: 5.9 percent).

Inflation rates are also predicted to rise in 2021. The IMF expects global consumer prices to increase by 1.3 percent (2020: 0.7 percent). Nevertheless, central banks across the globe will stick to their expansionary monetary policy. This should lend support to an economic recovery and underpin the low interest rate environment on the bond markets. As a result, the extremely low interest rate level may continue to lead to investors reallocating their assets, favouring the equity and property markets, especially in the first half of 2021.

On the foreign exchange market, bank economists are forecasting a slightly positive development in the euro and more of a downward trend for the US dollar, as the latter tends to suffer in the event of an economic recovery worldwide. Brexit could continue to weigh somewhat on the pound in 2021, as many of the effects on the British economy will only start to come to the fore as the year progresses. As far as the Swiss franc is concerned, we still expect to see minor fluctuations and more or less stable exchange rates, as in 2020.

Funding spreads for banks are likely to remain very attractive. The new TLTRO tenders will continue to provide banks with plenty of liquidity at favourable interest rates for the time being. Accordingly, the volume for bank funding on the market should decrease overall and at least not exert any upward pressure on funding spreads. In the event that discussions within central banks about a potential withdrawal of monetary policy measures intensify in the second half of the year, this could result in spreads widening slightly.

For covered bond markets, experts predict weaker issuing activity in 2021 as a result of the ongoing COVID-19 pandemic. The covered bond market will remain affected by the impact of the global COVID-19 pandemic in the coming year, too. A new issue volume for benchmark covered bonds denominated in euros of EUR 90 billion is forecast for 2021, which will be offset by maturities of around EUR 130 billion. It is expected that these maturing bonds will not be replaced in full by new issues and that the cheap central bank money provided via the TLTRO tender, in particular, will have an impact.

Property markets and property financing markets

As far as the property markets are concerned, experts increasingly expect the consequences of the recession to spill over. In particular, there are fears that the economic recovery will not reach the commercial property markets in full and that demand will not bounce back to pre-pandemic levels.

The German residential property market is expected to continue its solid, positive performance. Demand for housing – both owner-occupied and rented – is likely to remain at a high level, not only because of low interest rates and a lack of investment alternatives, but also because people are generally seeking to upgrade their housing situation due to the increased use of working from home arrangements. We can therefore expect that professional investors, too, will continue to see German residential properties as a safe haven. The high demand will also fuel a further increase in purchase prices and rents, albeit most likely at a slightly slower pace due to a gradual improvement in the supply situation and slower population growth in metropolitan areas.

The residential property market in Switzerland is predicted to follow a similar trend to its German counterpart – with keen interest in purchases of owner-occupied residential property. The demand for residential property is also being supported by sustained low interest rates. Vacancy rates are rising in the rental housing market. The market is expected to ease slightly as a result, also in light of weaker demand.

The commercial property markets in which MünchenerHyp operates are still being affected by lockdown measures. Investors nevertheless continue to see Germany, in particular, as a safe haven due to its economic strength. In terms of asset classes, investors have returned to focusing more on core properties due to the recession. All in all, the transaction volume for the German commercial property market is expected to remain on a par with the previous year due to its stability.

While the COVID-19 pandemic might be impacting the commercial property markets in Europe and the USA in different ways, its consequences are similar as far as the individual segments are concerned. As a result, it makes more sense to consider the outlook regarding opportunities and risks in the main commercial property segments than it does to focus on a country-specific analysis.

Office markets typically react to economic developments with a six to twelve-month lag, meaning that it is likely a downward trajectory in rents and yields still lies ahead. This sort of decline will be more marked in large US cities and in London, as property cycles here are more pronounced than in other markets. It remains to be seen how much the increase in working from home will affect the demand for office space. While many experts do not expect to see any major upheaval on the office property markets, they also predict weaker demand overall. It is probable that this would translate into lower rents and rising vacancy rates.

The retail sector was already undergoing radical change before the COVID-19 crisis. The pandemic and the associated business closures will continue to drive this process of transformation. We therefore predict that insolvencies of retail chains are on the cards for 2021, putting pressure on the rental and investment market. Falling rents and rising vacancy rates are to be expected as a result. By contrast, supermarkets, specialist stores and retail parks, which are allowed to remain open due to the range of essential everyday goods that they offer, will show stable development. It is still impossible to reliably predict the extent to which the strong growth in online shopping will continue once the pandemic is over. Travel restrictions have left a particular mark in areas of major European cities that are popular with tourists, with both falling rent levels and rising yields emerging. In the future, shopping centres will be faced with the question of what form the retail concepts of the future will take.

Logistics properties will continue to benefit from the increasing importance of online shopping in 2021. Additional demand is coming from the relocation of industrial production and warehouse capacities back to Europe to compensate for the weak points in global supply chains that emerged in the course of the pandemic.

As long as lockdown measures still have to be imposed in 2021, hotel properties will remain the hardest hit by the COVID-19 pandemic. As a result, the recovery of the hotel industry will depend largely on the extent to which infection rates can be reduced, opening up opportunities for leisure and business travel again.

Business development at Münchener Hypothekenbank

Due to the consequences of the COVID-19 pandemic and the opportunities and risks described in the previous section, MünchenerHyp's new business plans are generally associated with a number of uncertainties.

In particular, good overall conditions and high demand on the German residential property market present opportunities. As a result, we plan to slightly increase our new business in private residential property financing overall, where we expect the favourable interest rate level to lend further support. At the same time, however, competition remains fierce as residential property financing becomes an increasingly appealing business segment for banks and insurers. With this in mind, we will continue to optimise and expand our processes and services and to strengthen the partnership with our financial intermediaries.

In our 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 underpinning our funding on the capital market.

In our partnership with PostFinance, we are planning new business at the previous year's level. We will expand the financing business in Austria following completion of the trial phase by entering into partnerships with additional Austrian financial service providers.

Commercial property financing remains a focal point of our business strategy alongside financing for private customers. We consider the downturn in commercial property markets triggered by the COVID-19 pandemic to be pronounced, but also see it as a temporary influencing factor. As a result, when it comes to planning our new business, it is important for us to assess the risks associated with the pandemic appropriately. In this respect, when making financing decisions we will continue to prioritise the criteria we have established for a positive assessment, being a viable location and the sustainability of individual cash flows, in line with our business and risk strategy.

Risks for our financing business are linked primarily with the duration of the pandemic and the associated economic implications. On the other hand, the low interest rate level, which is unlikely to change to any considerable degree, and continued high inflow of capital into property from investors and institutional buyers due to the lack of alternative, more profitable forms of investment, present us with opportunities. In our view, this should give rise to a sufficient level of financing opportunities overall. Against this backdrop, we plan to slightly expand our domestic and international business in 2021.

We anticipate a high level of transaction activity on the national and international syndication markets in 2021 as well, as the trend towards very large volumes of financing continues. We therefore expect the trend witnessed in 2020 to continue in 2021. On the one hand, we are prepared to participate to a significant extent in third-party financing and, on the other, to surrender portions of our own financing to other banks or institutional investors. In this regard we will also continue to use our established syndication programme with the Cooperative Financial Network.

The objective of our lending business with the public sector and banks continues to be primarily to manage liquidity. For 2021, we expect stable development of our portfolio volume, as maturing securities will have to be replaced to manage liquidity.

For 2021, we forecast a refinancing requirement of between EUR 8.5 billion and EUR 9.5 billion, of which EUR 6.5 billion to EUR 7.0 billion is expected to 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 tap existing bonds. Due to its partnership with PostFinance in Switzerland, MünchenerHyp will continue to have a funding requirement in Swiss francs.

Two large-volume bonds will mature and fall due for repayment in the 2021 financial year: a Mortgage Pfandbrief with a volume of EUR 750 million in April and a Mortgage Pfandbrief with a volume of EUR 500 million in November.

We will further expand our sustainability business activities in 2021. In particular, we want to give our sustainable financing solutions an even stronger foothold in the market and expand our sustainable issuing activities. We also plan to refine our sustainability strategy further.

We are aiming to achieve a moderate increase in net interest income generated from business operations in 2021. Stable trends in 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, mounting competition and ongoing high regulatory pressure will have the opposite effect.

Loan loss provisions will depend primarily on how the COVID-19 pandemic develops going forward. In our planning we have assumed that these will increase compared to 2020.

In the current market environment, we are nevertheless confident that we will attain our targets for the 2021 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 plethora 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 funding 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.