MANAGEMENT REPORT 2016
ECONOMIC REPORT

OVERALL ECONOMIC CONDITIONS

ECONOMIC DEVELOPMENT

The global economy continued to lose momentum in 2016 and was particularly slow-moving in the first half of the year. Despite a renewed pick-up in the third quarter, the upswing noted in the second half of the year was not enough to generate stronger global gross domestic product (GDP) growth. Thus, in January 2017 the International Monetary Fund (IMF) estimated that the world's GDP expanded by 3.1 percent in 2016 compared to the slightly higher 3.2 percent recorded for 2015.

Growth within the euro area also grew at a slower pace than in the previous year as GDP rose by 1.7 percent following 2.0 percent in 2015. Economic growth was primarily held back by political uncertainties stemming from gains made by populist movements such as the one in Great Britain where a referendum on the UK's continued membership in the European Union (EU) led to a majority voting for Britain to exit (Brexit) the EU.

Based on initial estimates prepared by the Federal Statistical Office, Germany's economy grew by 1.9 percent, or more than expected and at fastest pace seen in the last five years. The good economic results were mainly driven by a 2.5 percent increase in consumer spending. Furthermore, economic growth was strongly supported by rising capital expenditures, especially a 3.1 percent increase in investments in construction projects. Growth in this sector was again driven by investments in new residential housing, which climbed by 4.3 percent. Investments in construction within the public sector grew by 2.4 percent while investments in construction of commercial property expanded by 0.9 percent.

The annual average rate of inflation remained low at 0.5 percent. Prices for consumer goods did, however, rise notably towards the end of the year as the Federal Statistical Office recorded a 1.7 percent jump in December. This increase was primarily due to a notable increase in energy prices.

The labour market continued to develop favourably in 2016 as the annual average number of employed persons during the year increased by more than 400,000 to 43.5 million. The average number of unemployed persons receded further as 2.7 million jobseekers were registered, or about 100,000 less than in the previous year. The unemployment rate decreased by 0.3 percentage points to 6.1 percent.

FINANCIAL MARKETS

Financial markets in 2016 were influenced by the political successes scored by populist movements, as well as the increasing divergence in monetary policies pursued by central banks in mature economies. The results of the Brexit referendum led to a massive decline in stock prices for a short period as a majority of market players had expected a "remain" victory. Donald Trump's election as president of the USA also resulted in a sharp reaction as the bond market posted losses while equities gained. In contrast, the market's reaction to the failed Italian referendum to reform the constitution was far more moderate.

Different rates of economic growth and inflation in developed economies led to a divergence in monetary policies pursued by the European Central Bank (ECB), the Bank of England and the Bank of Japan, on the one hand, from the policy followed by the American Federal Reserve (Fed), on the other hand. The ECB embraced a very loose monetary policy to strengthen inflation and avoid the dangers of deflation. For this reason, it lowered its interest rate on main refinancing operations by 5 basis points in March 2016 to 0 percent and its deposit facility rate by 10 basis points to minus 0.40 percent. In addition, it expanded its monthly asset purchase programme by an additional € 20 billion to € 80 billion. The Bank of England – in response to the Brexit vote – as well as the Bank of Japan – to counter low inflation and weak economic growth – also retained their expansive monetary policies. In view of improved economic data and lower unemployment in the USA, the Fed, in contrast, increased its key interest rate by 25 basis points in December 2016 to the range of 0.50 percent to 0.75 percent. Among other things, the difference in yield between ten-year German Bunds and US Treasuries widened to 166 basis points at the end of the year.

The ECB's policy led to further declines in spreads and yields in the bond market. Economic development in the euro area was expected to weaken further at mid-year due to the Brexit decision. As a result, the yield on the 10-year Bund to hit a new historic low of minus 0.205 percent. Over the remaining course of the year higher oil prices as well as favourable economic data in the UK, plus statements made by the newly elected American president regarding financial policy, raised expectations for economic growth and inflation, which led to a rebound in yields. At the end of the year 10-year Bunds were yielding plus 0.20 percent.

The stock markets once again experienced greater volatility as the DAX lost almost 20 percent in the first weeks of the year only to recover and then rapidly decline again following the Brexit vote. The DAX went on to stabilise and rise sharply following the election of Donald Trump through to the end of the year. DAX rose by about 7 percent to the end of 2016 compared to its start in January and closed out the year at almost 11,500 points. The Dow Jones index also had a weak start but was able to make up for initial losses over the course of the year. The results of the presidential election in the USA also drove a notable rise in the Dow Jones in the remaining weeks of the year.

The US dollar was able to gain in the foreign exchange markets during the year. The gains were driven by improved economic data in the USA in the third quarter of 2016, as well as the newly elected president's announced plans to expand fiscal policy and spending. The fact that the Fed was pursuing a more restrictive monetary policy than the ECB also helped to raise the value of the dollar. The US dollar spent most of the year in a range of 1.08 to 1.14 to the euro. The rate only made a major move higher for the US dollar in the fourth quarter when it became increasingly apparent that interest rates were going to rise in the USA. Towards the end of the year the dollar stood at 1.04 to the euro, the highest it had been in 14 years. The Brexit decision placed a heavy burden on the British pound as it lost value against all major currencies. This led the Bank of England to lower interest rates in response to the Brexit vote and to increase the volume of its bond purchase programme. These steps restored a certain level of stability. In addition, economic data did not develop as weakly as had been feared following the Brexit vote. At its low point the pound lost about 20 percent to the euro. At the end of the year the pound was quoted at 0.85 to the euro, or about 15 percent lower than at the start of year. The Swiss franc remained at a relatively stable rate vis-à-vis the euro and closed out the year at 1.07 CHF to the euro.

The ECB remained the main driver of activity in the covered bond markets as it bought more than one-third of all benchmark covered bond issues as part of its Covered Bond Purchase Programme (CBPP 3). Although traditional investors, like banks, insurance companies and investment funds, remained present as

Figures in % | YIELD ON TEN-YEAR BUNDS 2016

Source: Bloomberg (closing rate)

buyers in the market, the ECB's purchases pushed them further to the sidelines. In addition, the low level of interest rates and spreads also reduced their willingness to build new positions. At the same time, high ratings and regulatory preferences associated with covered bonds and Pfandbriefe continued to make them favoured investments.

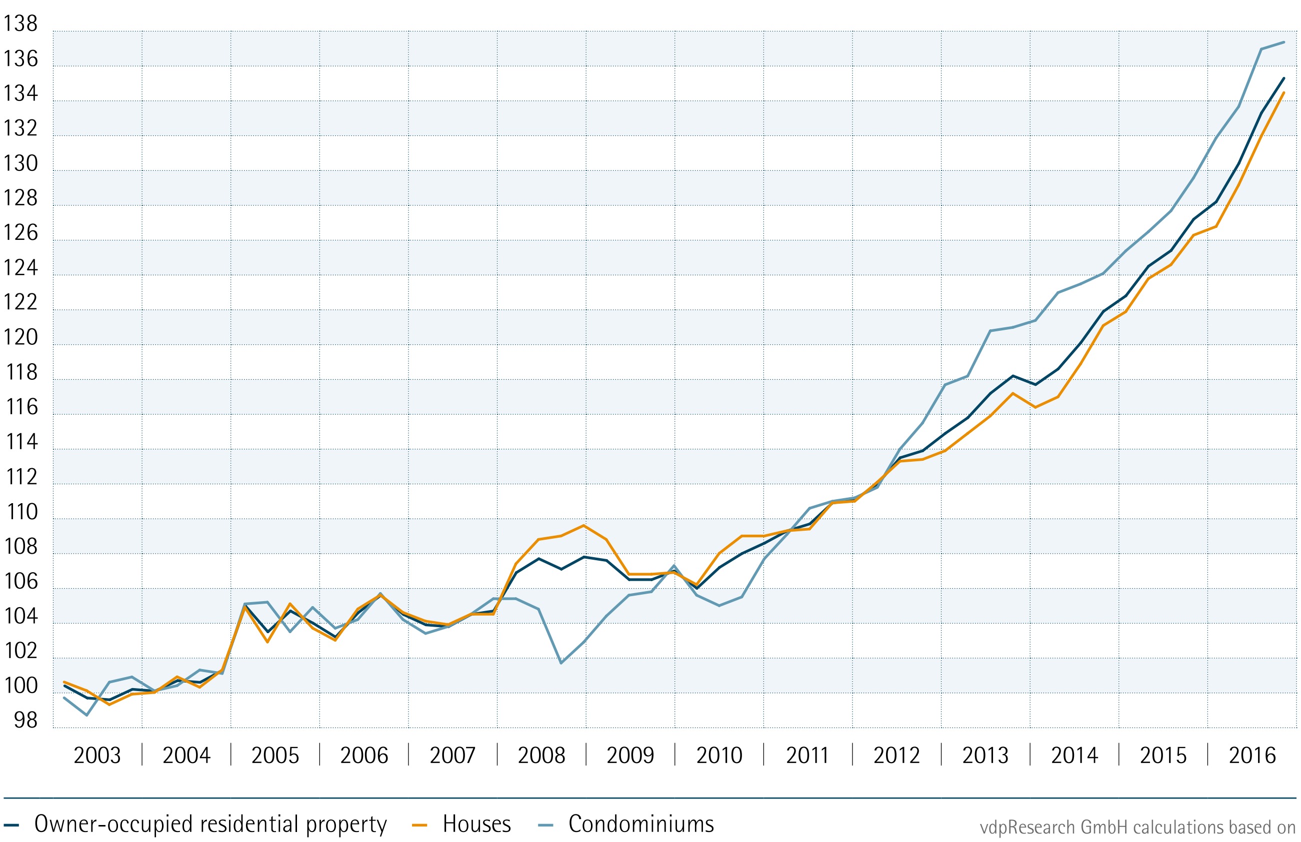
The volume of new issues declined due to the ECB's longer term financing operations, and regulatory pressures on banks to lower the volume of low-margin public-sector loans on their balance sheets. Furthermore, issuing activities also declined due to political uncertainties. However, the year's issuing activities got off to a stronger start than in the previous year. About three quarters of the total volume of new benchmark covered bonds were issued in the first half of the year. Total issuing activities did not, however, meet the market's expectations as total volume fell from € 145 billion in 2015 to € 127 billion. As in the previous year, German Pfandbriefe, with € 24 billion in new issues, held the lion's share of new issues, followed by French covered bonds with € 21.6 billion and Spanish Cedulas with € 13.5 billion.

PROPERTY AND PROPERTY FINANCING MARKETS

RESIDENTIAL PROPERTY – GERMANY

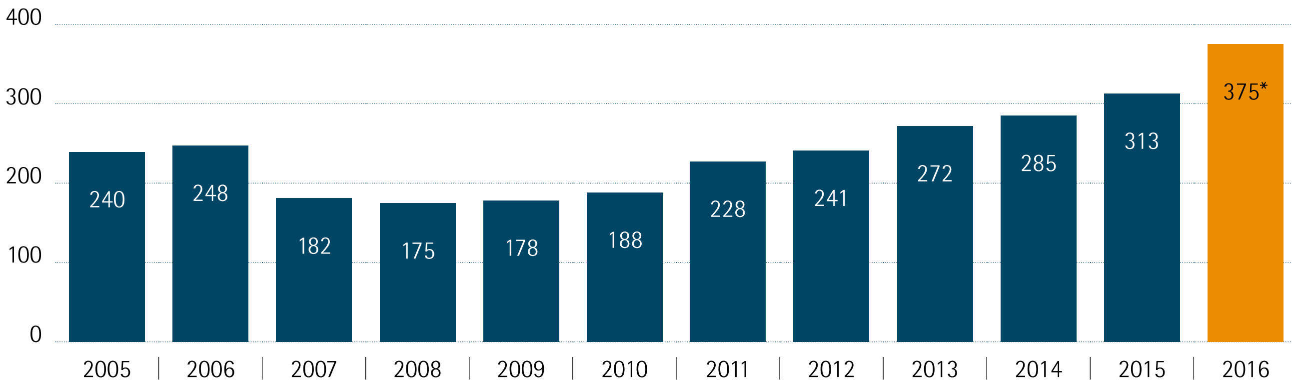
The dynamic pace of the upswing in the German residential property market increased further in the previous year. Purchase prices paid for houses and apartments rose faster than in 2015. According to the Association of German Pfandbrief Banks' (vdp) index for residential property prices rose by 6.6 percent in 2016 in comparison to the same year-ago figure.

DEVELOPMENT OF PROPERTY PRICES IN GERMANY (YEAR 2003 = 100)



vdpResearch GmbH calculations based on information provided by vdp transaction databank
As of: February 2017

Figures in 000 | RESIDENTIAL BUILDING PERMITS IN GERMANY 2005 – 2016



* 2016 = estimated
Source: German Federal Statistical Office

This development was again primarily driven by significantly higher demand for housing than the available supply. Just the number of newly-built housing units alone reveals that the needed volume of housing per annum still has not been reached despite a substantial expansion of construction activities. Although 340,000 building permits for housing units (plus 23 percent) had been issued by the end of November 2016 – a level last seen in the year 2000 – it is estimated that only about 240,000 housing units were actually completed in full-year 2016, or about 10 percent more than in 2015. Nevertheless, this number remains considerably below the estimated demand, which is seen as at least 350,000 housing units per year.

In contrast to normal practice, the rise in prices for residential property in many locations was not accompanied by a noticeable increase in transactions. The German market for housing investments was particularly affected by this as the volume of transactions fell significantly despite greater demand shown by institutional investors. The volume of sales recorded in 2016 was about € 13 billion, a decline of roughly 50 percent from the previous year's figure of € 23.5 billion.

Prices for multi-family houses rose sharply as the supply of available properties fell notably. According to the vdp Property Price Index, prices paid in this segment increased by 7.1 percent in 2016 making multi-family houses once again the asset class with the strongest rise in prices in the housing market.

This led to a further intensification of the situation in the rental housing market in 2016 – with clear regional differences: markets in rural regions tended to remain stable in the face of declining population numbers, while shifts in settlement structures and rising population led to significant housing shortages in major metropolitan areas. Despite higher construction activity, the availability of low-cost housing and affordable family housing tightened further.

Buyers' demand for houses and condominiums also reached a new record high due to a further decline in mortgage rates, which hit new historic lows towards the end of the year. Other factors driving demand were the unbroken lack of attractive investment alternatives in the capital markets and the solid economic upswing. As a result, the limited supply of properties led to a notably stronger rise of 5.8 percent in prices for houses and 6.5 percent for condominiums according to figures in the vdp Property Price Index.

Voices were again heard in the previous year warning that rapidly rising prices could be creating a bubble in the property market with potentially serious consequences for the financial sector. The German Bundesbank addressed this issue in their current Financial Stability Review and concluded that the German housing market currently does not pose direct threats to the financial stability. This conclusion was based on the facts that the volume of lending was rising very moderately and that the total debt level of private households was tendentially shrinking. In addition, the volume of new property loans with an initial fixed-interest period of over ten years rose further. According to the Bundesbank, this means that risks facing private households over a long period of time are calculable.

The implementation of the Directive for residential property loans in March 2016 resulted in controversy and discussions. Against the background of the last property crisis in the USA and parts of Europe, the stated objective of the Directive was to better protect borrowers with new standards for counselling, information and creditworthiness assessment associated with financing residential property. Numerous banks complained soon after the Directive was put into practice that it made it excessively difficult for them to finance residential property. This position, however, was only partially confirmed by Bundesbank figures. Although there was a distinct decline in new property lending business activities in the months following the implementation of the Directive for residential property loans, the volume of new lending commitments had already been declining since the fall of 2015. In addition, the banks' new residential property lending business in 2015 had risen at an unusually strong rate in comparison to previous years. The Directive primarily affected young families and seniors as the new rules regarding creditworthiness assessment made it more difficult for them to obtain property loans. This was recognised by policymakers. Towards the end of the year a new law aimed at eliminating some of the negative effects of the Directive was submitted for approval.

RESIDENTIAL PROPERTY – INTERNATIONAL

House prices in the EU have been rising nearly continuously since 2012. According to Eurostat, this trend accelerated further in 2016. Eurostat recorded a 4.3 percent year-over-year increase in EU-wide prices in the third quarter of 2016 following the 2.9 percent increase recorded in the same quarter of 2015. The rates of increase varied widely with above-average gains reported in Great Britain, Austria and Portugal, while the strongest increases were reported in Hungary and Latvia. Prices declined only in Italy and Cyprus.

The development of prices noted in the British housing market changed notably due to Great Britain's decision to leave the EU. The rise of house prices slowed substantially within the last months of 2016. When viewed on an annual basis purchase prices rose by 5.7 percent over the previous year. It is, however, notable that purchase prices outside London posted significantly stronger growth than residential property prices in London. The rental housing market, which is markedly less volatile than the house buyers' market, also posted a gain, but the increase of 3.1 percent was lower than in previous years. London and the southwest of England were particularly affected by the lukewarm development of prices.

The French housing market left its downward path in 2016 due to solid economic growth and extremely low lending rates. Rising demand by private investors, which appeared in 2015, remained intact. This notably encouraged new construction of houses, as well as sales of existing properties. Greater buying interest was also apparent in the investment market. This meant that prices for apartments and privately-owned houses increasingly stabilised or even trended slightly higher in certain segments. For example: the average increase in prices paid for apartments in Paris rose by 2.7 percent in the first two quarters of 2016. Rents paid for residential housing also increased slightly.

The Dutch housing market is on an upswing. House prices rose by 5.6 percent over the same year-ago period in the third quarter of 2016. A strong, above-average development of prices is particularly visible in major cities and driven by solid economic growth and low mortgage rates. Thus, price levels seen in the record-setting year of 2008 have already been exceeded in Amsterdam and Utrecht. This led to growing demand on the part of investors, which was reflected by the newly set record volume of about € 2 billion in property investments recorded by the end of third quarter. High demand and rising prices pushed the net initial yield generated by multi-family houses down to 3.75 percent. Investors were focused on properties located in Amsterdam, Rotterdam and Utrecht.

The Swiss housing market developed unevenly in 2016. The market for condominiums was driven by low interest rates and demand for property as a capital investment. However, the number of newly completed condominiums declined and the supply of existing apartments was very tight. These factors led to a 3.9 percent increase in prices in 2016 over the same year-ago period. There was a noticeable increase in new building activity for investment properties in the rental apartment market, which led to an increase in the supply of rental apartments. At the same time, population growth has slowed which in turn has increasingly changed the rental apartment market into a tenants market with slightly declining rents. On an overall basis, the pace of growth in the Swiss housing market weakened.

Overall favourable economic conditions, including a high rate of employment and rising incomes, once again propelled the housing market higher in the USA. Demand for owner-occupied houses rose and prices paid for residential property also increased further. The S&P/Case-Shiller Index figures for October 2016 showed a 5.6 percent year-over-year increase in house prices for the entire country, although with notable regional differences. As in the previous year the fastest growth rates among the metropolitan areas were recorded in Seattle and Portland with over 10 percent. The lowest rates were noted for Chicago, Cleveland and Washington with less than 4 percent. Nevertheless, prices in these three cities rose at a faster pace than in the previous year. Rental prices continued to climb and were 4.1 percent higher than the same year-ago figure. This was not lastly due to a tighter supply of available units in the rental housing market. As a result, institutional investors increased the flow of their capital into multi-family houses. More than US dollar 100 billion was invested in multi-family houses in the first three quarters, which indicated that 2016 would become a new record year.

COMMERCIAL PROPERTY – GERMANY

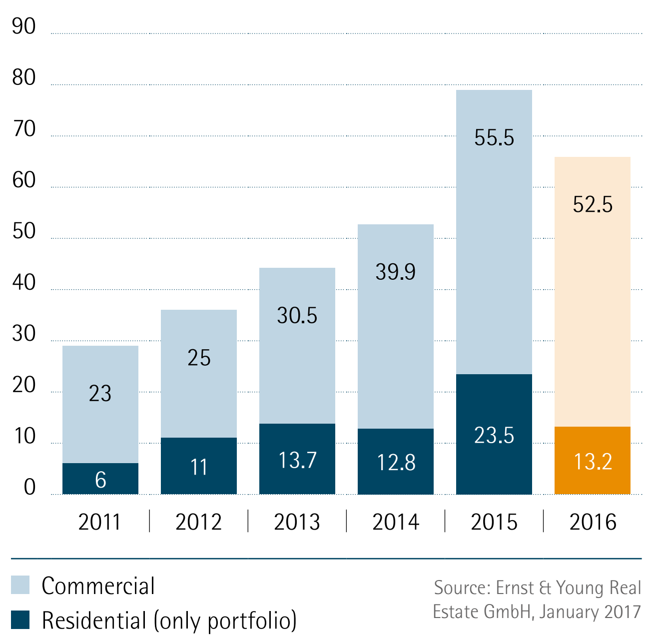
Development seen in the German commercial investment market since the end of the financial crisis has been marked by high, and rising, demand noted for all domestic and foreign institutional investor groups. However, the supply of suitable properties in the preferred investment segments is limited and becoming increasingly rare. This was also reflected for the first time by the volume of transactions last year, which declined by € 3 billion to € 52.5 billion. However, numerous market players had expected a bigger decline. More than half of all transactions involved the top 7 cities in Germany.

High demand was reflected by further rising prices for commercial property in the previous year. The vdp index for commercial property posted a 6.0 percent increase in 2016, or three times stronger than the gain recorded in the previous year.

Office properties remained the most important sector of the commercial property market with a share of about 45 percent as prices in this sector rose at an above-average rate of 7.7 percent. High demand further increased pressure on returns, which in the interim have reached a historic low. Strong buyer interest in office properties was driven by solid economic development. Demand for office space, and thus turnover of office space, increased notably. Turnover of office space in the top 7 cities rose by 9 percent. Despite increased new construction activity, vacancy rates reported for office properties declined further. This was mainly due to the fact that more than 80 percent of newly built office space was no longer available upon completion. The increasing shortage of modern office space in city centres has led to a renewed rise in demand for office space in less central office locations.

The limited supply of office properties and the very high purchase prices that have been paid in the meantime prompted institutional investors to increasingly shift their investment plans to include retail and specialty properties, such as logistics properties, nursing homes and retirement homes, as well as hotels. Returns on investments in these segments have also fallen slightly due to high demand.

DEVELOPMENT OF COMMERCIAL PROPERTY TRANSACTIONS IN GERMANY 2011 – 2016
Figures in € billion



Source: Ernst & Young Real Estate GmbH, January 2017

COMMERCIAL PROPERTY – INTERNATIONAL

The global volume of investments in commercial property declined in 2016 for the first time since 2012. However, strong above-average growth in the fourth quarter noted in some European countries slowed the decline in Europe to a level that was better than had been widely expected. Total investments in commercial property in Europe amounted to about € 251 billion, or 10 percent less than in 2015 with most of the money again invested in Great Britain, Germany and France. Spain and the Netherlands were ranked four and five, respectively. The investment markets in these two countries recorded strong above-average growth in the previous year of 8 percent in Spain and 17 percent in the Netherlands.

Demand for office space by renters and owner-occupiers declined slightly in the previous year. Total turnover in Europe fell by 2 percent year-over-year to nearly 12 million square meters. Despite this performance, the pan-European vacancy rate fell again, and at the end of the year stood at 8 percent, which was the lowest rate since the end of 2008. Against the overall background of solid key figures, rents paid rose on average in Europe by nearly 3 percent. In light of the different cycle phases noted for the countries, development reported in individual nations varied very strongly.

Market developments in Great Britain have been influenced by the Brexit vote since the middle of 2016. Rising uncertainty was felt in the investment market and reflected by the volume of transactions, which amounted to € 60 billion, or the lowest figure since 2012 and a drop of 37 percent from the same year-ago figure. About one-third of the total volume of transactions were generated by London property deals, which mainly involved office properties. The user market developed similarly. The London rental market notably lost momentum in the second half of the year to the extent that turnover of office space was one-quarter less than in the previous year. Furthermore, the vacancy rate for office space again increased notably again for the first time. As a result of this development, rents paid for office space came under pressure in certain areas. Top rents paid recorded a particularly strong decline and fell by 4.3 percent just in the fourth quarter alone.

Investments made in French commercial property declined by 4 percent in 2016 to about € 26 billion, with the majority – about 80 percent – invested in the greater Paris area. Office properties were the most important investment segment and represented 60 percent of the total volume of investments. Demand noted in this market segment was high in nearly all locations. This situation resulted in a further decline in net initial returns. Demand on the part of users of office properties was also very strong. Turnover of office space rose by 6 percent to 2.4 million square metres pushing the vacancy rate down to 6.4 percent, the lowest rate seen since 2009. Rents rose again slightly.

The sharp 17 percent increase in investments made in the Netherlands to € 13 billion was driven by good overall economic conditions. The upswing in the commercial property market was primarily fuelled by the office properties market – with rising turnover of office space and declining vacancy rates. In some locations, like the centre of Amsterdam and the Zuidas urban district, both peak rents and average rents rose again slightly for the first time.

Following the record-setting 2015, current estimates expect the volume of transactions declining by about 15 percent in 2016 to US dollar 466 billion, with a generally stable office property market. New York easily defended its lead as the top location for office investments far ahead of Boston and Los Angeles. The user market was marked by an expanded supply of newly built properties, as well as a decline in demand for space. Net absorption fell by almost 40 percent to about 50 million square feet. As a result, the vacancy rate only fell slightly to 14.5 percent and ranged from 6.2 percent in Nashville to 24.9 percent in Westchester County. Rental prices, which had risen since 2011, generally continued to climb. However, the upward movement almost came to a complete stop in the fourth quarter. This could indicate that this phase of the cycle is slowly coming to an end.

BUSINESS DEVELOPMENT

NEW MORTGAGE BUSINESS

The objective for our new mortgage business in 2016 was to once again achieve the record results we had posted in 2015. We are very pleased to report that were able to even slightly increase the volume of lending commitments we made as our new business rose by 1.6 percent to € 4.93 billion (previous year € 4.85 billion).

MÜNCHENERHYP NEW MORTGAGE BUSINESS
2012 – 2016
Commitments in € million

Private residential property lending again generated about two-thirds of our new business. In this area of business we continued to benefit from the continuing low level of interest rates, high demand for property and property financing, as well as the strong market position of our brokerage partners, especially the cooperative banks. Our volume of lending commitments rose by 2.1 percent to € 3.27 billion.

We were able, in particular, to expand the volume of business brokered by banks within the Cooperative Financial Network, as well as our business with independent providers of financial services. Our collaboration with our cooperative partner banks generated € 2.45 billion (+2.4 percent) in new business, while sales via independent providers of financial services rose to about € 400 million (+15.5 percent).

Our new business activities were not negatively affected by the complex implementation of the Directive for residential property. This was because we had converted our systems to accommodate the new conditions as early as possible thus enabling us to ensure that our production capabilities in the lending processes continued to operate smoothly without interruption. This meant that we were able to continuously deliver financing solutions to our partners at all times, which had a very favourable effect on the volume of loans brokered before and after the implementation of the Directive for residential property loans.

One of our competitive advantages is our wide range of products with numerous optional choices coupled with favourable conditions. One of them is our latest product: the MünchenerHyp Sustainability Loan, which was successful from the time it was launched in the fall of 2015. Since then this product has grown to represent almost 10 percent of our new private residential property financing business – and we were able to gain a new target group for our partner banks and our Bank: customers who place great value on sustainability.

The price wars in the property finance sector in Switzerland intensified notably as growth slowed in the Swiss residential property market. Due to these developments we strengthened our marketing activities with our collaborating partner, PostFinance, and very successfully conducted a sales campaign. As a result, we were able to record € 430 million in new lending commitments, thereby keeping our volume of new business at almost previous year's level.

Business also developed favourably in the commercial property finance area, where we were able to slightly increase our volume of new business. We made a total of € 1.66 billion in new loans in this area.

We achieved these results against the background of the difficult environment that confronted both lenders and investors in 2016. The total volume of investments made in commercial property in most of the countries where MünchenerHyp is active declined in 2016 – along with new business opportunities for lenders. This, however, did not lead to changes in their financing offers or their willingness to make them, which intensified price competition notably.

MORTGAGE RATES MÜNCHENERHYP (TEN YEAR FIXED RATE)

As of: 02.01.2017

We faced the stiffer price competition and at the same time expanded our capacities by optimising our new business procedures. As a result, we now can process a higher volume of new business enquiries while retaining the high level of quality in our analysis work. Both measures made it possible for us to slightly increase our volume of new business over the previous year's level without altering the Bank's approach to risk.

CAPITAL MARKETS BUSINESS

Our investment strategy concerning securities issued by the public-sector and banks continued to be strongly influenced by regulatory requirements and the ECB's asset purchase programme.

Yields on 10-year Bunds fell to a new historic low of minus 0.205 percent due to the ECB's asset purchase program making it hardly possible to find a low-risk security offering a profitable return on capital.

Due to this situation, and in accordance with our business strategy, we refrained from capital market business during the year under review. The volume of new business fell by € 0.7 billion to € 109 million, while the volume of securities in our portfolio declined by € 1.4 billion to € 6.8 billion at the end of 2016.

REFINANCING

The Pfandbrief market remained influenced by the ECB's third Covered Bond Purchase Programme (CBPP3). Furthermore, investors were at times hesitant to act due to political events and especially because of the Brexit vote and the results of the American presidential election. Finally, there was the volatility noted in interest markets towards the end of the year. Despite these, more difficult overall conditions we were able to fully cover our refinancing needs to our complete satisfaction.

During the year under review we only had to service one large volume security – a € 1.25 billion Mortgage Pfandbrief – that matured. Repayment took place at the beginning of the year and had already been partially prepared by measures taken in 2015. This allowed us to primarily focus on managing our liquidity and choosing good windows for new issues over the remaining course of the year.

In April, we placed a new benchmark issue, a ten-year € 500 million Mortgage Pfandbrief with a 0.5 percent coupon. The issue was priced at one basis point below the mid-swap rate, which was the highest risk discount in this maturity segment up to this date in 2016. A total of 44 orders were received from ten countries with German investors counting as the largest group as they bought almost 79 percent of the volume sold. Refinancing conditions improved again later in the year enabling the Bank to successfully tap this issue by an additional € 250 million in July. The price was set at 8 basis points below the mid-swap rate underlining our outstanding placement power.

During 2016 we bolstered our issues of foreign currency denominated Mortgage Pfandbriefe. About 40 percent of MünchenerHyp's total covered refinancing volume was accounted for by Pfandbriefe that were not denominated in euros. We owe this to our many years of intensive relationships with our investors, especially those in Europe, overseas and in the Far East.

Highlights of our foreign currency denominated issues in 2016:

- A 225 million pounds sterling Mortgage Pfandbrief placed in January 2016.
- A benchmark three-year Mortgage Pfandbrief for 600 million US dollars issued in July and carrying a coupon of 1.375 percent. This issue met with very strong international demand and was placed with investors located in 14 countries on three continents. About three-quarters of the volume issued were bought by supranational institutions, state-owned funds and agencies.
- In addition, we repeatedly issued Mortgage Pfandbriefe denominated in Swiss francs, including a 2-year Mortgage Pfandbrief with a volume of 200 million Swiss francs and a coupon of 0.01 percent.

MünchenerHyp received the Deal of the Year Award from mtn-I, a well-known international data platform for fixed-income securities, for the last mentioned Mortgage Pfandbrief in Swiss francs.

The total volume of issues placed in 2016 amounted to almost € 5 billion, of which Mortgage Pfandbriefe accounted for € 2.8 billion in covered refinancing, while unsecured bonds totalled € 2.1 billion. Due to the direction of MünchenerHyp's business strategy the Bank did not issue any Public Pfandbriefe.

ASSET, FINANCIAL AND EARNINGS SITUATION

BALANCE SHEET STRUCTURE

The unbroken strength of our new business results led to an increase in total assets which rose from € 38.1 billion on 31 December 2015 to € 38.5 billion at the end of 2016.

During the course of the year our mortgage loan portfolio grew by € 2.2 billion to € 27.8 billion.

Private residential property loans were once again the strongest growing area of business and increased by € 1.8 billion.

PORTFOLIO DEVELOPMENT MÜNCHENERHYP
2012 – 2016
in € million

The item "Other liabilities to customers" is structured as follows:

	Remaining term < one year	Remaining term > one year	Total
	in € 000	in € 000	in € 000
Other liabilities to customers as of 31.12.2016	**1,312,843**	**2,184,659**	**3,497,502**
Registered bonds	**9,994**	**1,199,621**	**1,209,615**
of which institutional investors	9,985	1,198,621	1,208,606
Promissory note loans on the liabilities side	**930,401**	**952,038**	**1,882,439**
of which institutional investors	733,805	940,838	1,674,643
Other	**372,448**	**33,000**	**405,448**
of which institutional investors	355,272	33,000	388,272

Our portfolio of private residential property loans is structured as follows: domestic mortgage loans € 15.9 billion (previous year € 14.4 billion), foreign mortgage loans € 4.2 billion (previous year € 3.9 billion), which were solely loans made to finance residential property in Switzerland.

Our portfolio of commercial property loans amounted to € 7.7 billion (previous year € 7.3 billion), of which € 1.7 billion (previous year € 1.7 billion) represented loans made outside of Germany. Property we financed in the USA accounted for 13 percent (previous year 22 percent) of the total, with EU countries accounting for the remainder.

In accordance with our business and risk strategy, our portfolio of loans and securities related to our business with the public-sector and banks declined further from € 8.2 billion to € 6.8 billion, of which € 2.9 billion were securities and bonds.

At the end of 2016 the net sum of unrealised losses and unrealised gains in our securities portfolio amounted to plus € 41 million (previous year plus € 34 million). These figures include unrealised losses of € 6 million (previous year € 10 million) stemming from securities issued by countries located on the periphery of the euro area and banks domiciled in these countries. The total volume of these securities amounted to € 0.6 billion (previous year € 0.9 billion).

Following a detailed examination of all securities we came to the conclusion that no permanent reductions in value are required.

We are keeping these bonds on our books with the intention of holding them until they mature. Write-downs to a lower fair value were not necessary.

The portfolio of long-term refinancing funds increased by € 0.6 billion to € 32.7 billion, of which € 20.3 billion consisted of Mortgage Pfandbriefe, € 4.7 billion of Public Pfandbriefe and € 7.7 billion of unsecured bonds. The total volume of refinancing funds – including money market funds – rose from € 35.4 billion in the previous year to € 35.8 billion on 31 December 2016.

Paid-up capital increased by € 250.7 million to € 956.0 million. Total regulatory equity capital amounted to € 1,343.1 million (previous year: € 1,372.0 million) and was slightly below the previous year's figure. The reduction does not affect the elements which count towards Common Equity Tier 1 capital.

Our Common Equity Tier 1 capital increased from € 979.6 million in the previous year to € 1,251.3 million. On 31 December 2016 the Common Equity Tier 1 capital ratio was 22.9 percent (previous year 17.3 percent), the Tier 1 capital ratio was also 22.9 percent (previous year 19.5 percent) and the total capital ratio was 24.5 percent (previous year 24.2 percent). The leverage ratio was 3.35 percent on 31 December 2016.

DEVELOPMENT OF EARNINGS

Net interest income[1] improved by € 11.9 million, or 5.4 percent, to € 233.4 million as we were able to increase this figure as predicted. This rise was due, in particular, to the continuing success and further expansion of our new business results during the year under review. This figure also contains a single-digit million euro income figure generated by the early termination of interest rate swaps.

Commissions paid amounted to € 82.4 million, or 8.8 percent higher than the previous year's figure. Commission income fell to € 8.2 million making the net commission balance[2] a minus € 74.2 million following a minus € 66.8 million in the previous year.

This resulted in net interest income and net commission income[3] of € 159.2 million, an increase of € 4.5 million, or 3 percent.

General administrative expenses rose by € 3.7 million to € 86.1 million. Personnel expenses increased by € 1.4 million or 3.2 percent.

The other administrative expenses rose by € 2.3 million, or 5.8 percent. The European banking levy was the main reason for the increase, as the percentage we claimed for irrevocable payment obligations declined. This figure was 30 percent in 2015 and only 15 percent in 2016. Payment of the banking levy, which is recognised as an expense, amounted to € 11.6 million for the year under review (previous year 8.6 million).

After adjustments for costs related to the banking levy, as well as expenses related to obligations stemming from various German and European supervisory authorities, which again increased, the remaining administrative expenses fell by 3.3 percent.

Depreciation and write-downs of intangible and tangible assets amounted to € 6.2 million or € 0.3 million less than the same year-ago figure.

Total administrative expenses[4] amounted to € 92.2 million, compared to € 88.9 million in the previous year. The cost-income ratio[5] excluding interest expenses from silent participations was 56 percent (previous year 52 percent).

The net sum of other operating expenses and income amounted to minus € 3.5 million.

This led to results from operations before deducting provisions for risk[6] of € 63.5 million, or 3 percent more than the previous year's figure.

The item "Write-downs on and adjustments to claims and certain securities and additions to provisions for possible loan losses", totalled minus € 7.9 million after allocations to reserves pursuant to Article 340f of the German Commercial Code. The credit risk situation remained unremarkable. Additions to provisions for risk in the lending business (including direct write-downs) amounted to a minus € 16.4 million (previous year minus € 18.4 million). Net income derived from the redemption and the sale of securities held as current assets, as well as promissory note loans, amounted to € 20.7 million. This item contains an inflow of € 20.1 million stemming from a settlement reached with the government of Austria regarding HETA Asset Resolution AG.

The item "Income from reversals of write-downs on participating interests, shares in affiliated companies and securities treated as fixed assets" amounted to plus € 11.7 million. This figure is primarily the result of proceeds from the sale of securities held as fixed assets.

Prior to the transfer of funds to the Fund for General Banking Risks pursuant to Art. 340g of the German Commercial Code, results from operations after deducting provisions for risk amounted to € 67.3 million. After transferring € 7.0 million to the Fund for General Banking Risks, and a tax expense item of € 28.4 million,

1) Net sum of Income Statement items 1 to 4
2) Net sum of Income Statement items 5 and 6
3) Net sum of Income Statement items 1 to 6
4) Net sum of Income Statement items 8 and 9
5) Percentual share of administrative expenses of net interest income and netcommission income excluding € 5.6 million in interest expenses stemming from silent participations
6) Net sum of Income Statement items 1 to 10

annual net income amounted to € 31.9 million, which is 44 percent higher than the same year-ago figure.

This performance enabled us to increase our net income for the year as predicted. We are satisfied with the way our business developed.

RATING, SUSTAINABILITY AND REGULATORY CONDITIONS

RATING

After the rating agency Moody's raised its ratings for our senior unsecured liabilities from A2 to A1 in January 2016 along with its rating for long-term deposits from A2 to Aa3, no further changes to our ratings took place over the remaining course of the year.

Moody's saw no need to make changes as the effects it had previously noted were still valid. The agency continued to acknowledge that the risk content of MünchenerHyp's loan portfolio had improved as the Bank had notably reduced its portfolio of loans originated in countries within the euro area that had been harder hit by the debt crisis, as well as its portfolio of loans to banks domiciled in these countries, and also its portfolio of loans originated within the USA. Furthermore, Moody's again favourably commented that MünchenerHyp had a solid reputation in the capital markets as an issuer of Pfandbriefe and thus a correspondingly high level of refinancing strength. The Bank's firm ties and support within the Cooperative Financial Network were also favourably noted by the agency.

Moody's continued to favourably point out that MünchenerHyp's increase in equity capital had enabled the Bank to meet the leverage ratio requirement.

Current ratings at a glance:

	Rating
Public Pfandbriefe	Aaa
Mortgage Pfandbriefe	Aaa
Senior unsecured liabilities	A1
Short-term liabilities	Prime-1
Long-term deposits	Aa3

The outlook for all ratings is stable.

The quality of the cover pool plays a greater role in ratings for Pfandbriefe since the agency revised its rating methodology in 2015. Even to achieve its highest rating of Aaa, Moody's only requires that legal requirements are observed, thus voluntary provision of surplus cover is not required.

Our long-term unsecured liabilities are rated AA- by the rating agency Fitch due to the group rating assigned to the Cooperative Financial Network by the agency.

SUSTAINABILITY

During the year under review we continued to make further progress in anchoring sustainability in our core business. In particular, we integrated additional ecological and social sustainability criteria in our loan processing and IT systems.

Our sustainability ratings developed favourably. The rating agency oekom research rated MünchenerHyp as one of the three best banks in the category of "Financials/Mortgage and Public Sector Finance". In June 2016 the agency raised our overall rating from C to C+. The Bank's ecological commitment was rated B-, while its social commitment earned a C+. In addition, oekom research confirmed MünchenerHyp's "Prime Status". The primary reasons given for the improved rating were the quality of the social and ecological aspects of the Bank's loan portfolio, as well as the responsible relationships with customers, and the Sustainability Loan that was introduced in 2015.

The rating agency imug confirmed our sustainability ratings in December 2016 with an unchanged "very favourable" for our Public Pfandbriefe, and "favourable" for our Mortgage Pfandbriefe and unsecured bonds.

The development our sustainability ratings since 2014 at a glance:

	2014	2015	2016
oekom research	C	C	C+
imug	Public Pfandbriefe: very favourable Mortgage Pfandbriefe: neutral Unsecured bonds: neutral	Public Pfandbriefe: favourable Mortgage Pfandbriefe: neutral Unsecured bonds: neutral	Public Pfandbriefe: very favourable Mortgage Pfandbriefe: favourable Unsecured bonds: favourable
Sustainalytics	**47 of 100 points**	**57 of 100 points**	**57 of 100 points**

REGULATORY CONDITIONS

BASEL III

MünchenerHyp uses the Internal Ratings Based Approach (IRBA) to calculate its equity capital requirements.

The Liquidity Coverage Ratio (LCR) was comfortably met throughout the entire year with figures considerably higher than 100 percent. Furthermore, the Net Stable Funding Ratio (NSFR) was also continually over 100 percent.

Within the framework of Basel III a leverage ratio will be introduced and set at 3 percent for the entire nominal volume of loans made by a bank in relation to its equity capital. Up until now this ratio only had to be reported. However, banks will have to observe this new requirement starting 1 January 2019. As a result of the successful additional increase in Common Equity Tier 1 capital during the year under review, MünchenerHyp's leverage ratio stood at 3.35 percent at the end of 2016.

The Basel Committee on Banking Supervision (BCBS) is currently negotiating new standards for capital rules for credit institutions. These are referred to as Basel IV within the banking sector. The committee is aiming to adopt these new regulatory standards as soon as possible, and is especially focused on revising the standard approach, as well as the internal approaches used to calculate risk weight for credit risks, establishing a binding definition of a new standard approach for operational risks, and the use of floors to limit the effects of internal approaches compared to standard approaches. It remains to be seen just how pronounced the changes will be. The current proposals regarding the required level of underlying equity for loans, however, indicate that banks operating with a low level of risk, like MünchenerHyp, in particular, will be impacted by the planned increases. Based on our very good level of capital we do not expect that we will have to raise additional equity capital.

We are attentively following current discussions and publications of various authorities regarding regulatory requirements. It is difficult to comprehensively prepare to meet future requirements at this time as widely varying positions are still regularly held by the different institutions involved in the current discussions at national, European and international levels. For this reason, we will continue to prepare to the greatest extent possible, although we will wait until the final version of the individual rules have been approved before we begin to implement them. As the example of LCR showed, significant changes can still occur during the proceedings. We therefore believe it is necessary for the regulators to provide an appropriate amount of time – especially IT requirements – for implementation purposes.

All regulatory issues were, and are being, monitored by a central unit within MünchenerHyp and implemented by the affected departments in various projects. Up until today all of the requirements have been implemented on time. The enormous flood of new requirements mandated by the supervisory authority does, however, generate significant costs and requires us to continually create new plans to utilise the Bank's tight resources.

SINGLE SUPERVISORY SYSTEM FOR EU BANKS

The ECB again conducted its Supervisory Review and Evaluation Process (SREP) in 2016 that carefully examines a bank's business model, its internal governance as well as its available capital and liquidity. The results were again presented as a score. The score indicates if additional equity capital or and liquidity is needed. The results of the SREP for MünchenerHyp revealed a mandatory minimum required ratio of 7.25 percent for the Bank's Common Equity Tier 1 capital, which was very significantly exceeded by 15.6 percentage points on 31 December 2016.

MINIMUM REQUIREMENTS FOR RISK MANAGEMENT (MaRisk)

No changes have been made to the MaRisk since 15 December 2012. The long-discussed amendment remained unapproved in 2016. As a result, no changes had to be made to MünchenerHyp's proven processes.

RECOVERY PLAN

The Recovery Plan was updated in December 2016. Only minor adjustments were necessary.

MAIN OFFICE, BODIES, COMMITTEES AND PERSONNEL

MAIN OFFICE

Münchener Hypothekenbank eG's main office is in Munich. In addition, the Bank maintains a branch office in Berlin, and also has ten regional offices.

BODIES AND COMMITTEES

The Delegates Meeting elected Dr. Hermann Starnecker, Spokesman of the Board of Management of VR Bank Kaufbeuren-Ostallgäu eG, as a new member of MünchenerHyp's Supervisory Board.

At the end of Delegates Meeting the previous Chairman of the Supervisory Board, Konrad Irtel, former Spokesman of the Board of Management of the Volksbank Raiffeisenbank Rosenheim-Chiemsee eG, and the Deputy Chairman, HSH Albrecht Prince of Oettingen-Spielberg stepped down as scheduled from the Supervisory Board due to age reasons. Wolfhard Binder thanked Konrad Irtel and HSH Albrecht Prince of Oettingen-Spielberg for their dedication and efforts during a period marked by extensive turmoil from which MünchenerHyp emerged even stronger than before.

In its subsequent constituent meeting the members of the Supervisory Board elected Wolfhard Binder, Chairman of the Board of Management of the Raiffeisen-Volksbank Ebersberg eG, as their new Chairman and Dr. Hermann Starnecker as his Deputy.

Due to MünchenerHyp's successfully implemented growth strategy the number of employees has grown strongly in recent years and currently the Bank sustainably employs more than 500 persons. This means that the Bank is now subject to the terms of the One-Third Participation Act (Drittelbeteiligungsgesetzes). For this reason, the Delegates Meeting resolved that in the future MünchenerHyp's Supervisory Board will consist of twelve members of which eight members of the Supervisory Board will be elected by the shareholders side and four members of the Supervisory Board will be elected by the employees. The four members representing the employees were elected on 12 July 2016.

On 14 March 2017 the Supervisory Board appointed Dr. Louis Hagen to be the Chairman of the Board of Management, he had previously served as the Spokesman for the Münchener Hypothekenbank's Board of Management.

The terms of office of MünchenerHyp's delegates ended during the year under review. The members of the Supervisory Board and the Board of Management thanked the delegates for their commitment and constructive collaboration. They actively supported the Bank's course in recent years and contributed towards enabling the Bank to successfully master the major challenges posed by the markets and banking supervision. Eighty new delegates – previously 52 – and 15 new alternate delegates – previously 10 – were elected following the Delegates Meeting.

EMPLOYEES

Following numerous years of intensive personnel expansion, the rising number of employees slowed during the year under review. Nevertheless, recruiting and, above all, the integration of new employees remained focal points of our personnel work. Between 1 January and 31 December 2016 a total of 105 personnel requirements were submitted from various departments consisting of 34 additional and 71 replacement requirements. In comparison to the previous year MünchenerHyp's employee fluctuation figure rose to 5.4 percent (2015: 4.7 percent). However, when compared to the average percentage (2015: 6.7) for the sector, our figure remained at a low level.

Integration and development of personnel continued to gain importance at the Bank in light of the more than 200 new employees we hired in recent years. The key elements in this area are the internal and external opportunities to advance employee skills and knowledge, as well as other personnel development and loyalty measures.

The average number of persons employed[7] by MünchenerHyp during the year was 493, plus 15 apprenticed trainees. The average number of years of employment per employee rose to 11.4 years.

CORPORATE GOVERNANCE STATEMENT PURSUANT TO ART. 289a GERMAN COMMERCIAL CODE

The German "Act on Equal Participation of Women and Men in Executive Positions in the Private and the Public Sector" became law on 1 May 2015. As the MünchenerHyp Supervisory Board was altered in 2016 to comply with the terms of the One-Third Participation Act (Drittelbeteiligungsgesetzes), the Supervisory Board passed a resolution on 17 October 2016 defining a quota for women represented on the Supervisory Board, the Board of Management and the top two executive levels below the Board of Management. The quota for all levels is 20 percent and 33 percent for the Board of Management. Independent of this new law, MünchenerHyp considers itself to be a modern enterprise as reflected by its social, cultural and business values and views the promotion of the underrepresented gender as a natural element of its embedded leadership culture.

7) Number of employees pursuant to Art. 267 (5) German Commercial Code (HGB): Excluding apprenticed trainees, employees participating in parental leave, early retirement, partial retirement (non-working phase), or employees suspended with pay.