
Münchener

Management Report.

MANAGEMENT REPORT 2016

ECONOMIC REPORT

RISK, OUTLOOK AND OPPORTUNITIES REPORT

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.

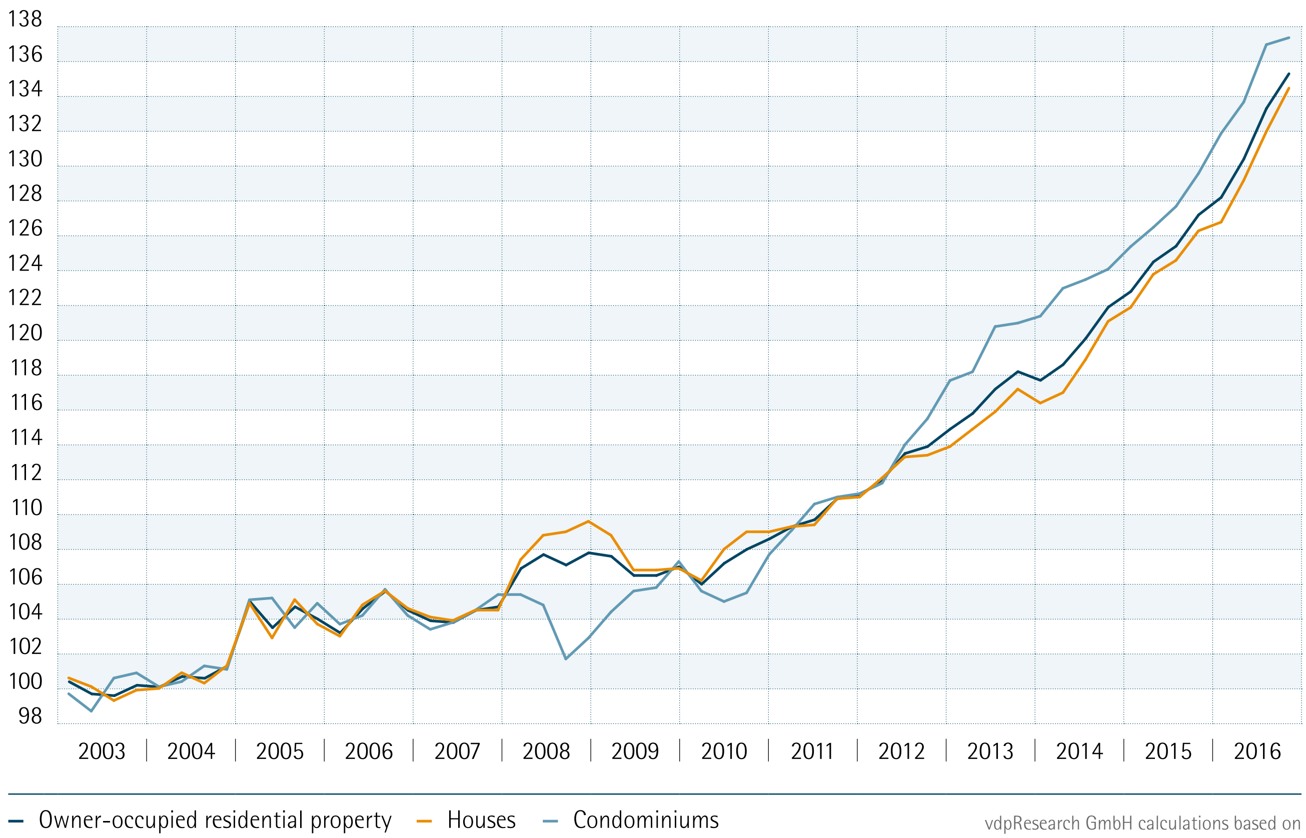
The volume of new issues declined due to the ECB's longer term financing operations, and regulatory pressures on banks to lower the volume of low-margin public-sector loans on their balance sheets. Furthermore, issuing activities also declined due to political uncertainties. However, the year's issuing 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

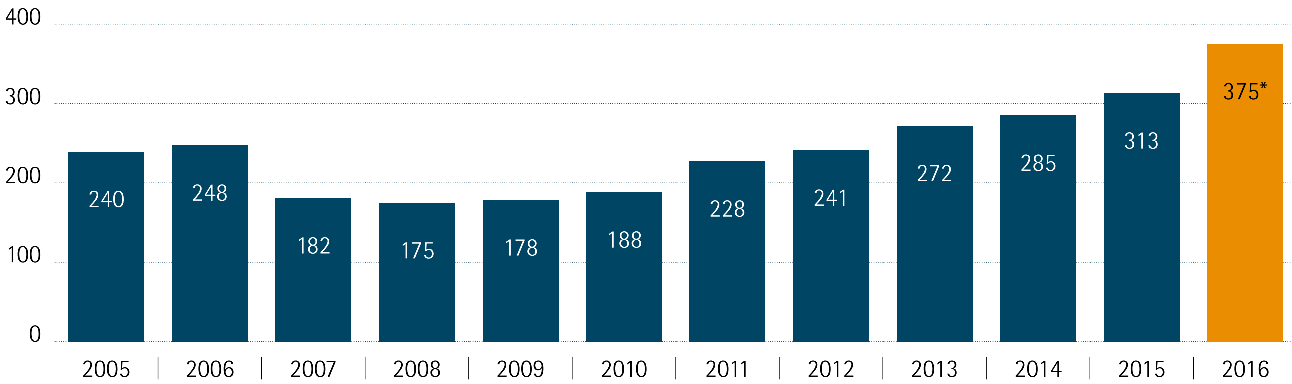
The dynamic pace of the upswing in the German residential property market increased further in the previous year. Purchase prices paid for houses and apartments rose faster than in 2015. According to the Association of German Pfandbrief Banks' (vdp) index for residential property prices rose by 6.6 percent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

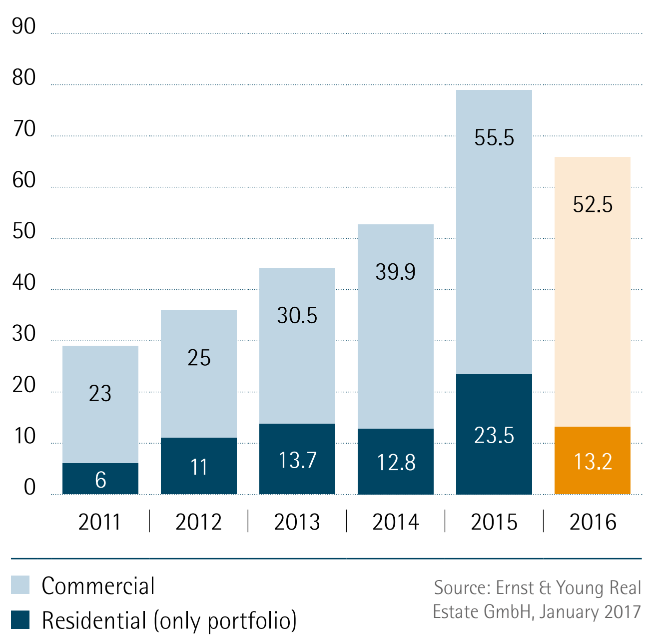
Development seen in the German commercial investment market since the end of the financial crisis has been marked by high, and rising, demand noted for all domestic and foreign institutional investor groups. However, the supply of suitable properties in the preferred investment segments is limited and 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.

MANAGEMENT REPORT 2016
RISK, OUTLOOK AND OPPORTUNITIES REPORT

RISK REPORT

The ability to monitor and keep risks under control at all times is essential for the successful steering of business development at MünchenerHyp. For this reason, risk management plays a very important role in the overall management of the Bank.

The business and risk strategy defines the parameters of the Bank's business activities. MünchenerHyp's entire Board of Management is responsible for this strategy, which is regularly reviewed regarding the attainment of goals and updated as necessary and then submitted to the Supervisory Board no less than once a year.

As part of its supervisory duties, the Supervisory Board is advised about the Bank's risk profile no less than on a quarterly basis and additionally as required. This takes place using the reports concerning the Bank's risk-taking capabilities, lending risks, as well as the risk report prepared in accordance with the "Minimum Requirements for Risk Management" (MaRisk).

The basis of risk management consists of, on one hand, the analysis and presentation of existing risks, and, on the other, comparing these risks with the risk cover potential (ability to bear risk). Furthermore, a series of additional relevant analyses are in place and only when they are viewed as a whole do they permit the Bank to be managed appropriately. This objective is achieved by employing appropriate monitoring processes involving internal process-dependent supervision measures. Our internal audit department, as a process-independent unit, plays an additional monitoring role within the Bank.

The analysis and presentation of existing risks primarily distinguishes between counterparty, market price, credit spread, liquidity, investment, modelling and operational risks. Additional risks such as placement risks, reputational risk, business risk etc., are viewed as parts of the abovementioned risks and are taken into consideration at the appropriate place in the individual calculations.

COUNTERPARTY RISK

Counterparty risk (credit risk) is of major importance for MünchenerHyp. Counterparty risk refers to the danger that counterparties may delay their payment obligations to the Bank, only make partial payments or even default.

The Credit Handbook presents the competencies and procedural requirements of the units involved in lending, as well as the approved credit products. The business and risk strategy contains additional explanations pertaining to sub-strategies regarding target customers and target markets, as well as definitions for measuring and controlling credit risks at the individual deal and portfolio levels. A procedure based on the credit value-at-risk (Credit-VaR) is used to determine lending limits. The individual contribution of every borrower (aggregate debtor or limit group as appropriate) – the Marginal Credit-VaR – to the Bank's total credit risk is limited. Furthermore, limits are also set for each country to ensure adequate regional diversification.

We take care to ensure that the vast majority of our mortgage business activities consists of top tier loans with moderate loan-to-value ratios. The current breakdown based on loan-to-value ratios is as follows:

TOTAL PORTFOLIO OF MORTGAGE AND OTHER LOANS (INCLUDING OPEN COMMITMENTS)				
MORTGAGE LENDING VALUE RATIO	31 Dec. 2016		31 Dec. 2015	
	€	relative	€	relative
Up to 60%	13,728,296,351.62	46.2%	13,271,710,357.89	47.9%
60.01% to 70%	5,677,718,196.80	19.1%	5,042,708,598.93	18.2%
70.01% to 80%	6,311,223,356.12	21.2%	6,073,353,119.95	21.9%
80.01% to 90%	2,154,390,691.97	7.3%	1,908,858,072.86	6.9%
90.01% to 100%	1,106,925,787.91	3.7%	780,335,345.71	2.8%
over 100%	711,366,203.19	2.4%	636,039,606.63	2.3%
without	25,419,250.26	0.1%	5,311,692.91	0.0%
Total	**29,715,339,837.87**	**100.0%**	**27,718,316,794.88**	**100.0%**

The regional breakdowns within Germany and abroad are as follows:

TOTAL PORTFOLIO OF MORTGAGE AND OTHER LOANS (INCLUDING OPEN COMMITMENTS)				
REGION	31 Dec. 2016		31 Dec. 2015	
	€	relative	€	relative
Baden-Wuerttemberg	2,616,357,406.41	8.8%	2,458,167,385.30	8.9%
Bavaria	5,646,905,936.17	19.0%	5,110,606,411.84	18.4%
Berlin	1,621,952,619.85	5.5%	1,608,952,190.17	5.8%
Brandenburg	490,537,743.87	1.7%	429,326,781.99	1.5%
Bremen	72,477,010.74	0.2%	64,728,357.23	0.2%
Hamburg	714,905,017.62	2.4%	734,733,778.71	2.7%
Hesse	1,616,366,977.79	5.4%	1,546,523,049.03	5.6%
Mecklenburg-Lower Pomerania	338,336,073.85	1.1%	274,672,252.37	1.0%
Lower Saxony	1,947,571,402.44	6.6%	1,810,173,371.57	6.5%
North Rhine-Westphalia	4,175,437,802.38	14.1%	3,880,816,308.44	14.0%
Rhineland-Palatinate	1,090,638,755.50	3.7%	895,637,075.59	3.2%
Saarland	224,663,431.89	0.8%	165,114,350.93	0.6%
Saxony	830,836,929.91	2.8%	775,623,988.84	2.8%
Saxony-Anhalt	432,564,548.35	1.5%	334,218,552.71	1.2%
Schleswig-Holstein	1,675,695,390.58	5.6%	1,641,592,673.04	5.9%
Thuringia	235,292,855.09	0.8%	220,928,993.69	0.8%
Total domestic	**23,730,539,902.44**	**79.9%**	**21,951,815,521.45**	**79.2%**

TOTAL PORTFOLIO OF MORTGAGE AND OTHER LOANS (INCLUDING OPEN COMMITMENTS)

SOVEREIGN STATE	31 Dec. 2016		31 Dec. 2015	
	€	relative	€	relative
Austria	129,371,291.34	0.4%	83,712,117.34	0.3%
France	306,183,794.26	1.0%	253,680,546.05	0.9%
Great Britain	389,373,033.56	1.3%	427,226,244.83	1.5%
Spain	187,861,502.87	0.6%	173,868,358.99	0.6%
Luxembourg	48,626,000.00	0.2%	48,626,000.00	0.2%
Sweden	0.00	0.0%	0.00	0.0%
Switzerland	4,321,626,705.80	14.5%	4,040,513,104.46	14.6%
The Netherlands	326,947,813.21	1.1%	281,486,842.93	1.0%
Belgium	49,976,456.52	0.2%	22,079,844.29	0.1%
USA	224,833,337.87	0.8%	435,308,214.54	1.6%
Total foreign	**5,984,799,935.43**	**20.1%**	**5,766,501,273.43**	**20.8%**
Total domestic and foreign	**29,715,339,837.87**	**100.0%**	**27,718,316,794.88**	**100.0%**

The management of credit risks begins with the selection of the target business when drafting the terms of the loan, using risk-cost functions that are regularly reviewed. A variety of rating or scoring procedures are used depending on the type and risk content of the transaction.

In addition, a computer-based early warning system is used to identify risks on a timely basis.

Property financing contains a broadly diversified portfolio of loans with emphasis on residential property financing and a credit approval process that has proven its value over many years as reflected in a portfolio with a low level of credit risk. Our lending business with public sector borrowers and banks is primarily focused on central and regional governments, regional and local authorities, and west European banks. It is a portfolio with little credit risk. Regional emphasis is on Germany or Western Europe respectively. Our objective for this portfolio is to further reduce its volume due to reasons such as the introduction of the leverage ratio. Highly liquid sovereign bonds and other very creditworthy securities will, however, continue to be needed in order to meet the new liquidity requirements mandated by Basel III.

Depending on their ratings, mortgage loans are examined to determine any non-performance or other negative factors which could trigger an individual adjustment to value. Furthermore, an additional system to monitor individual adjustment to value is used by the Bank's work-out management department, especially for the non-retail market business.

The Bank has created a general adjustment-to-value reserve as a precautionary measure to cover latent lending risks. This general adjustment to value is calculated per the terms contained in a Federal Ministry of Finance notice dated January 10, 1994.

Individual adjustments to value taken remained at a low level for our residential property financing business due to the great stability of the residential property market. This also generally applies for our commercial property financing business.

Business relationships with financial institutions are primarily based on master agreements that permit settlement of claims and liabilities (netting) vis-a-vis the other institution. In general, we also enter into security agreements. In the future we will use a so-called Central Counterparty (CCP) as the preferred basis for settling derivative trades.

The individual and general adjustments to value developed as follows in 2016:

TOTAL LENDING BUSINESS						
in € millions	Opening balance	Addition	Reversals	Utilisation	Changes related to exchange rate shifts and other factors	Closing balance
Individual adjust-ments to value	69.8	15.7	-4.8	-15.6	0.9	66.0
General adjustments to value	13.0	0.0	0.0	0.0	0.0	13.0

MARKET PRICE RISKS

Market price risks consist of the risks to the value of positions due to changes in market parameters including interest rates, volatility and exchange rates among others. These risks are quantified as potential losses of present value using a present value model that differentiates between risks related to interest rates, options and currency rates.

Interest rate risks are divided into two categories: general and specific interest rate risks. General interest rate risks refer to risks arising from changes in the market value of investments or liabilities that are dependent on the general level of interest rates, and which will react negatively if interest rates change.

Specific interest rate risks are also referred to as (credit) spread risks, and are included under market price risks. Credit Spread is the term used to describe the difference between the yield generated by a risk-less bond and a risky bond. Spread risks take into account the danger that this difference in interest rates can change although creditworthiness ratings remain unchanged. The reasons for altered yield premiums are:
- varying opinions of market participants regarding positions,
- the creditworthiness of the issuer actually changes although the issuer's credit rating does not yet reflect this change,
- macro-economic factors that influence creditworthiness categories.

The Bank's portfolio of bonds issued by euro area countries more heavily affected by the sovereign debt crisis, or in bonds issued by banks domiciled in these countries, remained at a moderate level. The Bank has not made any new investments in countries located on the periphery of the euro area since 2011. We do not believe that our investments are in danger of default. We are of the opinion that measures taken by individual countries, as well as protective mechanisms enacted at EU levels, are sufficient to ensure the repayment of the affected liabilities. In the case of bank bonds issued by banks domiciled in these countries, all of these bonds are covered bonds so that in this instance we also anticipate that they will be repaid as contractually agreed.

Among other risks, options involve the following risks: volatility risk (Vega; risk that the value of a derivative instrument will change due to increasing or decreasing volatility), time risk (Theta; is understood to the risk that measures how the passage of time impacts on the value of a derivative instrument), Rho risk (risk associated with a change in the value of the option due to a change in a riskless rate of interest), and Gamma risk (risk of a change in the option's Delta due to a change in the price of the underlying security; the option's Delta thereby describes the change in the price of the option due to the change in the value of the underlying security). The volume of risks assumed is moderate as options are generally not employed in the capital market business for speculative purposes. Option positions are generally entered into on an implied basis due to debtors' option rights (for example the right to give legal notice of termination per Art. 489 of the German Civil Code – BGB) and are then hedged if needed. These risks are attentively monitored in the daily risk report and are limited.

Currency risk defines the risk arising from changes in the market value of investments or liabilities dependent on currency exchange rates and which will react negatively due to changes in currency exchange rates. MünchenerHyp's transactions outside Germany are hedged against currency risks to the greatest extent possible and only margins involved in payment of interest are not hedged.

Stock risks are currently not relevant for MünchenerHyp as our total investments in this asset class – in addition to our investments in the Cooperative Financial Network – amount to less than € 5 million. The Bank plans to invest in a mixed fund (a special fund) in 2017. The specific content of the fund is still open. This investment will, however, increase our stock exposure.

Market price risks are managed by determining the present value of all of MünchenerHyp's transactions on a daily basis. The Bank uses the "Summit" IT programme for these calculations. The backbone of our interest rate risk management is the "bpV-vector", which is calculated on a daily basis. This figure is determined by the change in the present value incurred per range of maturities when the mid-swap curve is shifted by one basis point. Furthermore, sensitivities to currency exchange rates are identified by changes in the present value that occur with a 10 percent shift up or down in exchange rates, as well as the effect of volatility on the present value when volatility increases by 1 basis point.

MünchenerHyp uses the value-at-risk (VaR) figure to identify and limit market risks. Linear as well as non-linear risks are taken into consideration using a historical simulation when calculating VaR. In addition, different stress scenarios are used here to measure the effect of extreme shifts in risk factors and the effects of other risk categories.

The current (daily) stress scenarios are:

- Legal supervisory requirements: The current interest rate curve is completely parallel shifted up and down by 200 base points for every separate currency used. The worst result of the two shifts is used for calculation purposes.
- Parallel shifts: The current interest rate curve is completely shifted up and down by 100 base points across all currencies. The worst result of the two shifts is used for calculation purposes.
- Steepening/flattening: The current interest rate curve is rotated in both directions around the 5-year rate as the fixed point.
- Basis Spread Worst Case: A worst case scenario is used to quantify basis spread risks. The scenario analyses the effects of different developments in the basis curves on the portfolio of loans with variable interest rates.
- Historical simulations:
  - September 11, 2001 terror attack in New York: Changes seen in market prices between September 10, 2001 and September 24, 2001 – the immediate market reaction to the attack – are played out using the current levels.
  - The 2008 crisis in the financial markets: Changes in interest rates seen between September 12, 2008 (last banking day before the collapse of Lehman Brothers) and October 10, 2008 are played out using the current levels.
  - Euro-crisis: changes in interest rates that took place during the Euro-crisis between 21 May 2012 and 4 June 2012 are played out in this scenario. Interest rates fell sharply during this period.

The maximum Value at Risk (VaR) of the banking book (interests, currencies and volatilities) at a confidence level of 99 percent at a ten-day holding period in 2016 amounted to a maximum of € 78 million. The average figure was about € 44 million.

Due to the fact that MünchenerHyp is a trading book institution (only for futures) we also manage potential risks in this area on an intraday basis. Furthermore, these trades are also integrated into our normal reporting procedures. Once again, no futures deals were conducted in 2016.

MünchenerHyp manages its credit spread risks by calculating the present value of its asset-related capital market transactions on a daily basis along with credit spread risks. The Bank uses the Summit programme to calculate the Credit Spread VaR, the Credit Spread sensitivities and various credit spread stress scenarios.

MünchenerHyp uses the VaR figure to identify and limit credit spread risks. The VaR figure is calculated based on historical simulation.

The current (daily) credit spread stress scenarios are:

- Parallel shifts: All credit spreads are shifted up and down by 100 base points. The worst result of the two shifts is used for calculation purposes.
- Historical simulation of the collapse of the investment bank Lehman Brothers: the scenario assumes an immediate change

in spreads based on the changes that occurred one working day before the collapse of the investment bank until four weeks after this date.

- Flight into government bonds: The scenario simulates a significantly visible aversion to risk that was previously seen in the markets. Spreads for riskier classes of paper widen while spreads for safer government bonds narrow.
- Euro-crisis: The scenario replicates the development of spreads during the Euro-crisis that took place from October 1, 2010 and November 8, 2011. During this period the spreads of less creditworthy government bonds, in particular, rose sharply.

The credit spread VaR for the entire portfolio using a 99.9 percent level of confidence and holding period of one year stood at a maximum of € 109 million in 2016, while the average figure was about € 102 million.

The credit spread VaR for current assets (only third-party securities) using a 95 percent level of confidence and holding period of one year stood at a maximum of € 3 million in 2016, the average figure was about € 1 million.

LIQUIDITY RISKS

Liquidity risks consist of the following risks:

- inability to fulfil payment obligations when they come due (liquidity risk in the narrow sense),
- inability to procure sufficient liquidity when needed at anticipated conditions (refinancing risk),
- inability to terminate, extend or close out a transaction, or only be able to do so at a loss, due to insufficient market depth or market turbulence (market liquidity risk).

MünchenerHyp differentiates between short-term assurance of solvency and mid-term structural liquidity planning.

SHORT-TERM ASSURANCE OF SOLVENCY

The purpose of short-term assurance of solvency is to ensure that the Bank is fully able to meet its required payment obligations (payment willingness) as agreed on a daily basis, even during stress situations. All of the currently applicable legal supervisory requirements as defined by the terms of MaRisk and CRD IV, regarding liquidity reserves that must be held by banks, are being fully implemented.

In doing so, MünchenerHyp has categorised itself as a capital market oriented institution per the terms of MaRisk, and therefore also fulfils requirements pursuant to BTR 3.2.

MaRisk distinguishes between four different scenarios, which were implemented accordingly:

1) Base Case: corresponds to the bank's control case.
2) Bank stress: the reputation of the institution deteriorates, for example due to high balance sheet losses.
3) Market stress: Short-lived event that affects a segment of the financial markets. Examples of this are the September 11, 2001 terror attack, or the financial market/sovereign debt crisis.
4) Combined stress: Simultaneous occurrence of bank and market stress.

MaRisk demands that an institution must be able to meet the liquidity requirements arising from this scenario for at least 30 days.

Varying model assumptions for all important cash flows were derived for each scenario; for example utilisation of our liquidity lines or guarantees (Aval), utilisation of previously made lending commitments, or the development of collateral. Beyond this, all securities were divided into different liquidity categories. Based on this, we determined the volume that would be sold, over which time period, or could be used for a repo transaction, to generate additional liquidity in each individual scenario. Legal restrictions, like the Pfandbrief Act's 180 day rule, were always observed in all cases. The result is a day-certain presentation of the available liquidity for a three year horizon in three currencies: euro, US dollar, and Swiss francs. Positions in other currencies are negligible. Limitation in the stress scenarios takes place over a 90-day (yellow status) or 60-day (orange status) horizon, and in the base case over a one year (yellow status) or 90 days (orange status) horizon.

In addition, the Liquidity Coverage Ratio (LCR), including a forecast, pursuant to CRD IV is calculated at least once a week for all currencies, and presented separately for all relevant currencies. Currently, these currencies are the euro and the Swiss franc. The required ratio of 70 percent for 2016 was notably exceeded at all times.

MID-TERM STRUCTURAL LIQUIDITY PLANNING

The purpose of structural liquidity planning is to ensure mid-term liquidity. The legal basis consists of the MaRisk BTR 3 and CRD IV for the Net Stable Funding Ratio (NSFR).

Mid-term liquidity management in accordance to the terms of MaRisk is based on short-term liquidity management pursuant to the terms of MaRisk, which means that both procedures use the same scenario definitions and modelling assumptions. However, due to the longer observation period, additional modelling assumptions are also taken into account which are not essential for managing short-term liquidity – for example, new business plans or current expenses such as salaries and taxes.

Mid-term liquidity planning involves the following key liquidity figures as components for determining results across all due dates:

- accumulated total cash flow requirements,
- available uncovered and covered potential funding including planned new business and prolongations in line with the surplus cover requirements set by the rating agency Moody's,
- additional detailed data for planning and control activities.

The limitation of liquidity risks takes place using the structured liquidity forecast and the stress scenarios based on the available liquidity within a year.

In addition, pursuant to CRD IV, the NSFR is calculated on a quarterly basis for all currencies and presented separately for all relevant currencies; these are currently the euro and the Swiss franc. As the supervisory authority has not yet issued any binding plans for complying with NSFR requirements, and the values are currently relatively stable at just over 100 percent, this ratio is still not being actively managed at this time.

In order to reduce refinancing risks, MünchenerHyp strives to refinance loans with matching maturities and continuously checks if its relevant refinancing sources (primarily those within the Cooperative Financial Network) still remain available. In order to limit market liquidity risks in its lending business with public-sector borrowers and banks, MünchenerHyp primarily acquires securities that are acceptable as collateral by the ECB, and which can be used for open market transactions at any time.

MünchenerHyp does not have any investments in less liquid bonds, like Mortgage Backed Securities (MBS), in its portfolio.

INVESTMENT RISK

Investment risk is understood to mean the danger of financial loss due to a decline in the value of a holding to less than its book value. This refers to long-term investments MünchenerHyp has made in companies within the Cooperative Financial Network due to strategic reasons.

OPERATIONAL RISKS

Operational risks refer to possible losses caused by personal misconduct, weaknesses in process or project management, technical failure or negative outside influences. Personal misconduct also includes unlawful actions, improper sales practices, unauthorised actions and transaction errors.

We minimise our operational risks by qualifying our employees, using transparent processes, automating standard procedures, and by having fixed working instructions, comprehensive functional testing of the IT-systems, as well as appropriate emergency plans and preventive measures. Insurable risks are covered by insurance to the normal extent required by banks.

Within the framework of a risk analysis, the materiality in accordance with MaRisk standards of all of the services that MünchenerHyp outsources related to banking transactions, financial services or other services that are typical for an institution like MünchenerHyp, is examined. All of the outsourced services that are defined as being material are monitored pursuant to MaRisk requirements and are integrated within the risk management process.

ABILITY TO BEAR RISKS

The professional concepts and models used to calculate the Bank's ability to bear risks are continuously further developed in accordance with legal supervisory requirements. MünchenerHyp calculates its ability to bear risks based on the Going-Concern, as well as the so-called Insolvency Case scenario. However, the Going-Concern scenario is the relevant method used for control purposes, which determines if the bank would still have an adequate equity capital ratio exceeding legally required levels after the occurrence of risks contained in all of the risk categories.

The scenario deducts market risks, counterparty risks, operational risks, spread and migration risks, investment risks, property risks, as well as modelling risks containing other non-explicitly defined risks. Risks on cover potential for risks are accounted for on a conservative basis and without taking diversification effects between the risk categories into consideration.

The Bank's risk bearing capacity was given at all times during the year under review.

USE OF FINANCE 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. Credit derivatives are not employed. We use asset swaps as micro-hedges at the level of individual transactions. Structured fundamental transactions such as callable securities are hedged accordingly with structured asset swaps. Matching currency funding is primarily sought to hedge foreign exchange risks arising from transactions involving foreign currencies; the remaining deals are hedged using (interest rate) currency swaps. The main hedging instruments we use at the portfolio level are interest rate swaps and swaptions. In addition to linear instruments, Bermudan options on interest swaps (swaptions) and interest options (caps and floors) are also used as hedges for embedded legal termination rights or arrangements to limit interest rates.

ACCOUNTING-BASED INTERNAL CONTROL AND RISK MANAGEMENT PROCEDURES

The accounting-based internal control system is documented in organisational guidelines, descriptions of work processes, financial reporting handbooks, and numerous operating instructions. It contains organisational security measures, and ongoing measures and controls that are integrated in the work processes. These are, in particular, separation of functions, the double-check principle, access limitations, payment guidelines, new product and new structure process and balance confirmations. Process-independent measures are, above all, carried out by the internal audit department.

The risk management methods described in the risk report provide continuous qualitative and quantitative statements regarding MünchenerHyp's economic situation, including, for example, the development of performance. This evaluation involves aspects of all risk categories.

A close coordination process exists between the risk controlling and accounting departments at MünchenerHyp. This coordination process is supervised by the entire Board of Management.

The results from the risk management system form the basis for the multi-year planning calculations, year-end projections, and agreement procedures for approving the key figures generated by the Bank's accounting process.

CORPORATE PLANNING

MünchenerHyp continues to pursue a growth strategy focused on its residential and commercial property financing activities built on a solid refinancing foundation that is primarily based on Pfandbriefe and other bonds. The overarching strategic goal will continue to be the further strengthening of the Bank's earning power and thus its ability to retain profits. The Bank's strategic planning is focused on measures to improve net interest income and net commission income, increase cost efficiency, and keep risks under control.

The annual adjustment of our business and risk strategy required by the MaRisk defines the formal planning framework for this. Our integrated annual planning process plays a key role in the planning and management of our operations. This process synchronises our sales goals, management of the decentral and central components of our administrative expenses – including our project portfolio – with the outlook for the profit and loss account as it develops over the course of the year. All of the income and expense elements, as well as our ability to bear risks, are continually monitored, or additionally planned on a rolling basis, thereby allowing the Bank to respond appropriately and in a timely manner to fluctuations in earnings or costs.

Planning also includes issues regarding appropriate levels of equity capital – especially in view of meeting supervisory requirements.

OUTLOOK – OPPORTUNITIES AND RISKS

ECONOMIC DEVELOPMENT AND FINANCIAL MARKETS

Economic researchers anticipate that the global economy will grow slightly in 2017. The IWF is forecasting that the global gross domestic product will rise to 3.4 percent in the current year and to 3.6 percent in 2018. This increase is based on the assumption that economic development will pick up, especially in the USA and the emerging markets. The economic forecasts are, however, accompanied by great uncertainty. This applies in particular to the direction of the new American president's economic policies, which still remains unclear. His statements to date point towards a protectionist policy, which can have a negative effect on the American economy over the mid-term. Furthermore, the announcement that the British Prime Minister, Theresa May, will pursue a "hard Brexit" to take the UK out of the EU generated uncertainties concerning future economic developments in the EU and Great Britain.

Despite these uncertainties, economic experts still expect that growth in the euro area will not weaken substantially. The EU Commission predicts a 1.6 percent rise in the EU's GDP in 2017 and 1.8 percent in 2018 with a dampening effect expected, in particular, from high levels of debt in parts of the euro area. Moreover, inflation is expected to rise slightly as oil prices have rebounded in the interim period.

The German economy continues to benefit from strong domestic growth that is expected to carry the upswing into 2017. The German Federal Government's Annual Economic Report, however, anticipates that GDP will grow by a lower 1.4 percent. The report views the lower number of working days as the reason behind the decline and not a weaker economy. According to the report, both consumer spending and capital investments will act as primary growth generators with investments in residential housing construction, in particular, expected to expand. The labour market remains stable with the number of employed persons likely continuing to rise slightly while the unemployment rate could fall to below 6 percent. In addition, inflation is expected to rise to 1.4 percent due to higher prices for energy and food.

Central banks in the advanced economies will also act differently in 2017 as their monetary policies continue to drift further apart. While the Fed is expected to further raise its key interest rate, other central banks, and in particular the ECB, the Bank of England and the Bank of Japan, are expected to continue their expansive monetary policies in view of dampened economic prospects. If the rate of inflation in the euro area stays at the current higher level, it might generate discussions thereby increasing pressure on the ECB to alter its monetary policy regarding interest rates and taper its volume of bond purchases.

The improved outlook for the global economy, tapering discussions in Europe and the expected increase in interest rates in the USA could lead to a slight rise in the level of interest rates around the world and in turn also affect other asset classes. The foreign exchange markets are likely to see the gap between euro and dollar-based interest rates widen even further. However, during the second half of the year a countermovement could be seen if the ECB begins to retreat from its expansive monetary policy. It is anticipated that the British pound could again come under pressure at the start of Brexit negotiations and if the UK economy weakens as forecast. Development of the Swiss franc is expected to be stable to friendly and could benefit from possible political changes in Europe.

The first half of the year is likely to be quite lively for the covered bond and Pfandbrief markets as about three-quarters of the issues maturing in 2017 will come due in this period. Predictions call for a volume of about € 120 billion in benchmark covered bonds to be issued, a figure that is just below the level seen in 2016. The ECB's TLTRO-II Programme is one reason for this as it gives banks access to liquidity at comparatively favourable conditions. Demand for covered bonds will, however, continue to be supported by the ECB's purchase programme (CBPP 3). At a minimum, the ECB plans to pursue this programme until December 2017. This in turn will enable issuers to continue benefitting from favourable funding levels. Experts estimate that German Pfandbriefe will represent the biggest share of new issues followed by French, Spanish and Canadian covered bonds.

PROPERTY AND PROPERTY FINANCING MARKETS

The future development of property markets in Europe, and in particular in Germany, should be seen as being closely linked to political, monetary, and overall economic conditions. On the political side the very difficult to predict policy of the new American president, in particular, is a cause for concern among investors and companies. On the monetary policy side the ECB is not yet expected to depart from its low interest rate policy. This indicates that European and in particular German mortgage rates are only likely to rise marginally.

Despite political uncertainties, interest in property investments is likely to again remain at a very high level in across Europe and especially in Germany in 2017 due to low interest rates pressuring investments, as well as solid economic data. Development in regional markets will continue to be influenced by cross-border investments thereby reflecting the role of foreign investors who were responsible for about half of all property investments made in many countries in recent years.

The great interest shown by foreign and domestic investors in German property remains founded on the ongoing economic upswing, the country's image as a safer location for investments, and the attractiveness of the residential and commercial property markets. The top 7 cities will remain the preferred destinations for new investments while the very tight supply of good properties is likely to be mirrored in a slightly lower level of transactions. Experts are predicting that a volume of transactions within a range from € 60 billion to € 65 billion in 2017, with residential property portfolios accounting for € 10 to € 12 billion of this figure. Against this background it may be expected that returns will see a further slight decline associated with rising prices.

A stable rental market is one of the factors behind the strong interest in commercial property investments. Although market participants anticipate a slight decline in turnover of space in 2017, this change will, however, be solely due to a tight supply of marketable space. This is due to the likelihood that demand will remain high against the background of the good economy. New building activity will be at a similar level as in in 2016, although the pre-completion leasing rate will decline slightly. The combination of these individual factors will ease pressure on rents, which in turn will result in a slightly lower rate of growth on a year-over-year basis. As investor demand is expected to remain high, capital values of office properties should also rise slightly.

No signs are visible that the prevailing trend will change in the German residential property market in 2017 due to two reasons: first, capital investors and owner-occupiers will continue to strongly focus on residential property in view of very low interest rates and a slightly higher rate of inflation. Secondly, forecasts call for population growth in regions with strong and expanding economies at least until 2020, which in turn translates into unbroken high demand for housing.

Investments in housing will again increase notably in 2017. The Bundesbank anticipates growth of 3.7 percent. The number of building permits will also rise further. The Federal association of German housing and real estate enterprises (GdW) estimates that permits for about 400,000 housing units will be issued, a level that corresponds to the predicted number of units needed. This could slightly ease the pace of growth of housing prices and rents.

However, as prices continue rising in 2017 they will again be accompanied by discussions concerning possible formation of a property bubble in the German residential property market. Despite these worries, the risks of a bubble forming have not notably increased. This is particularly visible in the number of loans made and lending conditions. What has happened, however, is that the implementation of the Directive for residential property loans has actually placed greater demands on potential borrowers. At the same time, the faster rise of prices tends to be coupled with a danger of prices overheating in certain markets, making it necessary to continue closely monitoring this development.

Further developments in Great Britain will be influenced by the economic effects of Brexit, as its long-term impact on the property market still remains almost unpredictable. It is anticipated that the normalisation of the office property market will continue and the period of rising rents, especially in London, will be over for the time being. Furthermore, the future direction of prices in the residential property market is marked by uncertainty. It is expected that this will lead to growing hesitation among buyers and sellers. Forecasts for rents and purchase prices in numerous regions vary from no growth at all – for example in London – to even a slight contraction – for example in the North East.

The French residential and commercial property market is likely to continue the favourable development noted in the previous year into 2017 against the background of unbroken strong economic growth. This will generate additional momentum for the office properties market and be reflected by higher demand for office space. Vacancy rates for office space will decline further as new projects will only be completed if they have high pre-letting lease rates. This will continue the trend of slightly rising rents. For the investment market this development means that the appeal of French property will grow. At the same time it may be expected that globally active investors will shift their activities from Great Britain to France. This in turn is likely to generate notably higher demand for property and thus a further decline in returns. The French housing market is also anticipated to develop favourably. A slight rise in new construction activity is facing good demand supported by low mortgage rates. Therefore, rents and prices will rise.

Interest shown by institutional investors in the Netherlands will remain at a very high level in view of the expected continuing favourable economic development. Strong demand will be focused on business centres where the greatest increases in prices are expected to occur. Rents will record another increase as demand will be met by a further tightening of available space.

Experts anticipate that development in the Swiss residential property market will not differ a great deal from 2016. Unchanging low interest rates will keep demand for residential property high as investors also view it as a safe capital investment. The pace of growth in purchase prices and rents will slow once again, although regional differences will remain intact. Thus, prices for condominiums and single-family houses are predicted to rise slightly in the German-speaking part of Switzerland, while the decline in prices seen in western Switzerland is expected to lose momentum.

Forecasts for the future development of the commercial and residential property markets in the USA are clouded by the unchanging difficulty of understanding the direction of the new president's policies. However, no notable changes are expected for now in the office properties market, although in the interim a few American markets, especially Denver, San Francisco, Silicon Valley and Dallas, could have reached the end of a phase of rising rents. A slight decline is expected in the volume of investments, albeit from a still high level. Forecasts for the housing market tend to see it weakening with rents and purchase prices rising at a slower pace. At the same time, the completion of new housing units will reach its peak in 2017 thereby raising the risk of apartments remaining vacant, especially in the higher-priced segment of the market.

DEVELOPMENT OF BUSINESS AT MÜNCHENER HYPOTHEKENBANK

Our new business planning for the 2017 business year foresees interest rates remaining at a low level, although they could, however, rise marginally. In addition we also anticipate high demand for property financing in markets where we are present. As we noted in the previous chapter, we expect general economic conditions to be stable to favourable. Against this background we believe that our total new business performance will expand to some extent compared to the same figure for the year under review.

Our primary focus will remain on financing residential property in Germany via the banks within the Cooperative Financial Network – our key partners in this area of business. These banks have exceptional sales power and close relationships with their customers, two characteristics that have enabled them to steadily expand their market position in recent years. We anticipate that they will also grow faster than the market in the residential property financing sector in 2017. We will assist them by intensifying our sales support, in particular, and by further developing and optimising the brokerage process within the banking systems. These measures are intended to strengthen the perception of our partner banks as competent property financiers, thereby expanding the brokerage business.

We also want to intensify our collaboration with independent providers of financial services as well as with Swiss PostFinance. We plan to achieve a moderate increase in new business in both of these sales channels.

Our plans call for the volume of new commercial property financing business in 2017 to at least achieve the previous year's level. The prerequisites – unbroken investor interest and overall favourable conditions in our important markets – are in place for us to attain this goal. Furthermore, we intend to participate more heavily in domestic and international commercial property financing deals via the secondary market – and, in particular, again in the USA. Uncertainties are primarily due to the previously described political unknowns, which could make property investors more likely to act cautiously and hesitantly in 2017.

We expect that competition on the financing side of the commercial property business will remain tough in view of the predicted decline in the volume of transactions. As a result, both the pressure on margins and the willingness to accept greater risks will remain unchanged. We also believe that it is more likely that banks will be further burdened by regulatory requirements. These factors indicate that 2017 will again be a challenging year for the commercial property financing business. We will take these general conditions into consideration and take further advantage of the existing latitude we have regarding prices, and concurrently examine the chances of adding new products to our range of offers. We want to strengthen our presence in foreign markets, while in Germany – which will remain the focal point of our financing activities – we will reinforce the support we provide to our foreign investors. Beyond this we will expand the syndication programme within the Cooperative Financial Network. This programme assists and encourages banks within the Cooperative Financial Network to join us in financing commercial property transactions, thereby enabling them, and MünchenerHyp, to participate in additional deals and bigger volumes of financing.

The objective of our lending business with the public-sector and banks will remain unchanged and primarily serve to control liquidity and cover pools.

Our refinancing needs in 2017 are estimated to amount to € 7 billion, and thereby will be above the previous year's volume. We anticipate that we will float two large volume issues. Beyond these activities our focus will again be on issuing non-euro denominated securities for the purpose of achieving matching currency refinancing for our international business activities, especially our collaboration with Swiss PostFinance.

We plan to accept customer deposits from the Volksbanken and Raiffeisenbanken as part of our efforts to expand our refinancing mix. A corresponding product that meets the interests of the Cooperative Financial Network is currently being developed and should be offered during the remainder of 2017.

We want to further expand our sustainability activities. As part of these efforts we are currently developing a sustainability loan that is focused on social aspects. In addition, we want to integrate sustainability criteria even more strongly into our loan processing.

We are aiming to achieve a moderate increase in net interest income from business operations in 2017. The stable development in our core markets offers us unchanging opportunities to once again expand our new business and thus our portfolio of mortgage loans.

This will continue to have an increasingly favourable effect on the Bank's performance. As a result, we anticipate that our earnings will improve again in 2017.

We anticipate that our administrative expenses will increase slightly in 2017. Nevertheless, we currently expect that our cost-income ratio will decline slightly.

Based on the currently available information, we expect that provisions for lending risks will develop stably.

In view of the anticipated favourable market conditions, we are confident that we will achieve our objectives for the 2017 business year and further expand our market position. We expect that our net income will exceed the previous year's level.

DISCLAIMER REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements concerning future expectations and forecasts. These forward-looking statements, especially those pertaining to the development of MünchenerHyp's business and income, are based on our planned assumptions and estimates and are subject to risks and uncertainties. There are a number of factors that could affect our business and which are mainly beyond our sphere of influence. These include, above all, economic developments, the state and further development of the financial and capital markets in general and our refinancing conditions in particular, as well as unexpected defaults on the part of our borrowers. Therefore, the actual results and developments may vary from the assumptions that have been made today. For this reason they are only valid at the time this report was prepared.