MANAGEMENT REPORT 2017
ECONOMIC REPORT

OVERALL ECONOMIC CONDITIONS

ECONOMIC DEVELOPMENT

The upturn in the global economy accelerated in 2017 as the global gross domestic product increased by 3.7 percent, which was higher than the International Monetary Fund (IMF) anticipated at the start of 2017. The gain showed that the economy was largely unaffected by the numerous political uncertainties that marked global events during the year under review. This applied, in particular, to global trade, which expanded substantially.

During the course of the year economic development within the euro area became increasingly dynamic resulting in a 2.4 percent increase in gross domestic product. The upswing was mainly driven by rising exports as global trade picked up and domestic demand remained strong.

The German economy also flourished as its gross domestic product increased by 2.2 percent in 2017, which was a stronger gain than in the previous year. The strongest drivers were private consumption followed by public-sector investments, and capital expenditures. In addition, the export sector grew notably to make a favourable contribution to the economy. Investments in construction also developed favourably and increased by 2.6 percent. The greatest gain of 3.1 percent was noted by investments in residential housing. Investments in construction within the public sector rose by 2.7 percent while investments in construction of commercial property increased by 1.4 percent.

The annual average rate of inflation rose to 1.8 percent, the highest rate noted since four years. Energy prices grew by 3.1 percent and were the primary reason behind the increase. Furthermore, food prices were notably more expensive than they had been in the previous year.

Development seen in the labour market also reflected the favourable economy as the annual average number of employed persons rose by over 600,000 to 44.3 million. The unemployment figure fell further as the average number of unemployed persons reported was 2.5 million, or more than 150,000 less than in 2016. The unemployment rate fell by 0.4 percentage points to 5.7 percent.

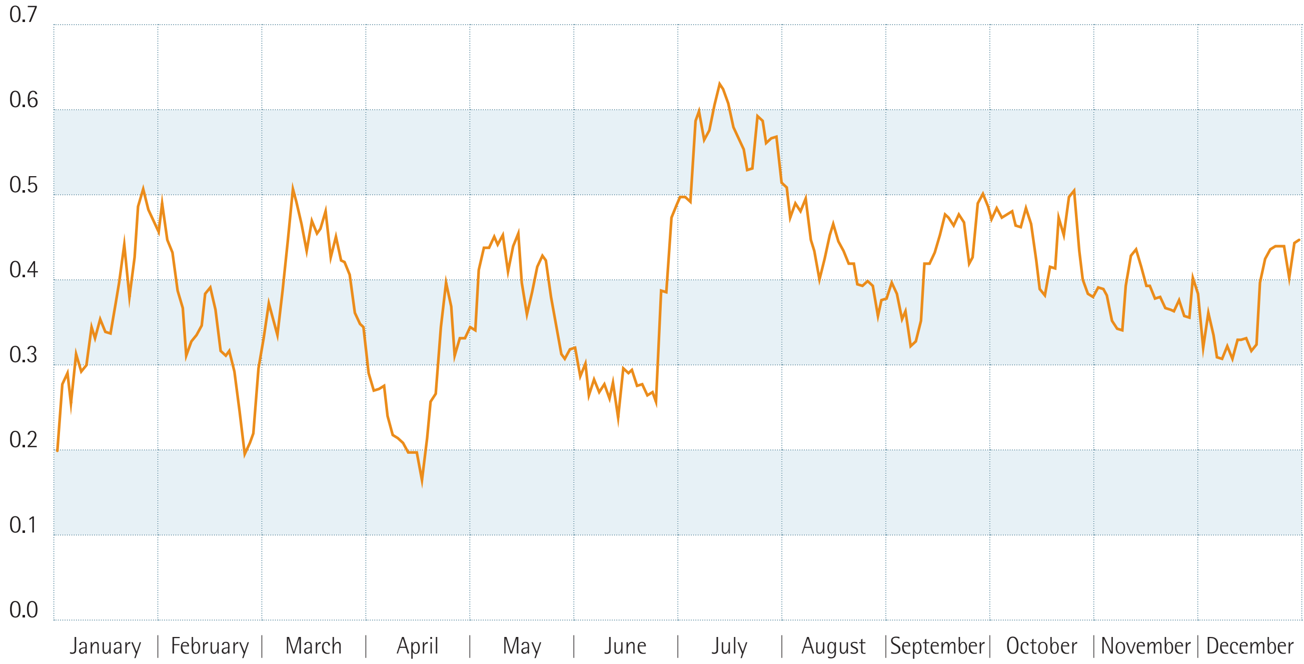
FINANCIAL MARKETS

Financial markets were supported by the unexpectedly favourable economic developments, as well as the central banks' unchanged generous provision of liquidity, and a better mood among market participants than in previous years.

During the course of the year the European Central Bank (ECB) nevertheless retained its expansive monetary policy and left its deposit facility rate for banks unchanged at minus 0.40 percent, while its interest rate on the main refinancing operations (MRO) held steady at 0 percent. Within the framework of its asset purchase programme the net amount of monthly purchases over the course of the year amounted to 60 billion euros per month. Additional important central banks, like the Bank of Japan, the Bank of England and the Swiss National Bank, also provided expansive liquidity in support of the economic recovery process. The policy followed by the American central bank, the Federal Reserve (Fed), diverged from the other central banks as the Fed further tightened its monetary policy during the year under review and raised its key interest three times by 25 basis points each time in light of the favourable development of the American economy. At the end of 2017 the Fed's decisions led to a federal funds rate corridor of 1.25 percent to 1.5 percent. Concurrently, the Fed began to reduce its balance sheet that had expanded due to its bond purchases.

The ECB's policy led to further declines in spreads versus swaps and a slight increase in yields in the bond market. Over the course of the year the yield on 10-year Bunds rose moderately from 0.20 percent to 0.42 percent and was primarily driven by adjusted expectations in light of the economic upswing in the euro area. Yields on longer term treasury bonds in the USA still remained stable despite increased interest rates. Shorter maturities moved in line with interest rates increases resulting in a notable flattening of the yield curve. Starting at the mid-year point capital markets increasingly believed that the ECB was really aiming to achieve normal conditions and not a further loosening of its monetary policy. In contrast, the ECB's continued purchases of sovereign bonds, covered bonds, corporate bonds and asset-backed securities supported these asset classes and in some instances resulted in a further tightening of spreads.

Figures in % | YIELD ON TEN-YEAR BUNDS 2017



Source: Bloomberg (closing rate)

In the currency markets the US dollar tended to weaken over the year despite the substantial increase in US money market interest rates and unbroken low euro rates. This development was in response to declining political risks and the surprisingly favourable development of the European economy. Over the course of 2017 the US dollar lost 14 cents to the euro and at the end of the year stood at 1.19 to the euro. The euro also posted significant gains over the Swiss franc during the year adding 9 percent to about 1.17 CHF. Although the British pound had already lost substantial value due to the Brexit decision it continued to weaken into 2017, albeit at a slightly slower pace. The improved outlook for an orderly Brexit had a stabilising effect on the pound in the second half of the year. Over the course of the year the pound fell by about 4 percent to end the year at 0.89 euro.

The covered bond market remained heavily influenced by the ECB's Covered Bond Purchase Programme (CBPP 3). About 30 percent of the volume of new issues was bought by the ECB. Although classical investors like banks, insurance companies and funds were active as buyers, the low level of interest rates and spreads limited their willingness to build new positions. Nevertheless, investments in covered bonds continued to benefit from their high credit standing and preferential regulatory treatment. The volume of new euro-denominated benchmark covered bond issues did, however, decline from € 127 billion in 2016 to € 112 billion in 2017, with a notable weakening seen in the second half of the year. French covered bonds represented 25.7 of the total volume of new covered bond issues in 2017 giving them the largest market share followed by German Pfandbriefe with 18.7 percent.

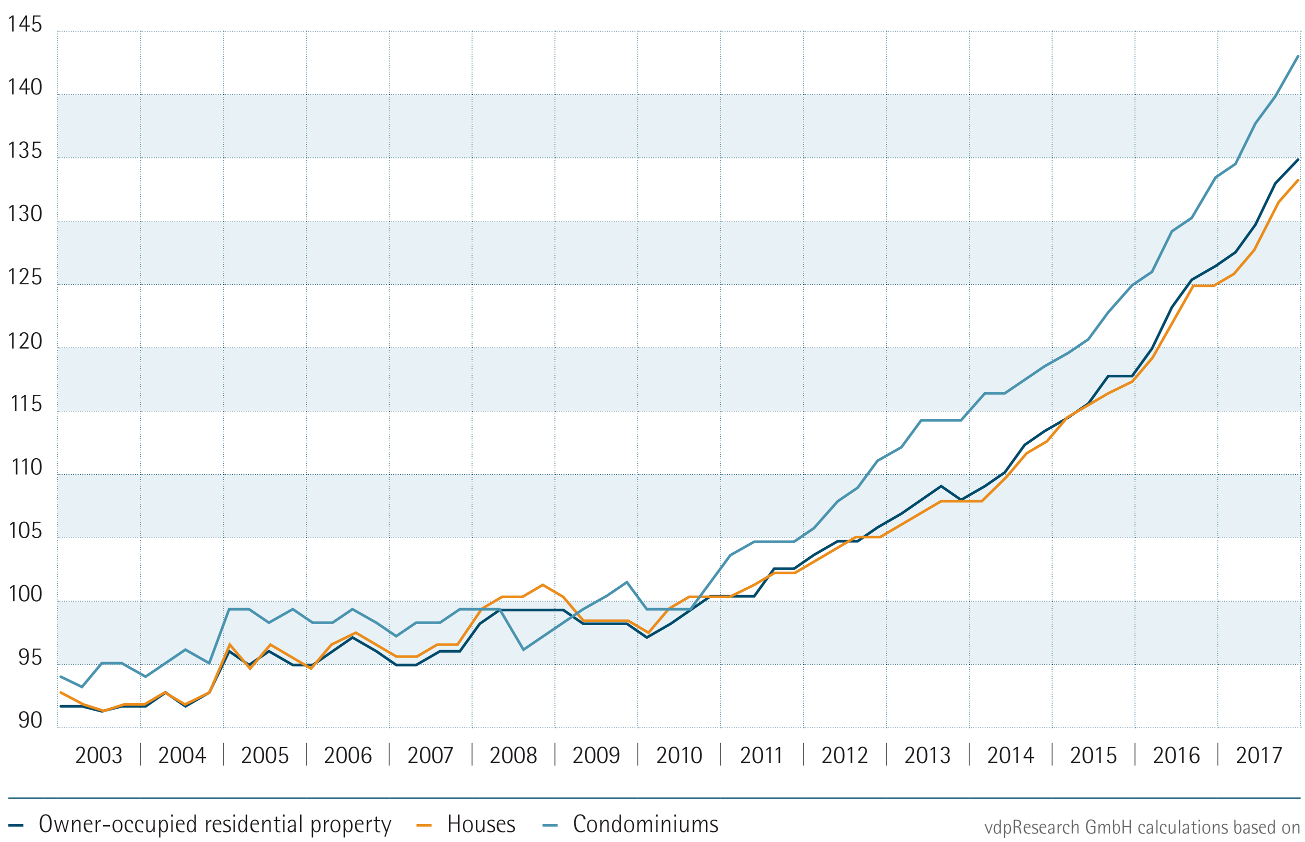
PROPERTY AND PROPERTY FINANCING MARKETS

RESIDENTIAL PROPERTY – GERMANY

The residential property market in Germany was again marked by rising purchase prices and rents in 2017. Prices accelerated even further compared to the previous year rising by 6.9 percent in 2017 according to the Association of German Pfandbrief Banks' (vdp) index for residential property prices. The strong 5.8 percent rise in prices affected owner-occupied residential property, as well as multi-family houses, which posted an increase of 7.9 percent.

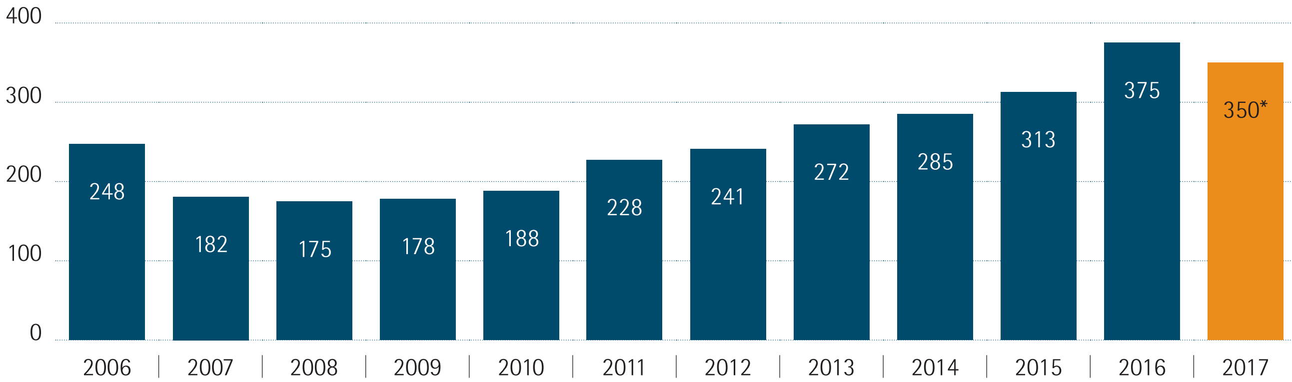
The pronounced increase in prices paid for multi-family houses was driven by high demand shown by institutional investors, which in turn led to a further decline in yields. A total of € 15.6 billion was invested in residential property portfolios in 2017, the third highest amount recorded within the last ten years. This segment of the market remained dominated by domestic investors with foreign buyers only representing 20 percent of the capital invested. Buying activity was focused on the seven biggest cities and major cities with above-average population growth as investors viewed these cities as offering the greatest market liquidity and thus the least risk. The availability of existing properties was tight across Germany. This led to a shift in investors' buying activities over to projects that were in the developmental stage. As a result, new construction developments represented about 30 percent of the total volume of transactions.

DEVELOPMENT OF PROPERTY PRICES IN GERMANY (YEAR 2010 = 100)



vdpResearch GmbH calculations based on information provided by vdp transaction databank
As of: February 2018

Figures in 000 | RESIDENTIAL BUILDING PERMITS IN GERMANY 2005 – 2017



* 2017 = estimated
Source: German Federal Statistical Office

The great interest shown in residential property in Germany – despite low yields – is due, in particular, to the situation in the rental housing market where shortages have existed for years in major metropolitan areas. The excess demand is due to the high number of persons moving to these regions, the current favourable income opportunities, as well as the significant increase in single-person households. This has led to rising rents, in particular, without higher yields as purchase prices have increased at a faster pace than rents. Based on vdp figures, the tempo of rental increases has slowed slightly to 3.2 percent, although it does continue to show that the situation in the rental housing market remains tight.

Although construction of new multi-family housing accelerated, the figures for newly completed housing still lags noticeably behind the number of newly issued building permits. In addition to the fact that the construction sector is operating at a high level of its capacities, it is thought that many building permits are being obtained without a specific intention to build. The total number of building permits issued by the end of November 2017 declined by 7.8 percent compared to the same year-ago period. This decline affected all segments.

Despite the very strong gains recorded for housing prices in many regions, high demand seen for houses and condominiums has also remained unchanged. Many private households would like to realise their hopes to buy their own home in view of low interest rates, the good employment situation and the favourable development of incomes. However, the number of transactions involving one and two-family houses barely changed in 2017. On average, about 250,000 private homes change hands every year indicating that there is a limited supply. Homeowners' willingness to sell was held back by a lack of investment alternatives and expectations that property prices will continue to climb.

New construction activity noted during the year under review was once again unable to keep pace with the high demand. Although the number of newly built homes has continually increased across the nation since 2010, and set a new 15-year record in 2017 with about 280,000 new housing units, it still lags behind actual housing needs. After taking into consideration various factors – above all migration to and within Germany, smaller households, and the backlog of demand for housing – Germany needs 350,000 to 400,000 new housing units per year.

Higher demand is primarily driven by fast growing regions and cities, which in turn have posted above-average strong price increases in recent years. According to figures released by vdp, residential property prices in the seven largest German cities rose by 13.7 percent in comparison to the previous year.

This was sufficient reason for the Bundesbank to closely examine development in cities and regions with very strong price growth in its latest Financial Stability Review. The study concluded that exaggerated prices exist in 127 German cities. However, the Bundesbank believes that threats to price stability still remain limited. This statement is based, in particular, on the slower pace of growth of loans for new housing, which is lower than the long term average rate. Furthermore, debt carried by private households showed a further slight decline and in 2017 and was substantially below the average figure in comparable economies. Another important aspect in the assessment was the unbroken trend of borrowers to obtain longer terms of fixed interest rate loans for financing housing, which also reduces their risk of fluctuating interest rates.

Competition among providers of private property financing increased even further. Enterprises within the Cooperative Financial Network, which include MünchenerHyp and its partner banks, held up well in this environment. As in previous years, the portfolios of residential property loans held by institutes within the Cooperative Financial Network expanded at a faster rate than the market.

RESIDENTIAL PROPERTY – INTERNATIONAL

In general, the residential property markets in Europe developed favourably, whereby the average increase in prices for all countries within the European Union (EU), as well as those within the euro area, strengthened again in 2017. The rise was driven by the favourable economic situation and the continuing low level of interest rates. Prices paid for houses in the EU in the third quarter of 2017 rose by 4.6 percent over the same year-ago period and by 4.1 percent in the euro area. Markets where a stronger pace of growth was noted include the Czech Republic, Ireland, Portugal, Hungary and the Netherlands, where double-digit percentage gains were recorded. Italy was the sole market where housing prices once again declined slightly.

The pace of rising prices for residential property in Great Britain weakened since mid-2016 as a consequence of the Brexit vote. However, in 2017 housing prices still increased by 5.2 percent over the previous year's figure, although there were notable regional differences. Prices in South West England grew by 7.5 while prices in London only increased by 2.5 percent. Furthermore, the volume of transactions fell by 6 percent in the same period of time. New construction of housing amounted to about 180,000 new housing units, which was substantially below the government's target of 275,000 housing units per year. The pace of growth noted in the private rental housing also slowed and the 1.1 percent increase noted was the lowest recorded since January 2012. London's increase of only 0.2 percent made it one of the weakest growing regions in the UK.

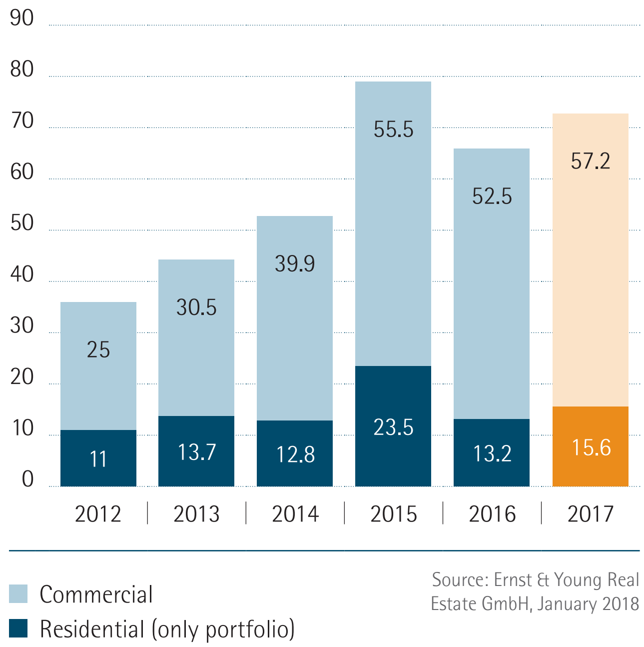
New construction of housing in France expanded notably in the past year as the number of housing units being built rose by about 15 percent to nearly 400,000 units or the highest level since 2011. At the same time, demand for housing was quite favourable in light of low lending rates. This development was also reflected in the number of new housing transactions, which climbed by 8 percent, and turnover of existing properties, which advanced by 9 percent. Prices paid for housing also rose. In the third quarter of 2017 prices of newly built properties rose by 3.6 percent over the same year-ago quarter, while existing properties were 3.9 percent more expensive. French residential property also gained in attraction by institutional investors, which in turn increased pressure on yields notably and especially for prime properties.

The Dutch housing market was driven by above-average economic growth, which was reflected by the very substantially higher figures recorded for the number and volume of transactions. A total of about 242,000 housing units changed hands in 2017, or about 13 percent more than in the previous year. The volume of transactions surged by 22 percent to nearly € 64 billion. Parallel to this development, prices paid for housing rose even further by 7.9 percent in comparison to the previous year's figure. This increase was driven by high demand that met a very limited supply. Excess demand was particularly visible in the four major population centres of Amsterdam, Utrecht, Den Haag and Rotterdam. Institutional investors also focused their demand on these four cities last year as they invested € 3.5 billion in residential property. Domestic buyers accounted for about two-thirds of the volume of transactions. The Dutch housing market as a whole was marked by a very tight supply of properties for institutional investors, which led to a further decline in returns.

Despite overall favourable economic conditions, growth noted for the Swiss housing market slowed over the course of the year. This is reflected by figures released by the Swiss Federal Statistical Office which showed that the number of vacant housing units stood at about 65,000 at mid-year 2017. This figure is nearly 15 percent higher compared to the previous year's figure, whereby the rental housing market was particularly affected. During the course of the year rents declined slightly, especially for units in the higher-priced segment. The level of prices paid for housing hardly changed on a year-over-year basis. Prices for condominiums rose by 1.9 percent and were only marginally higher than in 2016; prices for single-family homes grew at an unchanged 3.2 percent. Demand for residential property for personal use and as an investment remained high due to the Swiss National Bank's negative interest rates, as well as low mortgage rates.

The upswing in the housing market in the USA continued in 2017. In November of 2017 the S&P/Case-Shiller Index figures showed a 6.2 percent year-over-year increase in housing prices. Prices did, however, vary quite differently on a regional basis with the strongest growth again recorded in the Seattle region, while Chicago and Washington D.C. remained at the bottom of the list. The increase in prices is due to excess demand and insufficient construction of new housing. Rents developed less dynamically rising by 2.4 percent following the 3.8 percent increase recorded in the previous year. Investments in residential property also fell. During the first nine months of 2017 USD 94 billion, or 12 percent less, was invested than in the same year-ago period. This change indicates that for the first time since 2009 the volume of transactions may also be lower for the entire year.

DEVELOPMENT OF COMMERCIAL PROPERTY TRANSACTIONS IN GERMANY 2011 – 2017
Figures in € billion



Source: Ernst & Young Real Estate GmbH, January 2018

COMMERCIAL PROPERTY – GERMANY

German commercial property was again highly sought after by both national and international investors. This was, above all, due to the quality of Germany as an investment location, and not yields, as meanwhile returns on all asset categories are at historically low levels following above-average increases in prices seen in recent years. This was also the case in 2017 as the vdp index for commercial property rose by 6.5 percent on a year-over-year basis. This was the greatest increase in prices since the outbreak of the crisis in the financial markets.

The strong pace of growth noted for prices also led to a record volume of transactions in 2017. The figure if more than € 57 billion exceeded the top results recorded in 2015 by about 3 percent. Investors continued to focus on the seven biggest cities. Where € 31 billion were invested, or 54 percent of the total volume of transactions.

Office properties retained their preferred status as investments. This sector has held about a 44 percent share of the total volume of transactions for years and represents turnover of just about € 25 billion. The great popularity of office properties is based on the very good state of the rental market, which again set a new record in the past year with total turnover of about 4.2 million square metres of space in the seven biggest cities. The volume of newly completed properties was, however, lower compared to the previous year's figure. This led to a further decrease in available vacant space. At the end of 2017 the vacancy rate stood at the lowest level seen in the last 15 years. In the interim there is hardly any office space available in preferred office districts in the seven biggest cities, which in turn has driven rents for office space even higher. The greatest increase in rents was noted in Berlin. Moreover, rising rents and great investor interest accelerated the pace of rising prices for office properties. Based on vdp figures, prices for office properties rose by 8.4 percent in comparison to the previous year.

The popularity of logistics properties increased in the past year while interest in retail properties decreased slightly. Many investors are increasingly viewing retail properties more critically in view of the booming online shopping business and the very high level of prices demanded for retail properties, which has shifted investors' attention to other asset categories.

COMMERCIAL PROPERTY – INTERNATIONAL

The good overall economic conditions had a particularly beneficial effect on the European office property market. Turnover of space in the rental market increased by 10 percent to 13 million square metres, which was the best result noted since 2007. This rise was accompanied by a substantial reduction of vacant space, which declined across Europe to 7.4 percent. On average, rents in Europe rose by 4 percent due to the limited availability of space.

Following the sudden downturn after the Brexit decision, the commercial property market in Great Britain has regained its footing and is advancing notably once again. This is reflected by the 15 percent increase in the volume of investments made in 2017. Foreign investors dominated market activities and accounted for about three-quarters of the volume of transactions recorded for office properties in London. Furthermore, turnover of space increased by 7 percent shrinking the vacancy rate to 4.7 percent and below the 10-year annual average. The short-lived drop in rents that occurred the previous year was stopped in 2017 due to the good demand seen for office space. This made it possible for peak rents to end the year on a stable note.

The volume of transactions noted for the French investment market declined once again. During the first nine months of 2017 more than € 14 billion was invested in commercial properties, or about 30 percent less than in the same year-ago period. The drop was due to a lack of investment properties as investors were still very keen on buying. Yields fell further in view of this situation. Properties in the Île-de-France were the preferred choice of investors with a significant focus on office properties. The vacancy rate moved at the previous year's 6.7 percent level. Top rents paid for office space remained stable while average rents paid, however, rose to a level last seen in the year 2000.

The Dutch investment market ended the last year with record results as total turnover for properties amounted to € 19.5 billion. Foreign companies accounted for a major portion of the capital invested. The primary focus was on office properties followed at great distant second place by retail and industrial properties. The upturn in office properties continued in 2017 and led to a substantial increase in rents. Amsterdam posted the highest rate of growth in Europe. The vacancy rate for office space fell reflecting the extremely favourable development of the economy.

The volume of transactions recorded for the American investment market declined again as foreign investors were less active. At mid-year point in 2017 volume was 14 percent below the same year-ago level. As the most important investment location in the USA, New York was particularly affected by this development as the volume of transactions recorded fell by half. In contrast, investors significantly expanded their activities in Boston, Washington D.C. and Los Angeles. The rental market is already in an advanced phase of its cycle, as reflected in the notable weakening in the growth of rents. Office properties were also the most important asset class in the USA and demand for office space was robust. The average rent paid for office space rose by 2.7 percent on a year-over-year basis. Nevertheless, the vacancy rate for office space rose slightly due to brisk new construction activities accompanied by a lower rate of pre-completion leases signed.

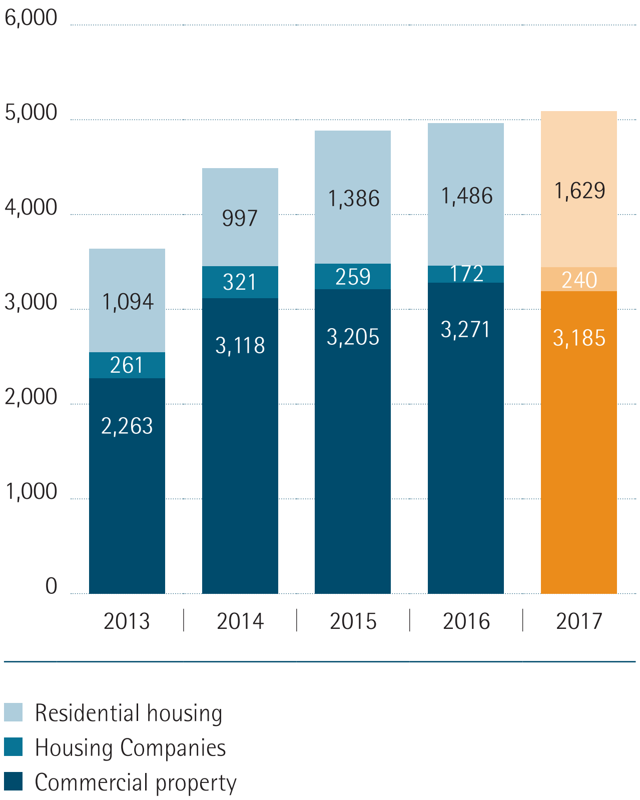
BUSINESS DEVELOPMENT

NEW MORTGAGE BUSINESS

MünchenerHyp set a new record in 2017 as our volume of new mortgage business exceeded € 5 billion for the first time. Our new business grew by 2.5 percent as we made € 5.1 billion in lending commitments (previous year € 4.9 billion), thereby reflecting a slightly faster pace of growth in our business.

Both of our main areas of business, private and commercial property financing, benefited from the good environment for property and the associated high demand for property financing seen during the year under review. For this reason, we are very satisfied with the development of our new business activities, which were able to expand as forecast

MÜNCHENERHYP NEW MORTGAGE BUSINESS
2013 – 2017
Commitments in € million



We were able to sustain our new business performance in the private property financing area at the previous year's very high level in the intensely competitive market. We made loan commitments for a total volume of € 3.2 billion (previous year: € 3.3 billion). Our special sales campaigns in the spring and autumn of 2017 contributed to this success as each of them was met very favourably by our partner banks and customers. In addition, the share of forward financing transactions developed favourably in view of considerations that the ECB's loose monetary policy could be ending.

The volume of new lending commitments made to finance domestic private residential property brokered by banks within the Cooperative Financial Network was € 2.4 billion, basically unchanged from last year's volume of € 2.45 billion. Sales generated by independent providers of financial services increased by 8 percent on a year-over-year basis to € 419 million. New business brokered by Swiss PostFinance totalled € 373 million, or about € 50 million below the previous year's level due to intensifying price competition.

Our commercial property financing business was successful in 2017 and grew by 13 percent to € 1.9 billion (previous year € 1.7 billion).

We are particularly pleased that we were able to achieve these good results in a competitive environment characterised by shrinking margins and competitors willing to take on riskier financing deals. For our part we succeeded in attaining comparatively attractive margins across the entire span of our new commercial property business without exposing the Bank to inappropriate risks.

We posted gains in our domestic, as well as our international business activities, especially in Great Britain, Spain and the Netherlands, which contributed to our good results. In addition, our re-entry into USA also made a favourable impression.

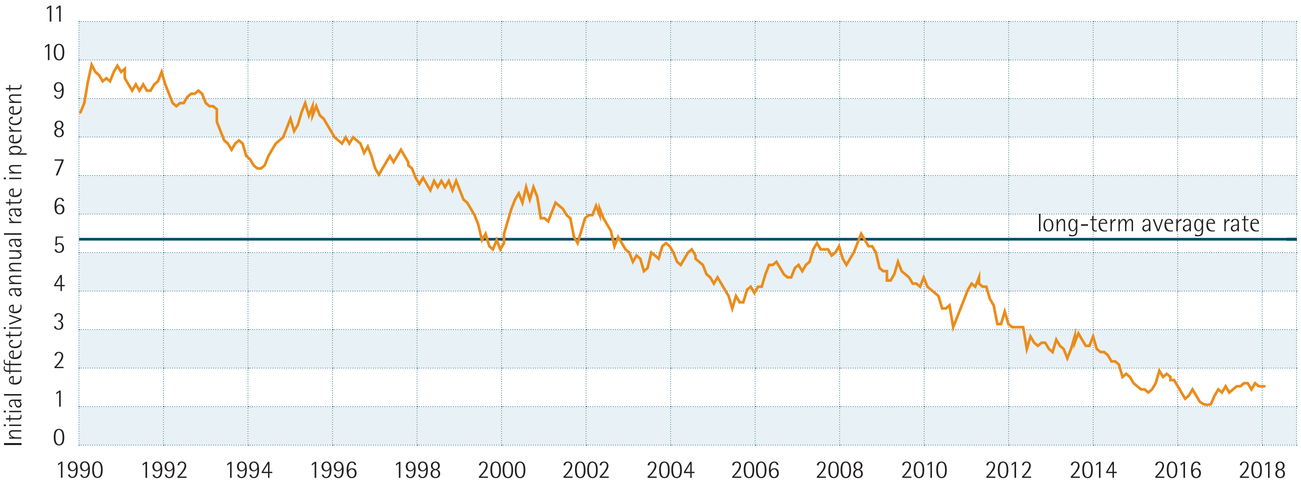
Furthermore, our new commercial property finance business benefited from the Bank's new syndication strategy where we act as the underwriter for larger loans that are generally more margin-attractive. We then syndicate a volume of about € 200 million to other providers of financing, with a special focus on our Cooperative Financial Network's syndication programme. Within the framework of the programme we enable the Volksbanken and Raiffeisenbanken to participate in commercial property loans we have made. This offer received a very favourable response.

CAPITAL MARKETS BUSINESS

Our investment strategy concerning securities issued by the public-sector and banks in 2017 was determined by regulatory requirements and very low spreads. Sovereign bonds and covered bonds continue to trade at very high levels due to the ECB's asset purchase programme.

In accordance with our business strategy, we again limited our capital market dealings in the past year. The net total volume of our existing portfolio was reduced by about € 1.0 billion to

MORTGAGE RATES MÜNCHENERHYP (TEN YEAR FIXED RATE)



As of: 02.01.2018

€ 5.7 billion. Our volume of new business totalled € 25 million in 2017 following € 109 million in 2016.

REFINANCING

The Pfandbrief markets were once again dominated by the ECB's Covered Bond Purchase Programme (CBPP3) in 2017. Markets were additionally influenced by political developments in Europe, especially elections in Germany, France and the Netherlands. Despite this difficult environment we found ample windows of opportunity to place new issues, which we used to refinance our activities at attractive conditions.

We floated our first benchmark issue of the year under review in May with a € 500 million Mortgage Pfandbrief that had a term of ten years and carried a coupon of 0.625 percent. The issue was priced at 12 basis points below the mid-swap rate. Thirty-four orders were received from investors in nine countries with Germany accounting for 83.5 percent of the volume sold followed by countries in Asia and the Middle-East. Excellent market conditions allowed the Bank to tap the issue by an additional € 250 million in October. The success is reflected by the price, which was set at 17 basis points below the mid-swap rate.

We successfully issued another Mortgage Pfandbrief in benchmark format in August, which is actually the classical summer vacation month in the capital market. Demand in the market was so great that we issued a volume of € 750 million. The Mortgage Pfandbrief had a term of nine years and two months and again carried a coupon of 0.625 percent. Market interest was reflected by the 64 orders received form ten countries, with Germany once again with the lion's share of orders. The issue was placed at a price of 13 basis points below the mid-swap rate.

The share of foreign currency denominated issues declined in the year under review by a total of 13 percent as the attractiveness of refinancing in US dollars and pound sterling declined substantially in comparison to euro-denominated issues.

The Swiss franc was the primary currency for our foreign currency denominated issues as we placed a total volume of CHF 810 million. In January we issued a two-year Mortgage Pfandbrief with a volume of over CHF 250 million. We followed up this issue with an additional two-year Mortgage Pfandbrief that had a volume of CHF 250 million. Due to strong demand seen for this issue we tapped it for an additional CHF 50 million one day after the issue.

We successfully placed a seven-year unsecured Swiss franc denominated bond in September. The bond had a volume of CHF 160 million.

In October we entered new territory when we issued a 15-year Mortgage Pfandbrief in benchmark format with a volume of CHF 100 million. The issue was priced at 8 basis points below the Swiss franc mid-swap rate. The issue caused a commotion in the Pfandbrief markets as this marked the first time ever that a foreign issuer of covered bonds achieved a higher interest rate discount compared to the domestic Swiss Pfandbrief curve.

Only one large-volume bond matured during the previous business year: a Public Pfandbrief with a volume of € 0.5 billion matured in September.

The total volume of issues placed in the capital markets in 2017 amounted to € 5.6 billion, of which Mortgage Pfandbriefe accounted for € 4.2 billion in covered refinancing, while unsecured refinancing amounted to € 1.4 billion. During the period under review we once again did not issue any Public Pfandbriefe due to the direction of MünchenerHyp's business strategy.

PORTFOLIO DEVELOPMENT MÜNCHENERHYP
2013 – 2017
in € million

ASSET, FINANCIAL AND EARNINGS SITUATION

BALANCE SHEET STRUCTURE

By the end of 2017 total assets had risen to € 38.9 billion, following € 38.5 billion at 31 December 2016. The increase was driven by the unbroken favourable development of our new business results.

Our portfolio of mortgage loans grew by € 1.4 billion over the course of the year to € 29.2 billion. Private residential property financing was again the strongest growing segment of our business as it increased by € 1.0 billion.

Our portfolio of private residential property loans is structured as follows: domestic mortgage loans € 17.0 billion (previous year € 15.9 billion), foreign mortgage loans € 4.1 billion (previous year € 4.2 billion), which are solely loans made to finance residential property in Switzerland.

Our portfolio of commercial property loans totalled to € 8.1 billion (previous year € 7.7 billion), of which € 1.9 billion (previous year € 1.7 billion) represented loans made outside of Germany. Great Britain is our most important foreign market with 25 percent (previous year 23 percent), followed by the Netherlands with 21 percent (previous year 20 percent) and France with 18 percent (previous year 18 percent). Property we financed in the USA accounted for 10 percent (previous year 13 percent) of the total.

In accordance with our business and risk strategy, our portfolio of loans and securities related to our business with the public-

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 31.12.2017	**738,865**	**2,081,807**	**2,820,672**
Registered bonds	**13,852**	**1,283,681**	**1,297,533**
of which institutional investors	13,121	1,261,681	1,274,802
Promissory note loans on the liabilities side	**654,129**	**798,126**	**1,452,255**
of which institutional investors	353,825	759,926	1,113,751
Other	**70,884**	**0**	**70,884**
of which institutional investors	28,549	0	28,549

sector and banks declined further from € 6.8 billion to € 5.7 billion, of which € 2.4 billion were securities and bonds.

At the end of 2017 the net sum of unrealised losses and unrealised gains in our securities portfolio amounted to plus € 58 million (previous year plus € 41 million). These figures include unrealised losses of € 1 million (previous year € 6 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 still amounted to € 0.4 billion (previous year € 0.6 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 € 1.3 billion to € 34.1 billion, of which € 23.1 billion consisted of Mortgage Pfandbriefe, € 3.4 billion of Public Pfandbriefe and € 7.6 billion of unsecured bonds. The total volume of refinancing funds – including money market funds – increased from € 35.8 billion in the previous year to € 36.4 billion on 31 December 2017.

Paid-up capital increased by € 49.0 million to € 1,004.9 million. Total regulatory equity capital amounted to € 1,390.9 million (previous year: € 1,343.1 million).

Common Equity Tier 1 capital rose from € 1,251.3 million in the previous year to € 1,316.0 million. On 31 December 2017 the Common Equity Tier 1 capital ratio was 23.8 percent (previous year 22.9 percent), the Tier 1 capital ratio was also 23.8 percent (previous year 22.9 percent) while the total capital ratio was 25.2 percent (previous year 24.5 percent). The leverage ratio was 3.4 percent on 31 December 2017.

DEVELOPMENT OF EARNINGS

Net interest income[1] increased by € 23.2 million or 9.9 percent to € 256.6 million. We were able to increase this figure as predicted, which was especially due to the sustained success of our new business activities during the year under review. This figure also contains a single-digit million euro expense figure arising from the early termination of interest rate swaps.

Commissions paid were close to last year's level and amounted to € 82.6 million. Commission income declined to € 8.1 making net commission balance[2] a minus € 74.5 million, following minus € 74.2 million in the previous year.

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

This resulted in a net interest income and net commission income figure[3], of € 182.1 million, an increase of € 22.9 million or 14 percent.

"General administrative expenses" rose by € 7.6 million to € 93.6 million, while personnel expenses increased by € 1.9 million or 4.3 percent.

Other administrative expenses rose by € 5.7 million or 13.5 percent. This increase was mainly due to projects aimed at optimising the processing of loans. Regulatory issues also contributed to higher costs, especially the implementation of the Markets in Financial Instruments Directive (MiFID II) and its corresponding regulation.

"Depreciation and write-downs of intangible and tangible assets" amounted to € 6.0 million or € 0.2 million less than the same year-ago figure.

Total administrative expenses[4] amounted to € 99.6 million compared to the € 92.2 million noted in the previous year. The cost-income ratio[5] was 55 percent (previous year 56 percent).

The net sum of other operating expenses and income totalled minus € 3.8 million.

Results from operations before deducting provisions for risk[6] rose by 24 percent over the previous year's figure to € 78.7 million Euro.

The item "Income from reversals of write-downs to claims and certain securities, as well as from reversals of provisions for possible loan losses", totalled plus € 1.5 million after allocations to reserves pursuant t o Article 340f of the German Commercial Code. The credit risk situation remained unremarkable. The net sum of reversals to provisions made for risks in the lending business (including direct write-downs) amounted to plus € 10.5 million (previous year: minus € 16.4 million).

Net income derived from the sale of promissory note loans, and the redemption of registered securities and debt securities, amounted to € 4.5 million.

The item "Income from write-downs on participating interests, shares in affiliated companies and securities treated as fixed assets" amounted to plus € 4.9 million. This figure is primarily the result of proceeds from the sale of securities held as fixed assets.

Results from ordinary business activities amounted to € 85.1 million, an increase of 26 percent. After transferring € 5 million to the "Fund for General Banking Risks" pursuant to Art. 340g of the German Commercial Code and a tax expense item of € 33.8 million, annual net income amounted to € 46.3 million, which was 45 percent higher than in the previous year.

RATING, SUSTAINABILITY AND REGULATORY CONDITIONS

RATING

In November 2017 the rating agency Moody's raised its Baseline Credit Assessment (BCA) for MünchenerHyp to ba1. The BCA corresponds to the standalone rating of a bank. This decision takes various favourable developments of MünchenerHyp's key figures into consideration. The higher BCA rating was primarily due to the further improvement in the Bank's level of equity capital, as well as the moderate risks in its loan portfolio.

Moody's final rating for the Bank – including external support from the government and the Cooperative Financial Network – did not change. In December 2017 the agency did, however, change the outlook for the rating of the Bank's senior unsecured liabilities to negative.

3) The net interest income and net commission income balance is the sum of net interest income and the net commission balance.
4) Administrative expenses are the sum of Item 8 General administrative expenses and Item 9 Depreciation and write-downs of intangible and tangible assets as shown on the income statement.
5) Ratio between administrative expenses and net interest and commission income.
6) Net sum of Income Statement items 1 to 10.

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 the rating for senior unsecured liabilities is negative.

The revision is due to a change in the methodology Moody's employs to make its ratings. The rating agency now assumes that the EU's Bank Recovery and Resolution Directive (BRRD) will be transformed into national law in Germany leading to the federal government providing weaker support to many banks. For this reason, the negative outlook affects a total of 16 banks that Moody's rates in Germany. The outlook for all other of MünchenerHyp's ratings remained stable.

Moody's did not change its opinion that MünchenerHyp had a solid reputation in the capital markets as an issuer of Pfandbriefe and thus has a correspondingly high level of refinancing strength. The agency also noted favourably the Bank's firm ties and related support within the Cooperative Financial Network.

Even to achieve its highest rating of Aaa for Pfandbriefe, 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 both of the two other major rating agencies Standard & Poor's and Fitch due to the group rating assigned to the Cooperative Financial Network by the agencies.

SUSTAINABILITY

The strategic goal of our sustainability management activities is to further anchor sustainability in our core business. These efforts are directed by a sustainability manager and a sustainability committee comprised of employees from various departments within the Bank.

During the year under review we developed an additional sustainable financing product in our residential property financing area of business: the MünchenerHyp Family Loan. This product addresses an important social dimension of a holistic understanding of sustainability. The social benefits of the MünchenerHyp Family Loan consist of providing support to lower and middle income families by making an interest rate rebate available to them. The sustainability of the Family Loan has been certified by Oekom Research, which confirmed that the loan "makes a contribution to the intergenerational creation and securing of prosperity,

The development of our sustainability ratings since 2015 at a glance:

	2015	2016	2017/2018
oekom research	C	C+	C+
imug	Public Pfandbriefe: favourable Mortgage Pfandbriefe: neutral Unsecured bonds: neutral	Public Pfandbriefe: very favourable Mortgage Pfandbriefe: favourable Unsecured bonds: favourable	Public Pfandbriefe: very favourable Mortgage Pfandbriefe: favourable Unsecured bonds: favourable
Sustainalytics	**57 of 100 points**	**57 of 100 points**	**60 of 100 points**

taking into account such aspects as equal opportunity, participation and quality of life, as well as developments that arise in the course of demographic change". The Family Loan was introduced to the market at the beginning of 2018.

The sustainability rating agency oekom research continues to rate MünchenerHyp as one of the three best banks in the category of "Financials/Mortgage and Public Sector Finance". We received a C+ rating. Oekom Research rates MünchenerHyp ecological commitment with B-, and its social commitment with C+. At the same time the agency also confirmed the Bank's "Prime Status".

The agency imug confirmed all of MünchenerHyp's sustainability ratings at the beginning of 2017. The agency issued a "very favourable" rating for our Public Pfandbriefe, and a "favourable" rating for our Mortgage Pfandbriefe and unsecured bonds. The rating for Mortgage Pfandbriefe means that the Bank holds the best rating among the 30 German issuers rated by imug.

The sustainability rating agency Sustainalytics raised our rating in the beginning of 2018. We currently are rated 60 out of a possible 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 continuously over 100 percent.

Within the framework of Basel III a leverage ratio with a limit of 3 percent for the entire nominal volume of loans made by a bank in relation to its equity capital was also introduced. Up until now this ratio only had to be reported. However, as of 1 January 2019 this new rule will become a mandatory requirement for banks. At the end of 2017 MünchenerHyp's leverage ratio stood at 3.43 percent.

The Basel Committee on Banking Supervision (BCBS) finalised new standards for equity rules for credit institutions at the end of 2017. The regulatory standards are particularly 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 introduction of a floor of 72.5 percent to limit the effects of internal approaches compared to standard approaches. The finalised standards reflect the content of the most recent discussions to a great extent. Above all, this means that banks operating with a low level of risk, like MünchenerHyp, will be impacted by the changes as the introduction of the floor will have a negative effects on MünchenerHyp's equity capital ratios. Based on the current state of information, we do not expect that we will have to raise additional equity capital due to our very good level of 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. 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, transmitted to the responsible departments and implemented 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 2017 that carefully examined the Bank's business model, its internal governance as well as its available capital and liquidity. The results indicate if additional equity capital or liquidity is required. The results of the SREP for MünchenerHyp revealed a mandatory minimum required ratio of 7.88 percent for the Bank's Common Equity Tier 1 capital.

MINIMUM REQUIREMENTS FOR RISK MANAGEMENT (MaRisK)

The MaRisk was updated at the end of 2017. As no major changes were made compared to the last versions, we anticipate that the Bank will be able to implement the updated requirements on time.

RECOVERY AND RESOLUTION PLANS

The Recovery Plan was updated. Furthermore information required for the Resolution Plan was provided to the resolution authority. Only minor adjustments were required in comparison to the previous year.

MAIN OFFICE, BODIES, COMMITTEES AND PERSONNEL

MAIN OFFICE

Münchener Hypothekenbank eG's main office is located 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 Josef Hodrus, Spokesman of the Board of Management of Volksbank Allgäu-Oberschwaben eG, as a new member of MünchenerHyp's Supervisory Board.

At the end of Delegates Meeting Heinz Fohrer, member of the Board of Management of the Volksbank Esslingen eG, stepped down from the Supervisory Board. The Chairman of the Supervisory Board, Wolfhard Binder, thanked Heinz Fohrer for his great dedication and efforts during the years marked by numerous regulatory challenges.

EMPLOYEES

Following the slight increase in the number of employees noted in the past two years, the growth in the Bank's number of employees accelerated again in 2017 as we recruited 74 new employees to fill vacant position. This development meant that the focus of our human resources work was on recruiting and, above all, the integration of the new employees. In comparison to the previous year, MünchenerHyp's employee fluctuation figure rose slightly to 6.0 percent (2016: 5.4 percent). However, when compared to the average percentage for the sector, our figure remained at a low level.

The integration and development of personnel continued to gain importance at the Bank in light of the more than 100 new colleagues we hired in the past two years. The central elements in this area are the internal and external opportunities to advance employee skills and knowledge, management development, as well as other personnel development and personal commitment measures.

The average number of persons employed[7] by MünchenerHyp during the year under review was 509 employees, plus 11 apprenticed trainees. Despite numerous new hires, the average number of years of employment per employee remained almost constant at 11.3 years.

CORPORATE GOVERNANCE STATEMENT PURSUANT TO ART. 289f GERMAN COMMERCIAL CODE (HGB)

In 2016 the Supervisory Board passed a resolution 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 target quota for the Supervisory Board and the top two executive levels below the Board of Management is 20 percent and 33 percent for the Board of Management. During the year under review the quota for women in each of the top two executive levels below the Board of Management was 18 percent and 8 percent in the Supervisory Board. No women were represented on the Board of Management. During the year under review the Supervisory Board's Nomination Committee resolved to recommend that the target quota should be achieved by the end of October 2021. Notwithstanding the above 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.