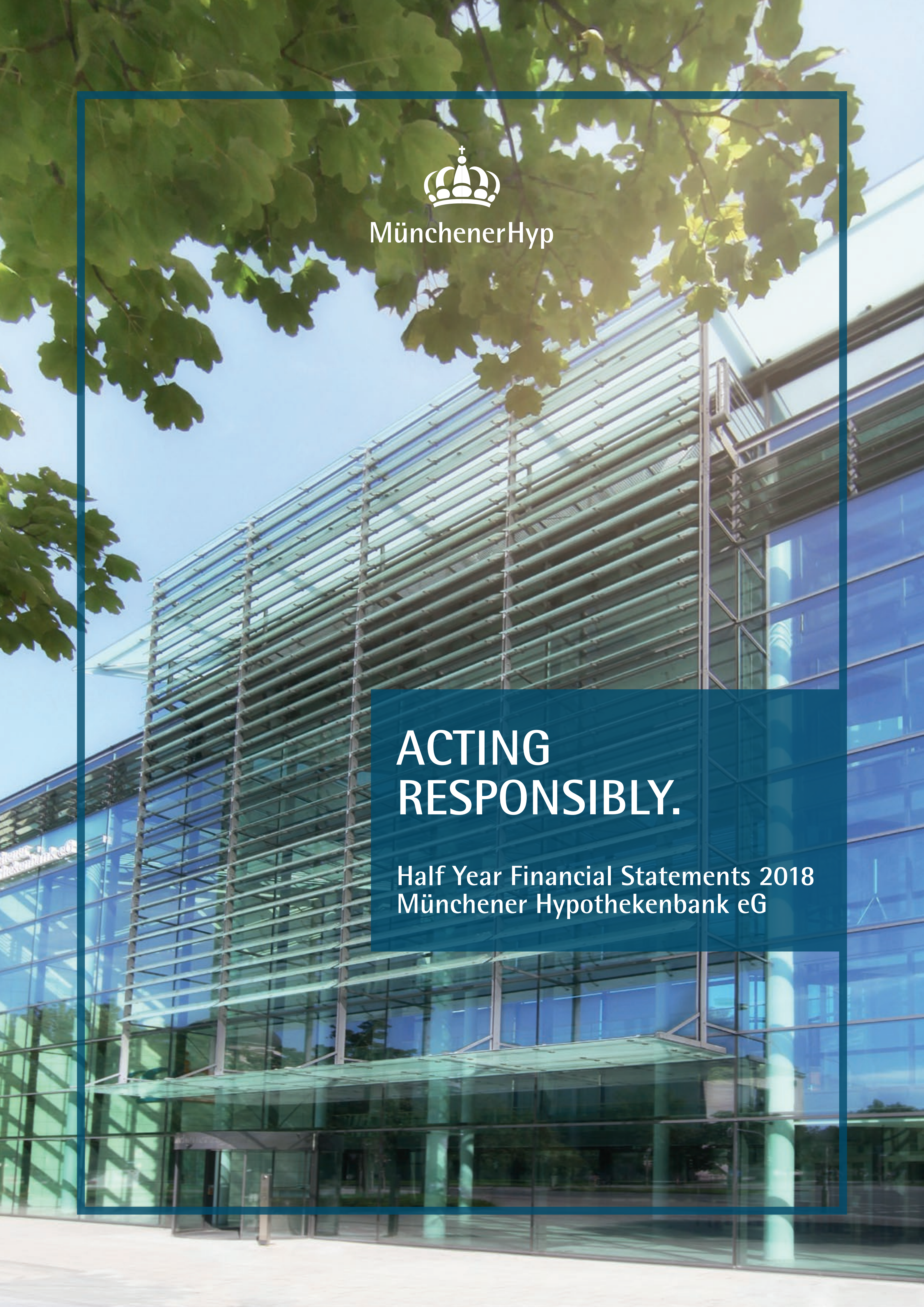

MünchenerHyp

ACTING RESPONSIBLY.

Half Year Financial Statements 2018
Münchener Hypothekenbank eG

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INTERIM MANAGEMENT REPORT 2018

OVERALL ECONOMIC CONDITIONS

ECONOMIC DEVELOPMENT

The optimistic forecasts made by economic researchers at the start of the year did not materialise during the first half of 2018. In fact, the global economy grew at a considerably slower pace during the first six months. Advanced economies were most heavily affected, with the exception of the USA. The slower rate of growth was due, in particular, to increased political tensions which led to greater uncertainty. Worth particular mention in this context are the protectionist policies pursued by the USA, the trade conflict between the USA and China, as well as the formation of the new populist government in Italy.

This uncertainty was primarily reflected by various market sentiment indicators which revealed a growing gap between the actual economic situation and economic expectations. In addition, development of Europe's gross domestic product (GDP) already decreased considerably in the first quarter; in contrast to the previous quarter growth in the eurozone fell by nearly half to 0.4 percent.

The upswing in the economy also weakened in Germany as its GDP only grew by 0.3 percent in the first quarter, or below the figure noted for the eurozone. According to economic researchers, the weakness was due to special factors including, in particular, a major outbreak of influenza, warning strikes in the electrical and metal industries, as well as the government's provisional budget management which led to a decline in public-sector spending. The two main favourable drivers of economic growth were private consumer spending and capital expenditures for plant and equipment. At the same time, the boom in the construction sector remained intact as investments in new construction rose by 2.1 percent, with the strongest gains seen for construction of new housing. In view of the declining rate of new orders in the industrial sector, experts did not foresee the economy picking up in the second quarter.

Higher crude oil prices pushed consumer prices up by over 2 percent in May and June compared to the same year-ago period. Furthermore, rising food prices also contributed to a notable increase in inflation. The upswing in the labour market continued as the number of unemployed persons fell by about 200,000 on a year-over-year basis to about 2.3 million in June for an unemployment rate of 5.0 percent. The number of employed persons in June rose by about 600,000 over the same year-ago period and stood at 44.8 million.

FINANCIAL MARKETS

During the first half of the year financial markets were also influenced by political and economic tensions arising from trade conflicts between the USA and China and the EU, as well as the formation of a new government in Italy. These factors contributed to increased volatility in the markets, especially for Italian bonds, and caused investors to seek safety in other assets.

Against this background, the rise in yields noted at the start of the year for sovereign bonds in the eurozone was largely corrected over the course of the first six months. For example, the yield on ten-year Bunds at the start of the first half was about 0.8 percent and then fell back to about 0.3 percent by the end of June. The favourable economic outlook in the USA pushed yields up from 2.45 percent to more than 3.10 percent in May only to subsequently decline to 2.85 percent.

The American central bank (the Fed) took advantage of the favourable economic environment to raise its key interest rate by 25 basis points in both March and June to the current target range of 1.75 to 2.00 percent. In the interim, other important central banks, especially the Bank of England, and the Bank of Canada have also raised their interest rates, while others such as the ECB, the Bank of Japan and the Swiss National Bank have left their rates unchanged. At the same time the ECB indicated that still overall robust economic conditions in the eurozone and higher inflation rates justified reducing measures to stimulate the economy. For this reason, the ECB announced that it would stop new purchases of bonds at the end of 2018 but will, however, keep its benchmark interest rate at 0 percent until the end of the summer in 2019.

Covered bonds, and thus German Pfandbriefe, continued to benefit from the ECB's covered bond purchase programme. About one-third of the volume of all bonds issued during the first half of 2018 was bought by the ECB. Despite this high demand, the market was unable to maintain the extremely tight spreads noted at the turn of the year and was forced to accept slightly widening spreads over the course of the first six months. Furthermore, the ECB's purchase programme continued to make it difficult for classical Pfandbrief investors to maintain their portfolio levels. As a result, the available level of tradable covered bonds declined further in the first half of the year, which in turn further limited liquidity in the secondary market.

During the first half of the year a total volume of € 88 billion in euro-denominated benchmark covered bonds were issued in the primary market, or 12 percent more than in the first half of 2017. As in the previous year, issuers based in France and Germany generated the biggest volumes of new issues.

The external value of the euro was burdened by political uncertainties in Italy and the trade conflict with the USA. In January the single currency was still able to strengthen from about 1.20 to 1.25 US dollars but in April began to decline noticeably to about 1.17 US dollars at mid-year. The value of the euro only declined marginally vis-à-vis the Swiss franc and the British pound during the first half of the year.

PROPERTY AND PROPERTY FINANCING MARKETS

RESIDENTIAL PROPERTY – GERMANY

The long running upswing in the German residential property market has not lost its dynamism yet as prices of houses and condominiums continued their notable rise. According to information from the Association of German Pfandbrief Banks (vdp), housing prices in general rose by 9.2 percent over the same year-ago quarter.

Rising prices were most evident for multi-family houses as they increased by 10.9 percent. This segment remains dominated by institutional investors that accounted for about € 11 billion worth of transactions during the first half of the year or about 80 percent more on a year-over-year basis. Residential property portfolios were primarily bought by domestic investors.

Against the background of tight supply, and prices that have already climbed to a very high level, investors shifted their buying activities to locations away from A-cities. Buyers were particularly focused on C-cities and although these cities are only regionally important, they do exert a material influence on their surrounding areas.

Nevertheless, demand for top locations remained intact as the seven largest cities, or the so-called TOP 7, accounted for nearly one-third of the volume of transactions. The volume of transactions was also influenced in part by a further increase in prices paid, which rose by 13.7 percent in the TOP 7, a rate that was significantly higher than the nationwide average figure.

Demand for residential properties continued to be fuelled by low interest rates and the favourable economy. Demand by owner-occupiers for property and property financing was also supported by a lack of investment alternatives, low unemployment, and rising incomes.

This constellation of factors led to a further notable increase in prices paid for owner-occupied housing. According to the corresponding vdp property price index, prices rose by 7.4 percent in the first quarter of 2018 over the same year-ago figure. While prices for single family houses climbed by 7.8 percent, prices paid for condominiums rose by a slower 6.3 percent and most likely because of increased construction of multi-family houses. This also applies fundamentally to the TOP 7 cities where, however, prices paid for condominiums climbed by an additional 10.6 percent. This increase was driven by unchanging strong inflows of new residents and demand for housing, which has also burdened the rental housing market. This situation is reflected in new rental contracts signed in the first quarter of 2018 in the TOP 7 cities where rents rose by 5.8 percent in contrast to the 3.5 percent increase recorded on a nationwide basis.

Despite the fact that the pace of rising prices has continued to accelerate, the Financial Stability Committee took note of this in its latest report and stated that risks to financial stability posed by residential property financing remained limited based on the long-term below average growth rate of residential housing loans, as well as the unbroken high standards in place for financing housing. At the same time the Bundesbank came to the conclusion that German banks are sufficiently capitalised to withstand a negative shock in the residential property market. The Bundesbank does, however, see a danger that credit institutions have not taken adequate account of regional overvaluations when determining mortgage lending values.

A notable expansion of new construction activity would be needed to dampen rising prices in the German housing market. This goal is thwarted by the fact that the construction industry is operating at almost full capacity coupled with an insufficient supply of building land – especially in the major metropolitan areas. The number of building permits granted in the first five months again rose slightly in comparison to the same-year ago figure by 1.8 percent. This development was solely driven by multi-family housing construction which is primarily an important factor in major cities. The number of approved housing units in this segment rose again, namely by more than 8 percent. In contrast, the owner-occupied housing segment fell slightly by about 2 percent.

RESIDENTIAL PROPERTY – INTERNATIONAL

Development of the residential property markets in Europe is mainly characterised by continuing price increases. During the first quarter of 2018 house prices in the eurozone rose by 4.5 percent over the same year-ago quarter and by 4.7 percent across the entire EU. Slight price corrections were only recorded in Sweden, Italy and Finland.

The pace of rising prices noted in the British housing market further decelerated during the first five months of the year. In May of 2018 the gain was just 3 percent, or the lowest rate of growth in prices recorded since August 2013 – although there were notable regional differences. While the greatest increases were recorded in the East Midlands and West Midlands, the price of houses in London, where the effects of the Brexit decisions are most felt, declined by 0.4 percent. However, a counter-trend was observed in monthly rents in London, which again rose slightly in June for the first time in two years.

In contrast, the prices in the French housing market gained additional momentum in the first quarter of 2018 as they accelerated by 3.4 percent over the same year-ago period, with prices for existing properties growing at a notably higher rate than those paid for new housing. This situation was due to increasing demand of foreign buyers for residential properties, especially British and Belgian investors. The rental housing market remains tight despite the increased construction of new housing.

Development of the owner-occupied and rental housing markets in Switzerland increasingly diverged from one another. The rate of rising prices weakened further and in particular for prices of condominiums and multi-family houses. During the second quarter of 2018 prices paid for condominiums even came to a halt. In contrast, sustained high demand pushed prices for single-family houses 3.9 percent higher in the second quarter compared to the same year-ago quarter marking the highest gain recorded since 2013. The decline of rents paid in the rental housing market could not be stopped due to lively new construction activities. Rents have fallen across Switzerland by 3.6 percent since the spring of 2015.

Prices noted in the US housing market continued to rise for the sixth year in a row. The S&P/Case Shiller Index figures for April 2018 showed a year-over-year increase of 6.4 percent and reflected that the unbroken rising momentum in prices had further strengthened since the previous year. The pace of price increases was, however, below the peak figures recorded in 2006. Prices for residential properties rose the most over the past twelve months in Seattle, Las Vegas and San Francisco, where price rates recorded double-digit increases. In contrast, prices noted in the greater Chicago and Washington D.C. regions advanced substantially below the average figure noted for the USA as the growth in prices weakened anew.

COMMERCIAL PROPERTY – GERMANY

The German commercial property market continues to be marked by lively demand in both the investment and user sectors. The limited supply of suitable properties is, however, impeding growth. This is reflected by the volume of transactions in the first half of 2018 of about € 26 billion, which did not rise over the previous year's level, although the comparable figure for 2017 was exceptionally high.

Domestic investors accounted for almost 60 percent of turnover and dominated the transaction market. The appeal of German property as a safe harbour investment for foreign investors remained high in light of rising economic and political tensions as they acquired about € 11 billion in property. Foreign buyers showed a preference for large-volume deals.

In contrast to the previous year investors focused on the TOP 7 cities, where a record turnover of nearly € 16 billion was booked. The greatest volume was noted in Munich where the volume of transactions surged by nearly 70 percent over the same year-ago figure, followed by Frankfurt am Main and Berlin. Investment opportunities were particularly limited in the nation's capital due to the shortage of large-volume objects.

Office properties were the preferred category for acquisitions and represented about 44 percent of the total volume of transactions. In contrast, turnover declined for retail and logistics properties while the market for special properties gained additional momentum thereby continuing the trend towards investing in properties not dependent on economic cycles such as nursing homes and clinics.

Office properties benefited from very good overall conditions in the user market. During the first six months of the year nearly 1.7 million square meters of space were let or sold to owner-occupiers thereby exceeding the ten-year average by 18 percent. Strong demand for office space has limited its supply. In the interim, the vacancy rate has reached a new low of 3.7 percent. Moreover, tight availability of office space also meant that rents, which have been climbing in the past years, continued upwards in the first half of 2018 with the strongest increases recorded in Berlin and Frankfurt am Main. According to the vdp index for commercial property, rents rose across Germany in the first quarter of 2018 by 4.1 percent. Prices paid for office property also increased by a substantial 9.7 percent in the first quarter.

COMMERCIAL PROPERTY – INTERNATIONAL

The volume of transactions recorded across Europe totalled over € 56 billion in the first quarter thereby reaching the previous year's level with notable differences noted in the individual countries. While a significant increase in investments was observed in Spain, Portugal, Ireland and Belgium, less money was invested in commercial properties in France, Italy and the Scandinavian countries.

This also applies to Great Britain where € 14.5 billion was invested, or about 8 percent below the previous year's figure. More than half of the transactions in the UK were made by domestic investors with London office properties as the preferred investment. During the first half of 2018 the office properties market in central London observed a pick-up in demand for space, a decline in available space, and stable peak rents.

In the second quarter of 2018 the French commercial property market recovered from its weak showing at the start of the year. In total, € 9.1 billion were invested in commercial properties in the first half of the year. This figure represents a gain of about 70 percent compared to the first half of 2017. Strong interest in property was driven, in particular, by the very good situation in the office properties market in the greater Paris area with the rental market recording its best results for the past ten years. This in turn has led to a notable reduction in available space, which resulted in a further rise in peak and average rents.

The first signs of a trend reversal in the American investment market appeared during the first three months of the year as the volume of transactions increased by 4.7 percent, and thereby faster than experts had expected as, in particular, the sale of industrial and residential properties, as well as hotel properties, rose. In contrast, the volume of transactions recorded for retail and office properties declined. The office properties market was marked by a further rise in rents in the first quarter of 2018, which set new records in the central business districts (CBD) of major cities like Washington D.C., New York and Chicago as vacancy rates in the CBDs declined even further. In contrast, vacancy rates rose in decentral urban areas due to a high level of new construction activity accompanied by significantly lower pre-leasing rates and demand.

BUSINESS DEVELOPMENT

NEW MORTGAGE BUSINESS

The new business results for the first half of 2018 fell short of our expectations. We made a total of € 2.2 billion in lending commitments to finance property. This figure represents a decline of 21 percent from the same year-ago figure and was split nearly equally between our private residential and commercial property financing areas of business.

Over the past six months we encountered increasingly tough pricing competition in both the residential and commercial property financing segments that was even fiercer than in the previous years. However, we are only willing to accept the correspondingly heavy pressure on margins and loan-to-value ratios to the extent that it does not exceed the limits of our conservative risk policy.

Furthermore, the development of available building land, houses and condominiums had an increasingly negative effect on our new private residential property financing business as supply lagged in some instances considerably behind growing demand. In addition, owners are not very willing to sell their properties.

Against this background, as of 30 June 2018 we had made € 1.4 billion in new lending commitments to finance private residential property compared to € 1.8 billion recorded in the same year-ago period. The largest portion of about € 1.1 billion was generated by our brokerage business with co-operative banks. Turnover of private residential property financing generated with independent providers of financial services declined to € 188 million (previous year: € 223 million), while loans brokered via Swiss PostFinance decreased to € 137 million (previous year: € 171 million). Our lower results in Switzerland were also due to a notable intensification of competition accompanied by additional pressure on margins.

During the first half of the year we made € 0.8 billion in new commercial property financing commitments compared to about € 1 billion in the same year-ago period. In addition to intensified competition and shrinking margins, a significant reason behind this decline is that the number of property transactions in the total market has been declining for some time, and thereby has reduced the number of enquiries seeking financing. The fact that this development has not affected the transaction volume is due mainly to rising property prices which reflect investors' willingness to pay higher prices as the availability of properties continues to tighten. Due to our fundamental conservative approach to business, we are cautious about financing highly priced properties.

The syndication market was intact during the first half of the year whereby the liquidity available to participate in loans notably exceeded the supply of financing. We were able to maintain ourselves quite well in the national and international syndication markets and could pass on portions of our own financing deals to partners. We also participated in large-volume loans to third parties both within Germany and abroad. Our re-entry into the American market for syndicated loans took place as planned and has been successful.

CAPITAL MARKETS BUSINESS

MünchenerHyp continues to conduct its capital markets business by investing in bonds and promissory notes issued by the public sector and banks on a cautious basis in accordance with its business and risk strategy. New investments were not made during the first half of 2018 and maturing securities were not replaced. This further reduced the portfolio by € 0.3 billion, which stood at € 5.4 billion at the end of June.

REFINANCING

MünchenerHyp was able to place a high volume of private placements with investors at attractive conditions at the end of 2017 thereby covering the Bank's initial refinancing requirements for 2018 with this surplus liquidity. Furthermore, no additional requirements arose from MünchenerHyp's maturity profile as the only large volume maturity coming due this year will mature in October.

For this reason, the focus of our issuing activities in the second quarter was also on private placements and issues denominated in Swiss francs. In April we issued an unsecured benchmark bond of 120 million Swiss francs with a term of about 5.5 years and a coupon of 0.35 percent. A second private placement of 250 million Swiss francs followed in the same month. Our issuing activities in foreign currencies in the first half of the year were rounded out with a 10-year Mortgage Pfandbrief that had a volume of 150 million Swiss francs and coupon of 0.50 percent.

We began the second half of the year by issuing a benchmark Mortgage Pfandbrief that had a volume of € 500 million and a term of nine years and four months. The Pfandbrief carried a coupon of 0.625 percent and was very successfully placed. The order book exceeded one billion euros. The volume issued was spread over a total of 52 individual orders from twelve countries. Almost 40 percent of the investors were from outside Germany. Banks represented the major group of investors followed by central banks, sovereign wealth funds, asset managers and insurance companies.

By the end of the first half of the year we had issued a total of € 1.4 billion in securities of which Mortgage Pfandbriefe accounted for € 0.6 billion and unsecured bonds € 0.8 billion. We again refrained from issuing Public Pfandbriefe due to the direction of the Bank's business strategy.

In 2017 we introduced a deposit product for private customers in conformity with the Cooperative Financial Network. The product expands our refinancing mix and is being sold via co-operative bank partners. The technology and marketability of the product were successfully tested in pilot phases on 2017. These results allowed us to launch the deposit product as a permanent offer in March 2018 under the name "GenoFestgeld" (Geno Fixed Term Deposit).

The name conveys the exclusivity of the offer that is only being made to members of the Cooperative Financial Network and that the liquidity will remain within the Network. GenoFestgeld currently has a term of one year and offers an attractive rate of interest. Amounts between € 10,000 and € 100,000 can be invested. The market launch was successful and GenoFestgeld was well received by co-operative banks and their customers. Furthermore, we were also able to win new banks as partners for the product.

ASSET, FINANCIAL AND EARNINGS SITUATION

BALANCE SHEET STRUCTURE

Total assets amounted to € 39.4 billion on 30 June 2018, following € 38.9 billion at the end of 2017.

We were again able to expand our portfolio of mortgage loans as it increased by € 1.1 billion to € 30.3 billion on 30 June 2018. In line with our strategy, we reduced our capital markets portfolio by € 0.3 billion to € 5.4 billion. Hidden reserves on securities held as fixed assets amounted to € 55 million while hidden burdens stood at € 3 million.

Equity capital as shown on the balance sheet amounted to € 1,343.4 million. Equity capital pursuant to the terms of the Capital Requirements Regulation (CRR) was € 1,413.9 million. This resulted in a Common Equity Tier 1 capital ratio of 23.0 percent at the mid-year point following 23.8 percent recorded at the end of 2017. The Tier 1 capital ratio also amounted to 23.0 percent (31 December 2017: 23.8 percent) while the total capital ratio was 24.3 percent (31 December 2017: 25.2 percent).

At mid-year 2018 the leverage ratio remained unchanged from the figure noted at the end of 2017: 3.4 percent.

DEVELOPMENT OF EARNINGS

Net interest income[1] rose by 11 percent over the amount recorded at the end of the first half of 2017 to € 138.1 million. The net commission balance[2] totalled to minus € 35.3 million. The figure for net interest income and net commission income[3] was € 102.8 million, or 19 percent over the same year-ago amount. Administrative expenses[4] rose by € 5.7 million to € 53.4 million while personnel costs increased by € 1.3 million to € 24.3 million.

Other administrative expenses increased by € 4.4 million to € 26.1 million, in particular due to rising consulting expenses and regulatory costs. Depreciation and write-downs of intangible and tangible assets did not change from the same year-ago figure and amounted to € 3.0 million.

The item "Write-downs and adjustments to claims and certain securities and additions to provisions for possible loan losses" totalled minus € 8.6 million compared to minus € 3.4 million on the same year-ago date. As the required provisions for risks in the lending business remained at a very low level, this negative figure primarily resulted from an allocation to reserves pursuant to Section 340f of the German Commercial Code (HGB).

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

	Remaining term < one year	Remaining term > one year	Total
	€ 000	€ 000	€ 000
Other liabilities to customers as of 30 June 2018	**1,033,365**	**2,165,438**	**3,198,803**
Registered bonds	**16,942**	**1,261,458**	**1,278,400**
of which institutional investors	16,924	1,259,458	1,276,382
Promissory note loans on the liabilities side	**548,296**	**883,980**	**1,432,276**
of which institutional investors	328,149	751,280	1,079,429
Other	**468,127**	**20,000**	**488,127**
of which institutional investors	310,353	20,000	330,353

1) Interest income is calculated by adding item 1 interest income plus item 3 current income less item 2 interest expenses as shown on the income statement.
2) Net commission balance is the net sum of item 4 net commission income and item 5 net commission expenses as shown on the income statement.
3) Net interest income and net commission income is the sum of net interest income and the net commission income.
4) Administrative expenses are the sum of item 7 general administrative expenses and item 8 depreciation and adjustments to the value of intangible and tangible assets as shown on the income statement.

At the mid-year point the item "Income from appreciation in value of participations, shares in affiliated companies and securities treated as fixed assets" amounted to € 0.0 following € 4.8 million in the previous year.

Results from ordinary business activities for the first half of 2018 totalled € 35.6 million. After deduction of € 12.9 million for tax expenses we recorded a pro rata temporis net income for the year of € 22.7 million (previous year € 22.1 million).

RATING AND SUSTAINABILITY

RATING

The rating agency Moody's confirmed their ratings for MünchenerHyp in their most recent Credit Opinion of June 2018.

Our current ratings at a glance:

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

*The outlook for the rating for senior unsecured liabilities is negative.

The development of our sustainability ratings at a glance:

	2016	2017	2018
oekom research	Corporate Responsibility Prime rated by ISS-oekom C+	Corporate Responsibility Prime rated by ISS-oekom C+	Corporate Responsibility Prime rated by ISS-oekom C+
imug	Public Pfandbriefe: very positive Mortgage Pfandbriefe: positive Uncovered bonds: positive	Public Pfandbriefe: positive Mortgage Pfandbriefe: neutral Uncovered bonds: neutral	Public Pfandbriefe: positive (BBB) Mortgage Pfandbriefe: positive (BBB) Uncovered bonds: positive (B)
Sustainalytics	**57 of 100 points**	**60 of 100 points**	**65 of 100 points**

Furthermore, Moody's has introduced an additional rating category, "Counterparty Risk Rating" (CRR). MünchenerHyp initial ratings in this category were as follows:

- Long-term (local currency) Counterparty Risk Rating, assigned Aa3
- Short-term (local currency) Counterparty Risk Rating, assigned P-1

Moreover, our long-term uncovered liabilities are rated AA- by the rating agency Fitch due to the group rating the agency assigned to the Cooperative Financial Network.

SUSTAINABILITY

During the first half of 2018 the sustainability rating agency Sustainalytics raised MünchenerHyp's rating twice: once at the start of the year to 60 out of a possible 100 points and in the spring to 65.

PERSONNEL

The Bank's earnings-oriented growth strategy, as well as the numerous regulatory requirements, continue to necessitate that we hire additional personnel, although at a more moderate pace. Moreover, our personnel requirements were also influenced by slightly higher fluctuation. By the half-year mark we had hired 36 new employees.

CORPORATE PLANNING

MünchenerHyp's business and risk strategy defines the planning framework for its key business activities and is regularly reviewed. The Bank's business strategy remains focused on the earnings-driven growth of our mortgage portfolio and a successive reduction of our lending business with the public sector and banks.

OUTLOOK

OUTLOOK – OPPORTUNITIES AND RISKS

The risk of the global economic upswing weakening increased substantially during the first half of the year. In particular, economic experts see the possibility that trade tensions arising from American policies could escalate into a trade war. Additional risk factors decelerating growth in Europe, as well as in the emerging nations, are continuing geo-political conflicts, as well as political uncertainties, and especially those regarding the future of Italy. Nevertheless, forecasts continue to anticipate a strong expansion of the global economy. The International Monetary Fund (IMF) has not changed its estimate that the global economy will grow by 3.9 percent in 2018 and in 2019.

In the interim, however, economic growth in the eurozone is projected to grow at a slower pace than foreseen at the start of the year. In July the EU Commission reduced its forecast for economic growth in 2018 by 0.2 percentage points to 2.1 percent due to the risk of growing trade conflicts, although it did not alter its view that the European GDP figure would rise by 2.0 percent in 2019.

The outlook for the German economy has also clouded against the background of political and economic tensions as it is particularly dependent on exports. At the mid-year point the average consensus among economic experts was that the economy would grow by 2.0 percent in 2018, or 0.4 percentage points below the German government forecast at the beginning of the year. On average, experts expect that the economy will grow by 1.8 percent in 2019. The economy is not expected to contract, however, as the German economy is supported, in particular, by rising incomes and the favourable labour market. These conditions are likely to again lead to increasing consumer spending. Economic growth is also being bolstered by the good level of order backlog, especially in the industrial sector, as well as unbroken favourable situation in the construction sector. This in turn has led the Kiel Institute for the World Economy to predict that construction investments will increase by 3.8 percent in 2018.

Financial markets are also observing the worsening trade policy confrontations with increasing concern. In this context, the possible effects of an economic downturn, in particular, has led to uncertainty regarding the valuations of numerous asset classes.

The ECB has decided to exit its quantitative easing programme at the end of 2018. This means that the ECB will only reinvest the principal payments from maturing securities and that markets will no longer be supported by the ECB adding net liquidity. This decision could lead to rising interest rates and widening spreads, and therefore result in losses for sovereign bonds, covered bonds and corporate bonds. The ECB's lowered willingness to purchase bonds has already led to somewhat wider spreads for Pfandbriefe in the covered bond markets. The relative appeal of Pfandbriefe has, however, slightly risen as European sovereign bonds and bonds issued by the German federal states are still trading at a very expensive spread levels. Due to the favourable financing conditions and the high level of issuers' activities in the first half of 2018, it is not expected that the second half will see a high level of pressure from new issues. Experts anticipate that the volume of euro-denominated covered bonds in benchmark format issued in 2018 will amount to € 125 billion.

The ECB's first interest rate hike is expected to take place in 2019. The ECB announced that this would not take place earlier than the autumn of 2019. Accordingly, the markets are anticipating that the first small rate increases will begin in September 2019, and could widen in the following years.

It is anticipated that the ECB will move very slowly with its measures to normalise monetary policy and raise interest rates in smaller increments than it did in previous years.

In the USA the Fed announced that it would continue to raise its benchmark rate on a step-by-step basis. Two additional interest rate increases were indicated for 2018 and are also expected by the markets. However, opinions concerning the Fed's actions in 2019 vary, as it is possibly planning to increase rates three times although the market only anticipates one.

In view of the ECB's decision to only begin raising its benchmark rate in 2019, coupled with the slightly more subdued economic outlook, we do not anticipate that interest rates for property loans will increase substantially. We therefore believe that the level of interest rates will remain almost unchanged in the second half of 2018, and that any increases will be small. For this reason, the overall conditions in the property and property financing markets will not change significantly.

The outlook for the German property market remains unchanged and is favourable. Demand in the residential property market remains high and prices, in turn, will continue to rise. The good situation in the construction sector will not dampen prices in 2018 as the number of building permits issued remains below the demand for new construction. This means that economically vibrant cities, in particular, which are experiencing strong inflows of new residents due to reasons related to jobs or vocational training, will still be marked by excess demand for housing. This applies to the residential rental market as well as the owner-occupied market. At the same time, regions that can no longer compensate for population outflows will become increasingly visible as the housing markets in these cities and counties will be characterised over the mid-term by higher vacancy rates, declining rents and lower purchases prices. This will further widen the price gap for housing within Germany.

The outlook for the German commercial property market is also good. Experts at the major real estate agents do not expect that the slight weakening of economic growth will have a significant impact on demand for commercial property. For this reason, forecasts still predict that the 2018 volume of transactions will be about € 55 billion. Demand for office space remains high. At best, the tight supply may increase slightly. At the same time the vacancy rate will shrink further as buildings under construction in the TOP 7 cities already have high pre-leasing rates.

Despite these overall favourable prospects for the residential and commercial property markets in Germany, voices are being increasingly heard warning that the investment market is slowly beginning to peak as political and economic uncertainties increase and the end of the ECB's low interest rate policy is perspectively in sight.

The overall outlook for the European commercial property markets remains favourable as investors are still believed to have a very high willingness to invest. Their interest will continue to be primarily focused on office properties. The office property markets in individual countries are in very good shape and are characterised by high demand for space and rising rents. The only exception is London where the office property market is likely to decline from its zenith in a short time. Good overall economic conditions in France are supporting the property market there with growth likely to continue in the residential and the commercial property sectors.

The Swiss housing market still needs to be viewed in a very differentiated way. While rents remain under pressure due the high level of new construction activity, there is still an unchanging level of excess demand for private residential property. Prices will rise further in this segment.

Overall conditions for the US property market are also favourable and indicate that prices for residential and commercial property will rise. The rate of price increases in the office sector may, however, lose additional momentum in certain regions.

The unbroken high demand for property and property financing has prompted us to expand and optimise our market development and services. In addition, we will again launch an attention-getting sales campaign featuring attractive prices. For this reason, we are confident that we will be able to at least partially even out the results noted in first half year over the rest of the year.

We also expect that our new commercial property financing business will see a certain degree of improvement in the second half of the year as more investments are made in our key markets. Furthermore, we expanded our business acquisition approach and are now talking directly to foreign investors who want to buy commercial property in Germany, and meeting them in their home countries. We believe that this offers potential as nearly half of all investments made in Germany are cross-border transactions involving foreign investors. Based on the number of financing enquiries received to date, we anticipate that our new business results outside of Germany for the full year will be good and exceed the previous year's performance.

We anticipate that the volume of business generated by our syndication business will remain stable in the second half of the year. In the future we will increasingly involve co-operative banks within the Cooperative Financial Network in syndication deals in Germany.

The primary purpose of our portfolio of assets in the banks and the public-sector segment remains unchanged and is to serve to manage liquidity and our cover pool.

Our liquidity requirements – money and capital market – will total about € 9 billion in 2018. Mortgage Pfandbriefe will remain our most important source of refinancing. Accordingly, we plan to float at least one additional benchmark issue in the second half of the year, and possibly an additional sustainable ESG Pfandbrief. In addition, we want to realise the potential offered by foreign currencies – with a continued focus on the Swiss franc. In the area of large-volume maturities, a Public Pfandbrief with a nominal value of over € 750 million will mature in October.

Our efforts to attract customer deposits have met with great and lively interest within the Cooperative Financial Network. We intend, therefore, to increase the volume of deposits.

We anticipate that the net interest income and net commission income will continue to develop favourably and that we will substantially achieve our planned goals for 2018.

We are striving to attain a net income for the 2018 business year that will match the level we achieved in the previous year.

DISCLAIMER REGARDING FORWARD-LOOKING STATEMENTS

The Half Year Financial Statements contain 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. 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 we have made today. For this reason, they are only valid at the time this report was prepared.

BALANCE SHEET AS OF 30 JUNE 2018

ASSETS		30 June 18	31 Dec 17
	€	€	€ 000
1. Cash reserve			
a) Cash on hand	11,927.98		14
b) Balances with Central Banks	121,297,802.23		685,749
of which			
with Deutsche Bundesbank € 121,297,802.23			
		121,309,730.21	**685,763**
2. Claims on banks			
a) Mortgage loans	6,783,491.09		7,991
b) Public-sector loans	130,763,759.92		226,076
c) Other claims	1,954,519,399.40		1,752,360
of which			
payable on demand € 901,559,668.34			
		2,092,066,650.41	**1,986,427**
3. Claims on customers			
a) Mortgage loans	30,266,305,705.61		29,130,017
b) Public-sector loans	2,981,455,669.83		3,127,167
c) Other claims	188,976,901.92		184,119
		33,436,738,277.36	**32,441,303**
4. Bonds and other fixed-income securities			
a) Bonds and notes	2,386,709,697.22		2,481,231
aa) Public-sector issuers € 1,316,575,898.73			(1,334,884)
of which			
eligible as collateral for Deutsche Bundesbank advances € 1,227,565,380.07			
ab) Other issuers € 1,070,133,798.49			(1,146,347)
of which			
eligible as collateral for Deutsche Bundesbank advances € 985,808,702.38			
b) Own bonds and notes	800,020,944.45		800,020
Nominal value € 800,000,000.00			
		3,186,730,641.67	**3,281,251**
Carried forward:		38,836,845,299.65	38,394,744

LIABILITIES, CAPITAL AND RESERVES		30 June 18	31 Dec 17
	€	€	€ 000
1. Liabilities to banks			
a) Registered Mortgage Pfandbriefe issued	808,847,789.21		876,903
b) Registered Public Pfandbriefe issued	91,735,721.01		172,504
c) Other liabilities	4,426,202,836.01		3,738,573
of which			
payable on demand € 964,561,553.36			
		5,326,786,346.23	**4,787,980**
2. Liabilities to customers			
a) Registered Mortgage Pfandbriefe issued	9,441,538,450.39		9,362,855
b) Registered Public Pfandbriefe issued	2,211,477,534.19		2,244,005
c) Other liabilities	3,198,802,736.84		2,820,672
of which			
payable on demand € 20,878,409.34			
		14,851,818,721.42	**14,427,532**
3. Certificated liabilities			
a) Bonds issued	17,193,364,191.40		17,519,990
aa) Mortgage Pfandbriefe € 12,939,034,797.81			(13,040,765)
ab) Public Pfandbriefe € 1,011,409,846.44			(1,028,056)
ac) Other bonds and fixed income securities € 3,242,919,547.15			(3,451,169)
b) Other Certificated liabilities	238,122,395.05		393,173
of which			
money market paper € 238,122,395.05			
		17,431,486,586.45	**17,913,163**
4. Liabilities incurred as trustee		**5,858.74**	**10**
of which			
loans € 5,858.74			
5. Other liabilities		**171,481,469.85**	**143,181**
Carried forward:		37,781,578,982.69	37,271,866

ASSETS		30 June 18	31 Dec 17
	€	€	€ 000
Brought forward:		38,836,845,299.65	38,394,744
5. Equities and other variable-yield securities		**155,153,141.79**	**155,307**
6. Participations and shares in cooperatives			
a) Participations	104,535,199.49		104,535
of which			
credit institutions € 22,955,936.29			
b) Shares in cooperatives	18,500.00		19
of which			
in credit cooperatives € 15,500.00			
		104,553,699.49	**104,554**
7. Shares in affiliated companies		**11,151,601.64**	**11,152**
8. Assets held in trust		**5,858.74**	**10**
of which			
loans € 5,858.74			
9. Intangible assets			
Concessions acquired for consideration, commercial rights and similar rights and values, as well as licenses to these rights and values	4,797,681.47		5,000
		4,797,681.47	**5,000**
10. Tangible assets		**69,199,864.96**	**70,165**
11. Other assets		**113,460,981.39**	**114,080**
12. Deferred items			
a) From issuing and lending business	46,935,699.29		50,013
b) Other	8,714,000.00		
		55,649,699.29	50,013
Total assets		**39,350,817,828.42**	**38,905,025**

LIABILITIES, CAPITAL AND RESERVES		30 June 18	31 Dec 17
	€	€	€ 000
Brought forward:		37,781,578,982.69	37,271,866
6. Deferred items			
From issuing and lending business	19,995,768.76		23,142
		19,995,768.76	**23,142**
7. Provisions			
a) Provisions for pensions and similar obligations	30,449,175.00		29,899
b) Provisions for taxes	3,925,512.40		7,845
c) Other provisions	30,267,880.44		34,649
		64,642,567.84	**72,393**
8. Subordinated liabilities		**106,200,000.00**	**156,200**
9. Profit-participation certificates		**0.00**	**2,557**
10. Fund for general banking risks		**35,000,000.00**	**35,000**
11. Capital and reserves			
a) Subscribed capital	1,015,937,890.00		1,006,914
aa) Members' capital contributions € 1,013,937,890.00			(1,004,914)
ab) Silent participations € 2,000,000.00			(2,000)
b) Revenue reserves	304,500,000.00		304,500
ba) Legal reserves € 298,500,000.00			(298,500)
bb) Other revenue reserves € 6,000,000.00			(6,000)
c) Unappropriated profit	22,962,619.13		32,453
		1,343,400,509.13	**1,343,867**
Total liabilities, capital and reserves		**39,350,817,828.42**	**38,905,025**
1. Contingent liabilities			
Contingent liability on guarantees and indemnities		**766.94**	**1**
2. Other commitments			
Irrevocable loan commitments		**3,577,418,120.53**	**3,620,174**

INCOME STATEMENT

1 JANUARY THROUGH 30 JUNE 2018

				1 Jan to 30 June 2018	1 Jan to 30 June 2017
		€	€	€	€ 000
1.	Interest income from			486,947,733.53	524,913
	a) Lending and money market operations		461,254,769.64		491,856
	b) Fixed-income securities and debt register claims		25,692,963.89		33,057
2.	Interest expenses			349,829,573.22	400,489
3.	Current income from			944,867.39	385
	a) Participations and shares in cooperatives		944,867.39		385
4.	Commissions received			2,773,761.12	3,622
5.	Commissions paid			38,078,260.29	41,904
6.	Other operating income			489,900.83	500
7.	General administrative expenses			50,410,173.39	44,677
	a) Personnel expenses		24,300,282.25		22,950
	aa) Wages and salaries	20,344,861.68			19,364
	ab) Social security contributions and cost of pensions and other benefits	3,955,420.57			3,586
	of which				
	for pensions € 765,583.88				713
	b) Other administrative expenses		26,109,891.14		21,727
8.	Depreciation and write-downs of intangible and tangible assets			3,000,000.00	3,000
9.	Other operating expenses			5,663,289.29	2,920
10.	Write-downs on and adjustments to value to claims and certain securities, as well as additions to provisions for possible loan losses			8,619,863.43	3,425
11.	Income from reversals of write-downs on participating interests, shares in affiliated companies and securities treated as fixed assets			0.00	4,798
12.	Results from ordinary business activities			35,555,103.25	37,803
13.	Taxes on revenue and income			12,855,542.93	15,700
14.	Net income			22,699,560.32	22,102
15.	Retained earnings brought forward from previous year			263,058.81	201
16.	Unappropriated profit			22,962,619.13	22,303

NOTES TO THE INTERIM FINANCIAL STATEMENTS AS OF 30 JUNE 2018 (ABRIDGED)

GENERAL INFORMATION ON ACCOUNTING POLICIES

Münchener Hypothekenbank eG's financial accounts for the first half of 2018 were prepared using the same methods used to prepare the balance sheet and determine valuations shown in the annual statement of accounts as of 31 December 2017.

The new edition of the Heubeck-Guideline Tables 2018 G, which were published on 20 July 2018, was not taken into consideration in the preparation of the 2018 Half Year Financial Statements. Application of these tables is expected to result in increased provisions for pensions recognised as an expenses, which Heubeck AG estimates between 1.5 percent and 2.5 percent.

The explanations of the significant amendments of the items in the abridged balance sheet and abridged profit and loss statement were provided in the interim management report.

Tax expenses noted for the period 1 January to 30 June 2018 were calculated based on the weighted average of the annual tax rate on income.

The annual fee due for the European bank levy was accounted for on a pro rata temporis basis for the first half of 2018.

AUDITING ASSOCIATION

DGRV – Deutscher Genossenschafts- und Raiffeisenverband e.V., Berlin, Pariser Platz 3

Munich, 3 August 2018
Münchener Hypothekenbank eG
Board of Management

Dr. Louis Hagen   Bernhard Heinlein   Michael Jung

CERTIFICATION FOLLOWING REVIEW

To Münchener Hypothekenbank eG, Munich

We have conducted a review of the abridged half year financial statements – comprising the balance sheet, the income statement, as well as the abridged notes to the financial statements – and the interim management report of Münchener Hypothekenbank eG, Munich, for the period 1 January to 30 June 2018, all of which are elements of the half year financial statements pursuant to Art. 115 Securities Trading Act (WpHG). The preparation of the abridged half year financial statements in accordance with German commercial law, and the interim management report pursuant to the applicable terms of the WpHG, are the responsibility of the cooperative's legal representatives. Our responsibility is to issue a certificate for the abridged half year financial statements and the interim management report based on our review.

We have conducted our review of the abridged half year financial statements and interim management report in accordance with the generally accepted German standards for the review of financial statements promulgated by the Institute of Public Auditors in Germany. These standards require that we plan and perform the review so that, by way of a critical assessment, we can exclude with a reasonable measure of certainty that the principal elements of the abridged half year financial statements have not been drawn up in conformity with the German commercial rules, and that the principal elements of the interim management report have not been drawn up in conformity with the WpHG regulations applicable to the interim management report. A review is limited primarily to interviewing the personnel of the cooperative and to analytical assessments and therefore does not achieve the level of certainty provided by an audit cannot be achieved. As we were not assigned to conduct an audit we cannot issue an audit certificate.

Based on the information gained from our review, we are unaware of any circumstances that could lead us to the conclusion that principal elements of the abridged half year financial statements were not drawn up in conformity with the requirements of German commercial law, or that the principal elements of the interim management report were not drawn up in conformity with the applicable terms of the WpHG.

Bonn, 3 August 2018
DGRV – Deutscher Genossenschafts- und Raiffeisenverband e.V.

Dorothee Mende
Auditor

Thorsten Schraer
Auditor

AFFIRMATION OF THE LEGAL REPRESENTATIVES

To the best of our knowledge and in accordance with applicable reporting principles for interim financial reporting, the interim financial statements give a true and fair view of the assets, liabilities, financial position and earnings situation of the company, and the interim management report of the company includes a fair review of the development and performance of the business and the position of the company, together with a description of the principal opportunities and risks associated with the anticipated development of the company for the remaining business year.

Munich, 3 August 2018
Münchener Hypothekenbank eG
Board of Management

Dr. Louis Hagen
Bernhard Heinlein
Michael Jung

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