DEUTSCHE PFANDBRIEFBANK

Annual General Meeting 2023

Management Board speech

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Introduction

Andreas Arndt, Chairman of the Management Board
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- Check against delivery -

Good morning dear shareholders,
Ladies and Gentlemen,

I would also like to welcome you to the Annual General Meeting of Deutsche Pfandbriefbank AG.

Before I start my speech: Dr Bräunig, allow me to address a few words to you personally.

You will be resigning your office at the end of today's AGM. Having been a member of Deutsche Pfandbriefbank's Supervisory Board for almost 14 years, including nine years as its Chairman, you have been very close to pbb since the Great Financial Crisis.

During this time, you have witnessed – and shaped – the entire journey: from the Bank's restructuring to its IPO and full re-privatisation.

Now even though one should always be careful about connecting the success of an institution too closely to particular individuals, in your case, my dear Dr Bräunig, I'm not exaggerating when I say, looking back, that you have contributed significantly to the very sound foundation that pbb can rely upon today.

You have not only provided the Management Board with critical support throughout all these years, using your expertise, your analytical skills and your vast experience – but also, the fact that this institution, with its very special history, has succeeded in regaining market trust through conservative approach to risk, is also thanks to your contribution.

Allow me to comment on a personal note: the Management Board has greatly benefited from your straightforward approach and perseverance. You have challenged us, questioning numerous aspects – always in a constructive, engaging and appreciative manner. You have always been committed to the Bank's future, and to achieving the best result – right up to the present day.

You deserve our respect and recognition for all this. On behalf of the entire Management Board – and I'm sure that I can also speak on behalf of our shareholders – I would like to express our sincere thanks to you.

Dr Bräunig, you have been a godsend to pbb.

I wish you all the best for the future!

Review of 2022

Ladies and gentlemen,

This brings me to my main comments.

Today, we can report to you on a successful financial year 2022. Yet I will keep my review shorter than in the previous years: on the one hand, I would like to inform you about the progress we're making with our strategic initiatives in some more detail. On the other hand, you will certainly be interested to know about pbb's view on the current market situation, and what key development trends we are seeing on the market for commercial real estate finance.

Let me start with the obligatory details – my report for the 2022 financial year, based on consolidated figures in accordance with IFRS, as usual.

We generated a pre-tax profit of €213 million in the year under review – which was within the range forecast at the beginning of the year, but short of the €242 million achieved the year before. The decline compared to 2021 was primarily due to markedly lower early termination fees, as well as the disappearance of lucrative income from interest rate floors, following the sharp interest rate increases seen in 2022. This development was offset by the increase in commercial real estate finance volumes, to €29.3 billion, alongside stable new business levels. New business – including extensions beyond one year – amounted to nine billion euros.

We succeeded in raising margins on existing exposures, with a marked improvement visible especially in new business originated during the final quarter. At €489 million, net interest income was virtually unchanged year-on-year. Net income from realisations, however, was down significantly, however, as reflected in lower early termination fees.

Risk provisioning almost halved year-on-year, to €44 million. This underlines the good quality of our loan portfolio. Given the very comfortable level of Stage 1 and Stage 2 loss allowance, only a modest 5 million euro increase in general loss allowance was required, with specific impairment charges of €39 million on top. This largely involved increases of existing loss allowance for UK shopping centres – an asset class that pbb no longer focuses on strategically.

Aggregate loss allowance and provisions in the lending business stood at around €400 million at the year-end, including a €69 million management overlay for Stage 1 and Stage 2 loss allowance. General administrative expenses only increased by 2 per cent, to €224 million, in spite of general cost increases and higher investments; this translates into a cost/income ratio of 45.6 per cent.

The common equity tier 1 (or CET1) ratio stood at 16.7 per cent at the end of the year. This means that we continue to have the necessary flexibility to absorb the impact of market fluctuations, invest in profitable growth initiatives, and diversify the business model, whilst maintaining an attractive level of dividend distribution. We have already calibrated risk-weighted assets – or RWAs in short – to match anticipated levels in accordance with Basel IV. Our own ambition regarding capitalisation remains a CET1 ratio of at least 14 per cent, which is well above the minimum regulatory level.

The sound results generated in 2022 and our comfortable capitalisation mean that we can indeed retain our high dividend payout ratio: we aim to distribute 50 per cent of consolidated net income after taxes attributable to ordinary shareholders of €171 million as a regular dividend, plus 25 per cent as a special dividend. Specifically, the Management Board and the Supervisory Board propose to you today to distribute a dividend of €0.95 per no-par value share entitled to dividends. With this, pbb remains one of the most attractive shares on the German market in terms of dividend yield: based on the 25 May share price, the proposed payout translates into a dividend yield in excess of 10 per cent.

We want to continue pursuing a strong dividend payout policy for the financial years 2023 to 2025. Any future distributions will continue to be subject to economic viability, taking into account macroeconomic and sector-specific risks, along with regulatory requirements and future investment. We see a sustainable CET1 ratio of at least 14.0 per cent as an adequate benchmark when deciding upon special distributions, especially in the context of the current geopolitical, macroeconomic and sector-specific uncertainty.

Strategic initiatives

As you can see, we have a strong financial basis which we want to leverage in order to further develop the Bank strategically. I reported on several strategic initiatives at last year's meeting. We have used the past year to specify these initiatives, fleshing them out with concrete measures – and we have already seen first successes.

We want to expand our position as one of the leading European specialist banks for commercial real estate finance over the coming years, thus creating added value for all of our stakeholders – for you as shareholders, but also for our clients and our employees. At the same time, we want to live up to our corporate social responsibility.

Our strategy is built on three pillars:

- Firstly, we will continue to grow in commercial real estate finance.
- Secondly, we will grow our commission-based business, leveraging our core expertise in commercial real estate finance.
- And thirdly, we will broaden and diversify our funding.

Accordingly, we want to become greener and more digital in everything we do.

If we succeed in doing this – and in my view, there are numerous factors in favour – we will generate significant added financial value. We aim to generate a return on equity of more than 10 per cent before taxes by the end of 2026; this implies a target pre-tax profit in excess of €300 million. We are looking for a cost/income ratio below 45 per cent at that time, with a CET1 ratio above 14 per cent. And we want to continue distributing between 50 and 75 per cent of profit after taxes, non-controlling interest income and the AT1 coupon.

Without doubt, these are ambitious targets. Yet we see ourselves as being in the best position to achieve them. We have the requisite expertise in our focal strategic areas – and we have the necessary capital to grow profitably. And we are convinced that now is the right time to set this strategic course: despite the challenging market situation, despite the headwinds facing financial and real estate markets, we will now take the necessary decisions – consistently pursuing our strategy, from our own resources, to sustainably position ourselves for future growth.

Our refined strategy is based on six initiatives which I would now like to present to you.

At the heart of the first initiative is continued growth in our core business of commercial real estate finance. We want to increase our lending volume by almost €4 billion, to €33 billion by the end of 2026, raising the margin on the total portfolio in the course of this. As soon as the market shows signs of improvement, we want to revert to exploiting opportunities in real estate market segments which we have been avoiding in the recent past due to cyclical risk considerations. We have always managed the cycle carefully and successfully. We do not ride out every downturn to the end of the cycle – but we build up exposure early enough following a downturn – a policy which has proven to be right, time and again. We have demonstrated that we can deliver stable revenues in all market phases. This is what we see as our job.

I said earlier that we want to become greener in everything we do. This brings me to our second initiative: we want to be a driving force within the transformation of the commercial real estate sector towards climate neutrality. Given that the real estate sector accounts for some 40 per cent of global carbon dioxide emissions, we have the responsibility of paving the way to a low-carbon world. Green finance will be an important contributing factor for the future strategic thrust of all our growth initiatives.

Our target is for more than 30 per cent of financed existing properties to be eligible for green loans by 2026 – up from a current share of just under 18 per cent. We will also launch a green consulting business and advise clients on holistic solutions within the green transformation, joining forces with Groß & Partner, one of the largest and most renowned real estate developers. We aim to offer transformation solutions to our clients, including implementation support, from a single source. This means that we are pushing ahead with our green loan proposition, expanding our green finance business. In this way, we will also generate important commission income for the Bank.

And that brings me to our third strategic initiative: the expansion of capital-light commission-based business. We decided last year to establish a new Real Estate Investment Management division. Our aim is to broaden our business model: we will leverage our extensive market expertise, our international presence and exceptional risk competency to bring attractive real estate investment products to the market for institutional investors. We are delighted that we were able to win Dr Pamela Hoerr to head up the new division. Dr Hoerr has joined pbb from Real I.S., a Munich-based real estate and asset manager, where she was a member of the Management Board, responsible for fund and asset management. At pbb, she currently holds the position of Senior General Manager. Subject to regulatory approval, Dr Hoerr is scheduled to assume responsibility for the division as a Management Board member in 2024.

We’re currently preparing the groundwork for this new division, identifying suitable assets and building up the distribution. Our pilot product is set to comprise mainly German office properties and mixed-use properties. We have joined forces with Universal Investment, thus winning a well-established partner in this business. Universal Investment will act as a servicing Investment Management Company, and will be responsible for launch and management of the planned open-ended real estate special fund. And on the distribution side, we have agreed upon a close cooperation with Amundi, a renowned asset manager providing first-class access to an extensive institutional investor base. This will be launched as soon as tensions on the real estate markets ease.

Ladies and gentlemen,

whilst the first three initiatives are mainly focused on growth, efficiency and costs are no less important for our long-term earnings ambitions. Our fourth initiative is one of the measures we have taken in this connection:

we have decided to merge the Public Investment Finance (PIF) and Value Portfolio (VP) segments, to form a new segment called “Non-Core”. We will dispose of the municipal loans intermediation franchise in the near future, or discontinue this business. Accordingly, we will not continue the CAPVERIANT platform, which we have operated jointly with French Caisse des Dépôts (CDC), any further. In short, we no longer consider the funding of public infrastructure as part of our core business activities. Going forward, we will be fully focusing on commercial real estate finance.

The fifth initiative is also set to make a substantial contribution to boosting profitability: broadening and optimising our funding base. Our decision to pave the way for successful deposit-taking at a very early stage is now increasingly paying off.

Last year – the year when interest rates started turning around – our deposit volume rose by more than one-third, or €1.2 billion, to €4.4 billion. With another billion euros added in the first quarter of this year, we reached a volume of €5.4 billion as at the end of March. More than three-quarters of these retail deposits are term deposits with a stable term structure. We want to exploit this positive momentum and are aiming to achieve a deposit volume in excess of €8 billion by the end of 2026. In these times of markedly higher interest rates, thanks to their lower rate sensitivity, term and even overnight deposits are a low-cost alternative to unsecured bonds which are currently clearly more expensive.

At the same time, we are working on becoming ever greener in our funding: with an outstanding green bond volume of currently €3.3 billion, we are already a leading German issuer of green senior preferred unsecured bonds. This is a position we want to expand further.

Now this brings me to our sixth – and last – initiative. We're vigorously pursuing the digitalisation of all processes, whilst strictly maintaining cost discipline. We are determined to keep costs at 2022 levels, in spite of investments, thus achieving a sustained cost/income ratio of below 45 per cent. To this end, we are preparing a cost-cutting programme focusing on IT expenditure and process efficiency, insourcing, nearshoring and reducing consultancy expenses.

Q1 and outlook

Ladies and gentlemen,

Overall, we expect these six strategic initiatives to generate an additional earnings contribution of more than €100 million between now and the end of 2026, translating into an increase of close to 50 per cent compared to 2022. We aim to generate this earnings growth in the years 2024 through 2026. In contrast, the current year will be a year of investment, during which we shall build the foundations for this leap in growth.

Yet 2023 is also projected to be a more difficult year for the entire sector, as the strong increase in interest rates has slowed demand for commercial real estate financing. I will come back to this in a moment.

We continue to anticipate being able to originate between €9 billion to €10 billion of new business. We will not yet be able to fully offset the impact of the TLTRO programme expiry on net interest income through portfolio growth. Despite this negative effect and rising investments, for 2023 we anticipate stable profit before taxes in a range between €170 million and €200 million.

The first quarter's pre-tax profit of €32 million is consistent with this full-year guidance. Net interest income declined due to the non-recurrence of income from floors, plus the expiry of the TLTRO programme. However, the increase in portfolio size had a positive effect: at the end of March, the portfolio totalled €29.4 billion, €1.6 billion more than one year ago.

Even though new business is usually somewhat weaker in the first quarter, the amount originated was exceptionally low, at €1 billion – half the previous year's figure. This reflects a significant decrease in market transaction volume and a conscious decision for a more restrictive lending policy at present. Especially in the US and the UK – two key markets within our regional diversification strategy – we are currently exercising restraint in new business, given the current market situation. However, we perceive the opportunity of generating new business at attractive terms there – as well as generally – as soon as the markets start to recover. We are keeping a close eye on this in order to exploit opportunities in a timely manner.

Now of course this begs the question as to when this recovery will in fact materialise. Throughout the sector, new commercial real estate finance business has been in decline since the summer of last year. This downtrend has even accelerated this year, alongside – sometimes significant – price corrections across all asset classes and regions. Owners are holding off sales because they want to avoid sizeable markdowns on their target selling prices. Conversely, investors are reticent, fearing further price declines. As a result, we have observed the number of transactions shrink to levels not seen for a decade – with the corresponding impact on credit demand, which has sunk to lows not seen for several years.

Mind you, this has not come as a total surprise. Having been blinded by low interest rates, many market participants had forgotten just how cyclical our industry can become. The turnaround in interest rates happened faster and more sharply than the market had expected. Never have interest rates risen so fast and so strongly in post-war Europe. And even though further interest rate hikes might be more moderate, or might not materialise at all: structural adjustments – specifically, the changes brought about by working from home, or growing ESG requirements – are here to stay as key drivers of market uncertainty.

At pbb, we know how to manage the cycle; we understand sustained market adjustments brought about by structural trends and the opportunities they offer. We have demonstrated that we can generate stable revenues across interest rate and market cycles. We expect the market outlook to improve during the course of the year, and we’ll be ready to exploit growth opportunities at an early stage – with all due care, of course.

Market trends

Independent from these cycles, the real estate markets are already experiencing structural changes which are likely to significantly accelerate over the next year:

- The gap between prime locations and B or C locations is likely to widen rather than narrow. Whilst top rents in prime locations are set to continue rising, vacancies will put pressure on prices and rents in small and medium-sized cities. This applies especially to the retail segment, but also to office properties.

- The trend towards working from home will persist. Whilst this will slow growth for office properties, it probably won’t wipe it out altogether. Once they move, companies mostly require less office space: with rental contracts having terms between five and ten years, this is a gradual process. Yet there is increasing excess space which markets will have to digest. Whilst offices are unlikely to become obsolete, they must change to remain successful. What we need is creative office concepts meeting rising requirements in terms of flexibility, networking and comfort. Businesses will be looking for such office space – which is becoming scarce, especially in good or very good locations. This might also explain rents and prices remaining stable – or even rising – in prime locations, in spite of low yields and higher interest rates.

- Finally, besides location, ‘green’ is likely to evolve into one of the most important investment criteria of all. Properties which no longer meet certain environmental standards, and which can no longer be refurbished to become green, will end up as ‘stranded assets’ sooner or later, for which tenants and investors are difficult to find. In contrast, new green properties are likely to be very much sought after – perhaps even contested: a trend we’re already seeing today, in fact.

Ladies and gentlemen,

These are changes whose impact on our industry should not be underestimated. That changes are also an opportunity is not a cliché. As a bank, we want to seize these opportunities, to further expand our strong market position. We are in the fortunate position to be able to flexibly shape this from our own resources. We want to increasingly diversify our business model over the coming years, thus establishing a broader foundation for future revenue growth.

In this context, we will not compromise on our risk standards. The most recent bout of turbulence in the global banking industry has clearly shown that our risk-conservative strategy is the right way to go. Our strong capital and liquidity base is particularly comforting at present – in fact, we see this as confirmation of our chosen path.

pbb's common equity tier 1 – or CET1 – ratio was at a comfortable 16.6 per cent as at the end of March – and the Liquidity Coverage Ratio, a key metric for liquidity available during stress, was as much as 309 per cent at 31 March 2023 – more than double the regulatory minimum.

But my confidence is based not only on our good financial standing. More importantly, it relies on the fact that this Bank is backed by a team whose competence, experience and commitment are a guarantee for success – and unparalleled in Germany. Our staff members are the cornerstones of our Company. Once again, they delivered a great performance during the past financial year, in a challenging environment. On behalf of the entire Management Board, I would like to extend a heartfelt thanks to our employees.

Ladies and gentlemen, dear shareholders,

I hope that I have been able to give you a convincing impression of our way forward. We adapt our strategy to the changing market environment. We are determined to keep pbb a reliable, dividend-paying share for long-term investors.

Please bear with us!

Thank you very much for your attention.