AGM speech manuscript 2024

Check against delivery

DEUTSCHE
PFANDBRIEFBANK

Annual General Meeting, 5 June 2024

Speech by Kay Wolf, CEO, Deutsche Pfandbriefbank AG

Good morning,
Dear shareholders,
Ladies and Gentlemen,

I would also like to extend a warm welcome to you.

This is my first Annual General Meeting as pbb's CEO. I joined pbb in early February and took the helm of the Bank to succeed Andreas Arndt on 1 March. I would like to take this opportunity to thank Andreas Arndt for a smooth and well-structured transition in difficult times.

I was delighted at the prospect of taking on this role, well-aware that it would not be an easy start. These are tough times for commercial property financing. And as a leader in the field, pbb is not immune to a difficult market environment.

This is not the first time I've been on the pbb team. Many years ago, from 2007 to 2010, I was responsible for pbb's IT. But the 15 years that passed since I left have afforded me a fresh and very realistic view of what I found upon returning.

I do not mean to whitewash the Bank's situation. You, dear shareholders, have had to do without a dividend twice now since the IPO. And you have had to see the price of your shares plummet. Both are undesirable facts. But I am convinced that the Bank will master this cyclical low quite well to return to its shareholder-friendly course.

What makes me so confident?

It is, in essence, the Bank's great specialised lending platform and established expertise in real estate.

pbb has a clear business focus and a very distinct positioning in the market for commercial real estate finance. We act exclusively as senior lenders. This means that we always enjoy priority as a creditor, concentrating on the first-ranking part of a financing. This is worth emphasising given that a significant proportion of commercial real estate finance does not rely on first-ranked claims – and we are not active not active in these areas.

This is a fact we can't stress enough in the current market environment. The same holds true for our excellent real estate expertise. It's something our customers can vouch for: we are extremely well versed in special finance – and, above all, we know how to deal with cyclical developments. In fact, pbb remained profitable even in 2023, which was an extremely challenging year. We remain well-capitalised, with a comfortable liquidity cushion.

All this shows that in essence, pbb is in good health.

It's a diagnosis we're glad of, but to stay healthy, we need to take certain steps in terms of income, costs and the balance sheet.

I will come back to this in more detail later.

First, I owe you a look back on the financial year 2023. But before I turn to our own numbers and figures, allow me to try to explain the difficult situation of the market overall.

Put simply, there are three drivers:

Firstly, the two leading central banks in the Western world, the US Federal Reserve and the European Central Bank, had to increase their key interest rates as quickly and aggressively as never before in response to skyrocketing inflation in the wake of the COVID-19 pandemic. Between early 2022 and July 2023, the Fed increased its interest rate by five percentage points. This interest rate shock caught many market participants by surprise and some off guard.

Secondly, the Covid-19 pandemic reshaped work permanently in the US, where commutes tend to be quite long, with remote work exceeding expectations and surpassing Europe. A decreased demand for office space has resulted in significant vacancies in some metropolitan areas.

Thirdly, the long era of zero interest rates had attracted many new financing providers and investors to the commercial real estate financing markets. Some of them acted highly opportunistically. Unfortunately, this kind of provider or investor tends to falter in the face of a stronger headwind.

All this has resulted in prices for office properties falling, in some markets even plummeting, especially in the US. With pricing becoming harder, investment volumes have collapsed. So far in Europe less so, however, for structural reasons. I will circle back to this in my outlook.

So much for the market environment, Ladies and Gentlemen, that the Bank had to contend with over the past year – and contended with well at that.

Notwithstanding this very challenging market situation, pbb remained profitable in the financial year 2023. A very solid operating business partially offset a significant increase in risk costs, resulting in €90 million in consolidated profit before tax (in accordance with IFRS).

We decided to reduce new business. With a focus on long-term extensions and increasing margins, new business decreased from €9 billion to €7.2 billion. In this context, the existing portfolio still grew by €1.8 billion to €31.1 billion. Average loan-to-value in the existing portfolio increased from 51% to 53%. This is a very good result compared to our peers.

Net interest income of €482 million fell just short of the previous year's figure.

Expenses increased by 11% to €249 million, mainly driven by the investments and initiatives to increase our profitability as announced a year ago. The greatest outlier, however, in our income statement was our risk costs, which skyrocketed from €44 million to €212 million. US office properties account for the majority of these costs, with €194 million in additional loss allowance recognised.

The US is home to the largest real estate market in the world, offering specialised lenders such as pbb plenty of opportunity to diversify their portfolios wisely. Our small market share in the US allows us to be very selective when choosing what to finance and what not to finance. In the US, we act as senior lender exclusively. We're not burdened by the struggles facing other providers that offer mezzanine loans or other subordinated financings. But we, too, have been hit hard by the general price slump.

As at year-end, our US portfolio comprised €4.5 billion in financings in the seven major gateway cities. Most of these financings are for office properties. Following the re-evaluation of the entire portfolio during the past year, we recognised impairments of 19% – in line with the development of the US markets we are active in. As a consequence, the average loan-to-value for our US portfolios was significantly higher as at year-end 2023, at 64%.

This bloodletting in the US effectively more than halved our profit, both before and after tax. Looking at the current market environment, further strengthening our financial resources is our first priority. There was no way of reconciling this priority with paying a dividend.

With a CET1 ratio of 15.7%, the Bank enjoyed a very solid capital base at year-end 2023. There is a large buffer to the regulatory minimum requirements. And our liquidity situation remains comfortable, as I will explain in my outlook.

Ladies and Gentlemen, that was our look in the rear-view mirror.

The more important, but also harder and more opaque part is looking at what comes next. Where is the turnaround? When will the commercial real estate finance market hit the bottom of this cyclical valley?

As we look for answers, we need to keep a close eye on interest rates. The market currently expects the ECB to cut its interest rates ahead of the Fed and to make a larger move. While the euro area might see its first rate cut as early as tomorrow, the US will probably have to wait until the end of the year. These prospects should help calm the real estate markets going forward. But it is too early to call a turnaround.

We continue to be extremely careful and have refrained from writing new business in the US. Still, we believe fears of an eventual repeat in Europe of what we have seen on the office real estate market in the US to be unfounded. Yes, we have seen a further fall in prices in some European sub-segments, especially against the background of structural change in working practices. But this correction has so far been moderate, not least because of differences in

remote work practices in Europe and the US. There are also differences in the structural vacancies we see in both markets. Europe has proven to be more flexible in adjusting to changing demand. And European financing structures allow for a more adequate adjustment to higher interest rates.

Ladies and Gentlemen,

What does all this mean for the current financial year? What is our forecast for 2024?

We are confident that we will be able to move key parameters for pbb's further development back in the right direction in this late phase of the cycle.

We see new business in a range of €6 billion to €7 billion. This forecast accounts for the challenging market environment, particularly in the first half of the year. Once again, the focus will be on extensions. We expect our portfolio to remain virtually stable, at between €30 billion and €31 billion. On this basis, and assuming margins on new business will continue to rise, we anticipate aggregate interest income and commission income between €475 million and €500 million. This means that we will retain our solid operating earnings power. While our cost/income ratio will rise to around 50% this year driven by continued high investments, we remain committed to our medium-term target of below 45%.

Loss allowance is expected to decrease, but remain higher than on average, given the still difficult first half of the year. All in all, we expect profit before tax in the full year to be significantly higher than in 2023.

The first quarter has underscored our forecast, with numbers within the range of our full-year outlook. At €34 million in profit before tax, we were off to a good start into 2024. The slight year-on-year increase was driven mainly by a robust operating result, which in turn was rooted in solid net interest income. We benefited here from a slight portfolio increase coupled with increasing margins in both existing and new business. This strong operating development allowed us to handle the expected increase in loss allowance quite well. At €47 million, loss allowance was considerably lower than in the two previous quarters.

Our portfolio remains resilient. An average loan-to-value of 54% testifies to the solid book we maintain as a senior lender. In the US, asset valuations remain under pressure. The loan-to-value ratio in the well-performing portfolio has risen from 64% as at year-end to now 68%. We recognised what from today's perspective can be deemed adequate loss allowance for this portfolio.

Ladies and Gentlemen,

The market environment is set to remain challenging for the foreseeable future. That is why a comfortable liquidity cushion and strong capitalisation remain a top priority for us. pbb's liquidity situation has been good throughout the last couple of years. Using the full range of tools available, we have built

on this firm foundation at manageable costs. As at the end of March, our absolute liquidity position exceeded €6 billion. In other words, our regulatory liquidity ratios significantly exceed the required 100%.

We have largely covered our funding needs for 2024. In April, we increased a Pfandbrief issue at almost the same terms as in January, underscoring our ability to access to the market. In our opinion, there is no need for senior unsecured funding this year anymore. Retail deposits amounted to €8.1 billion as at the end of April. As this significantly exceeds the Bank's needs, we have adjusted terms and conditions for new money. At the same time, we remain well-capitalised with a CET1 ratio of 15.2% as at the end of March.

But there is no reason to sit back and wait for better times to come. We are making use of this difficult market phase to actively manage our balance sheet, with the aim of a more active approach to risk management, reducing assets that no longer fit our strategic focus and finding the best balance for our funding mix. We have a clear goal: we want to boost return on equity and create scope for profitable growth.

We have also gathered speed in the management of our non-core portfolio, selling assets worth €400 million in the first quarter alone after €600 million in the whole of 2023. More transactions are in the pipeline.

We are also adapting our real estate finance portfolio to the changed market environment. One example is the sale of a larger portfolio of exposures to a financial investor in May. The portfolio comprised financings of office, residential and hotel properties in the UK and the US with an aggregate volume of some €900 million. This transaction allowed us to reduce risk-weighted assets by around €700 million, freeing up a substantial amount of equity.

I see transactions of this kind as a key building block of a bank's business model. They will be an option for pbb wherever there is a business case for them and they help strengthen return on equity.

We have always been proactive in managing the liabilities side of our balance sheet. This means pursuing a balanced mix of secured and unsecured funding combined with repurchasing securities where it makes sense for us to do so. In the first quarter alone, we bought back securities worth €300 million after €600 million in the whole of 2023. Two days ago, we launched the partial buyback of three additional benchmark bonds, leveraging our comfortable liquidity situation to further improve our funding profile.

As you can see, we are very active across the board and we are far-sighted as we review pbb's opportunities. We are creating space for new business with an even better risk-return profile.

But we cannot escape shaping the Bank strategically, above and beyond the mentioned balance sheet management. I have no doubt whatsoever that specialised lenders such as pbb will have a key role to play in the future as well. Will we need to do some things differently? Most certainly! One key aspect will be to use our excellent real estate expertise to diversify our income sources to

a much greater extent.

While the "pbb 2026" strategy presented last year has the right thrust, we will have to take another critical look at our set-up against the backdrop of the most recent developments and may have to make adjustments. Just as you, dear shareholders, probably expect us to. The results of this assessment will be presented at a Capital Markets Day scheduled for autumn.

We are well aware of the need to win back your trust. This is why we have been identifying and mitigating risks with the necessary rigour and discipline, but also by communicating in a way that is transparent and easy to understand.

I am not being excessively optimistic. The views of the Bank and of the markets I share with you will always be realistic. And that is exactly why I would like to spread some optimism today.

Your Bank has remained profitable throughout a market cycle that has not been easy. And as things currently stand, your Bank will continue to be profitable. This is a testament to our business model, our financial resources, and our team.

More than anything, it is the expertise, experience and dedication of our team that makes me believe that we will weather this demanding market situation well. The financial year 2023 was a difficult year and a challenge for all. That is why I would like to take this opportunity on behalf of the Management Board to thank all of our employees for their tremendous dedication.

We would also like to extend our thanks to you, dear shareholders, for your loyalty during this difficult time. We truly appreciate this. Your loyalty has given us a mission, a duty: we want to lead pbb back to a path of growth.

Thank you very much for your attention.