Annual Press Briefing

4 March 2020

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1. INTRODUCTION

Ladies and Gentlemen, good morning.

A warm welcome to you all today. I would like to thank you for your interest in pbb and your attendance at today's meeting. A special welcome also to all those who are watching the webcast or are joining us by phone.

In an environment which continues to prove very challenging indeed, Deutsche Pfandbriefbank AG (pbb) **again performed well in the financial year 2019** (CHART 2).

- At €216 million, **pre-tax profit** was up on the previous year's figure – albeit only slightly, but still well above our initial guidance of €170 million to €190 million.

  At the same time, we were able to further increase **net interest income** – our most important income item – which, together with net commission income, totalled €464 million. Likewise, **operating income** rose markedly, to €506 million: besides net interest income, this was due to above-average early repayment fees of €39 million.

  We have accounted for what we see as an increased probability of a global economic and sector-specific downturn by significantly increasing our **risk provisioning** to €49 million.

  In turn, we are continuing to invest in pbb's ongoing process of **digitalisation**, the **US market,** as well as **regulatory-related projects.** With general administrative expenses rising only slightly to €202 million, the cost-income-ratio was 43.5% (44% the previous year). Increased project expenses were largely offset by savings generated by centralising our back-office activities and restructuring our PIF business.

- In what is now the tenth year of the current cycle, the **real estate markets** remained in good shape overall – despite weaker developments in individual markets and persistently very low yields. Competition among real estate providers remained fierce, not only among banks but other institutional lenders as well.

  In this very challenging market, pbb continued to build on its previous year's level of **new business** while adhering to its standards for risk management. We recorded a volume of €9.0 billion in our Commercial Real Estate Finance business, comfortably meeting our new business target. We also maintained our average gross new business margin at a stable level of around 155 basis points over the year.

- On this basis, the Management Board and the Supervisory Board will propose to the Annual General Meeting to pay a dividend of €0.90 per share. Our shareholders will also benefit from pbb’s good results.

In view of market and competitive conditions in Commercial Real Estate Finance, we remain cautious for 2020 and will be maintaining our conservative risk policy. This is particularly evident in **new business**, with a targeted volume of between €8 and €9 billion in Commercial Real Estate Finance.

Once again, we continue to focus on delivering a strong, stable **operating performance**, whilst keeping higher risk provisioning in line with our more cautious market outlook. This is reflected in our pre-tax profit guidance of €180 million to €200 million, which still remains above our initial guidance for 2019.

We will continue to invest in **innovation and digitalisation** in 2020. At the moment, we are working on a portal for our Commercial Real Estate Finance clients – but we are also pressing ahead with other projects, and will keep expanding CAPVERIANT.

Furthermore, we remain in a very good position to meet our future capital requirements. In view of the new regulatory requirements, particularly relating to the TRIM project and the EBA Guidelines, pbb has already geared its risk weighted assets to the level to be expected under Basel IV by the end of 2019, by calibrating the default loss ratios in its core portfolio higher and thereby showing higher risk weights. Due to the Group's solid capital base, capital ratios remain well above regulatory requirements, even in the wake of these changes.

We are anxiously watching **current developments**, not only with regard to the persistently low property yields in the commercial property market and the valuation risks associated with them, but also with regard to the broader economic ramifications of the current virus outbreak. However, we do not currently see any reason for further measures beyond the Bank's existing positioning.

2. FINANCIALS

I am now going to talk about the consolidated income statement. For further information on the consolidated income statement, please refer to our Investor Relations presentation, from which we also took the tables and graphics that we have provided for you. I intend to concentrate on the key aspects and not go into detail about each individual item. Our annual report will be published at the end of March.

I should point out here that, as usual, all figures are consolidated results for the pbb Group and that the financial statements were prepared in accordance with IFRS. Whilst the financial statements have already been audited, the figures must be formally considered 'preliminary' until the financial statements have been approved by the Supervisory Board.

2.1 Operating income

Operating income rose by 7% to €506 million during the year under review (2018: €471 million, CHART 3).

I already touched on **net interest income** in my introduction. Following a significant increase to €450 million in 2018, we again lifted our most important earnings item to €458 million in 2019.

- As a result of new business, our average interest-bearing funding volume increased. In other words: New business not only compensated for ongoing repayments relating to strategic business, but also for the reduction in business from the non-strategic value portfolio, which is in the process of being wound down.

  Increased volume and a slightly higher total overall margin – the latter benefiting from the higher weighting of the higher-margin real estate financing portfolio – resulted in higher **interest income**.

- At the same time, funding costs fell. The funding costs for new exposures remained below those for maturities, despite an increase over the previous year.

  In this area, we benefit from the low interest rate environment and the fact that pbb is able to fund itself almost exclusively via the capital markets. In the current environment, **wholesale funding** offers advantages over funding by way of deposits, as it is more cost-effective and can be steered on a more needs-based basis.

  Nevertheless, pbb is naturally also affected by the current interest rate environment when making investments in **equity and liquidity**. High-yield securities are about to expire and we are unable to replace them accordingly. Following the ECB interest rate decision, deposits with the German Bundesbank are increasingly becoming a burden.

- In addition, in a negative interest rate environment, we were able to impose **floors** in our lending business.

Net fee and commission income of €6 million was unchanged year-on-year: as in the past, its contribution to pbb's performance was not a material one. You know the reason for this: the vast majority of our commission income is allocated to net interest income.

Operating income also benefited from an increase in **prepayment fees**. These are booked in net income from realisations and totalled €39 million, compared with €16 million in the previous year.

2.2 Net income from risk provisioning

Net income from risk provisioning amounted to €49 million (2018: €14 million, CHART 4).

- This increase was partly due to provisions **for stage 1 and stage 2 impairments**, which are determined on a model basis. **Net additions here amounted to €16 million** (2018: net reversals of €9 million).

  More relevant, though, is a look at the **gross figures.**

  In view of the increased probability of a global economic and sector-specific downturn, we made gross additions of **€31 million** to general impairment losses on performing exposures. These were offset by reversals of €15 million resulting from lower probabilities of default and loss given default, particularly for certain Southern European counterparties, as well as from early loan repayments and shortened remaining terms.

- We made **net additions of €33 million (2018: € 19 million) to level 3 specific impairment losses**. These additions related almost exclusively to financings of shopping centres in the UK. We had already made allowances for this asset class back in 2018. As in the previous year, changes in valuation as a result of higher yield expectations and a lack of market liquidity had an impact here, yet there are no payment defaults to report; in most cases, projects displayed sufficient liquidity – despite a drop in income. New impairments are offset by minor reversals, including the reversal of an impairment loss on a UK retail shopping centre that was sold despite challenging market conditions.

2.3 General and administrative expenses

General and administrative expenses also rose slightly to €202 million from €193 million in the previous year (CHART 5). A number of aspects need to be considered here:

- At €192 million, general and administrative expenses in 2018 – due to the reversal of certain provisions – were below those of previous years, when we tended to report levels just less than €200 million.

- The moderate increase in general and administrative expenses was due, among other things, to investments in projects driven by regulatory requirements, which increased non-personnel expenses. We have also strengthened our investment in pbb's future and in measures aimed at improving our efficiency. I will go into more detail about these investments later.

- We do not take the increase in our costs for granted. Rather, we have been able to fund part of the additional costs through savings that we have made. These came from efficiency gains resulting from the centralisation of certain tasks at head office, and from re-dimensioning our Public Investment Finance business.

2.4 Results

I would now like to turn to our **results** (CHART 6).

- In the financial year 2019, pbb increased its **pre-tax profit** to €216 million (2018: €215 million).

- Profit after taxes amounted to €179 million, unchanged from the previous year.

  Income taxes resulted from an actual tax expense of €22 million (2018: expense of €35 million) and a deferred tax expense of €15 million (2018: expense of €1 million). Changes to current and deferred tax items resulted from the tax authorities' amendments to the tax treatment of a large-volume, multi-year transaction.

- Of the net income after taxes, **€162 million was attributable to our ordinary shareholders.** This figure is lower than the previous year's figure of €167 million despite the same after-tax profit. This is due to the coupon payment for the additional tier 1 (AT1) capital, which we issued in April 2018: owing to the issuance during the year, the coupon of €12 million in 2018 only accrued on a pro rata basis, while in 2019 it was €17 million for a full year.

2.5 Dividend proposal and new dividend policy

The profit attributable to ordinary shareholders forms the basis for dividend distributions: In accordance with our dividend policy, we intend to distribute 50% of the €162 million as a regular dividend and 25% as a special dividend, totalling €121.5 million. This translates into earnings per share of €1.20, and a **dividend of €0.90** per share.

The Management Board and the Supervisory Board will propose a distribution of said amount to the Annual General Meeting on 28 May 2020. The proposed dividend is slightly below the dividend for 2018 for the following reasons:

- Firstly, the profit attributable to ordinary shareholders is €5 million lower (the AT1 bond issued in 2018 paid out its first full coupon in 2019).

  Secondly, we have left the dividend payout ratio at 75%. For the last two years prior to this, we used the guidance as the basis for the communicated payout ratio, and distributed any excess amount after taxes in full. In view of the relatively small difference between this split approach and a 75% distribution based on the after-tax profit generated, we have not applied any differentiation this year. We therefore remain within the scope of our dividend policy and are thus within the range of analysts' consensus. Our dividend yield of 7.9% puts us in good stead compared with the market, based on the average share price (6.2% based on the year-end price).

As keen observers of pbb, you know that we have determined our dividend policy for 2017-2019. We intend to **maintain this dividend policy for the financial years 2020 to 2022**.

- Accordingly, we therefore intend to continue to distribute to our shareholders a regular dividend of 50% plus a special dividend of 25% of the consolidated profit after taxes attributable to shareholders – i.e. consolidated net income after taxes and AT1 coupon payments.

- Future distributions will depend upon economic viability, a generally more cautious assessment of the overall economic development and real estate markets, as well as upon possible regulatory requirements and demands.

- We are committed to maintaining a stable dividend payout ratio over the long-term and will review it regularly in light of these particular risks.

2.6 Key regulatory capital ratios and SREP

As expected and in line with previous capital market communication, **risk-weighted assets** (RWAs) rose during the fourth quarter of 2019 and totalled €17.7 billion at year-end (CHART 7). The increase in risk weights in commercial real estate financing is mainly due to the new requirements of the European Banking Authority (EBA) and the expected effects of the Basel IV banking regulations. The result of the associated recalibration of the Bank's risk parameters are risk-weighted assets that reflect a level that complies with Basel IV requirements. This way, pbb is also addressing the capital market's expectation that upcoming regulatory changes will be taken into account at an early stage and will better cushion future cyclical RWA fluctuations.

In fact, we are doing what we will have to do anyway, due to regulatory requirements, we do it already now for the purpose of consistency – moreover, we are raising the resilience of our capitalisation against cyclicality and stress, at the right time.

Regulatory authorities refer to RWAs when determining banks' capital requirements. As a result of the increase in RWA, pbb's **capital ratios** fell, but remained well above the regulatory requirements and above industry comparison figures. Following approval of the annual financial statements, including the appropriation of profits, the following ratios apply:

- The **CET1 ratio** at the end of December 2019 was 15.2% (31 Dec. 2018: 18.5%); **Tier 1** ratio was 16.9% (31 Dec. 2018: 20.5%).
- The **own funds ratio** was calculated at 20.4% at the end of 2019 (31 Dec. 2018: 24.9%).
- The **leverage ratio** amounted to 5.3% (31 Dec. 2018: 5.3%).

Within the scope of the Supervisory Review and Evaluation Process (SREP), supervisory authorities assess and measure the risks that banks are exposed to. The **SREP requirement** for common equity tier 1 (CET1) capital was set at 9.5% for pbb from 1 January 2020 on a consolidated basis, and has remained stable compared to the previous year. The ratio is derived from the so-called Total SREP Capital Requirement (TSCR) of 7% CET1 plus the capital conservation buffer of 2.5% CET1. In addition, pbb must maintain an anticipated countercyclical capital buffer of 0.45% (2019: 0.35%). The SREP Total Capital Requirement (TSCR) in relation to own funds is 10.5%, on a consolidated basis.

2.7 Total assets

There was a small decline, mainly due to slightly lower financial assets measured at fair value through profit or loss, as well as financial assets at fair value through other comprehensive income, due to sales, syndications and maturities. Within financial assets at amortised cost, the nominal volume of commercial real estate finance increased slightly, in line with our strategy (€27.1 billion; 31 December 2018: €26.8 billion), whereas the volume of non-strategic portfolios declined. Tangible assets increased due to the activation of the right of use for pbb's new leased corporate headquarters in Garching, in accordance with IFRS 16.

3. Lending and funding

3.1 Markets, new business, and portfolio

3.1.1 2019

As I mentioned in my introduction, real estate markets remained in good structural shape overall – despite increased macroeconomic and political uncertainty and higher valuation risks – and so **the positive phase of the cycle continued.** Demand in the investment and space markets was high, so prices and rents remained stable for the most part. Renewed interest rate cuts by the ECB increased the relative attractiveness of the real estate asset class in particular, putting further pressure on yields.

Last year, standing at this very same spot, I highlighted the potential for instability that we are seeing. It did not materialise in 2019 (only in certain markets) – but in our view remains a major factor. The pressure points have not changed in this respect, and as I just mentioned, **individual markets continue to show weaker development.**

- This applies, for instance, to **retail properties, especially in the UK**, which are particularly affected by structural changes in the sector.

- Moreover, market players have had to – and continue to – deal with the uncertainty resulting from **Brexit** and the ongoing lack of clarity regarding an orderly transition.

  It should be noted, however, that the market for office space in London remained stable: new lettings in 2019 were only slightly below their long-term average, vacancy rates remain low and rents are rising in key office locations. Indicators in the investment market are somewhat weaker: Investment volume in 2019, for example, fell by more than a third while yields remained stable. More than half of all investment is coming from abroad.

pbb continues to position itself cautiously in this environment, which remains highly competitive. For the second year in a row, we have deliberately scaled back on **new business**, focusing more on higher-margin business and of course, on meeting our own high risk standards.

- This approach resulted in new business **totalling €9.3 billion**.

- Of this amount, **€9 billion was attributable to Commercial Real Estate Finance** (including extensions of more than one year), and we thus remained precisely in the middle of the range we set ourselves (CHART 8).

  Average Gross new business margin continued to rise since the first quarter. While the composition of new business in the first quarter led to an average gross new business margin of 135 bp, the margin rose during the course of the year and, at an average of around 155 bp over the year as a whole, was exactly the same level as in 2018.

  Germany remained the most important individual regional market for pbb, accounting for 47% of new business. Among the types of property financed, **office buildings** accounted for the lion's share, with 50%. For the year as a whole, the **US** accounted for 15% of new business and currently represents the second largest individual market for pbb (2018: 13%). Conversely, business in the **UK** declined as planned, with a 7% share (2018: 11%).

3.1.2 Credit market outlook

Looking ahead, **concerns about a macroeconomic slowdown** are still very real. The macroeconomic environment remains subdued. In its outlook, the International Monetary Fund (IMF) sees global economic growth of 3.3%. Although this outlook is higher than the growth rate achieved in 2019, it is lower than forecast in the previous year. The reasons for muted economic growth are the persistent risks relating to world trade and geopolitical uncertainties. The latest concern is the impact of the coronavirus epidemic on the global economy. Also within the euro area, the picture for growth is also rather blurry. Nevertheless, **new business in 2020** is developing in line with our expectations over the first two months

3.2 Funding and capital markets

3.2.1 2019

In 2019, pbb's **new long-term funding volume** reached €6.7 billion (2018: €5.2 billion, CHART 9).

- The increase was attributable to significantly higher volumes of **unsecured issues**, which rose to €3.6 billion (2018: €1.6 billion).

  Even a rough calculation shows that unsecured issues account for more than half of our funding volume – which, at first glance, does not seem to fit the mould typical of a Pfandbrief bank. One of the reasons is the reduction in the volume of deposits taken via pbb direkt, because in the current interest rate environment we have comparatively higher funding costs here than on the capital market.

  pbb continues to issue unsecured bonds, almost exclusively in the form of **"senior preferred" issues**. Due to their ranking in the liability cascade, they have lower risk premiums than non-preferred bonds. As in previous years, pbb has systematically and successfully expanded its share of foreign currency issues in order to continue funding lending business in non-euro currencies wherever possible with matching currencies.

- At €3.2 billion, **Pfandbrief issues** were slightly down on the previous year (2018: €3.6 billion).

Issuing spreads (over 3-month Euribor) remained higher in 2019 compared with the previous year,

- averaging 15 bp (2018: 6 bp) for **Mortgage Pfandbriefe** and 21 bp (2018: 0 bp) for Public-Sector Pfandbriefe.

- For **unsecured issues** the spreads were 74 bp (2018: 42 bp, with a reduced portion of senior preferred bonds).

- the current year's **funding costs** have remained below the levels of maturing funding instruments.

Unsecured benchmark transactions typically have shorter **maturities** than private placements, as do foreign currency issues, which tend to be shorter in nature. As a result, we report somewhat shorter terms – however shorter terms are required in our asset/liability reconciliation: At an average of 6.7 years for Pfandbriefe and 5.9 years for unsecured funding, terms remained significantly higher than those of new business on the assets side.

3.2.2 Outlook for the funding markets

During the current year 2020, we expect to be able to realise average funding costs on new issues which will still be below the **interest expense on the existing portfolio**. However, the cost benefits of new versus expiring funds are likely to continue to decrease.

4. Corporate development

Once again in 2019, we implemented or initiated a series of **improvements and innovations**.

- One of these initiatives makes particularly good use of the diversity within the Bank: employees from a wide variety of functions within the Bank, across different locations and from all levels of the corporate hierarchy, are working as part of a team to develop new ideas. Although this is not limited to initiatives relating to digitalisation, it is true that all of the ideas developed over the past year were very much along these lines. The chosen project proposals are currently being evaluated and prepared for implementation. We like to focus on generating new ideas and concepts in-house, rather than buying them in from outside.

- The projects essentially fit into one of three key areas defined in our **digitalisation strategy** (CHART 10), namely (1) improving customer interfaces, (2) increasing internal efficiency and (3) developing **new sources of income.**

  When seeking to tap new sources of income through digitalisation, **platforms** are absolutely essential today. Platforms are business models that specialise in linking market players – they bring together supply and demand on an electronic infrastructure in such a way that both sides of a market can operate freely. They stem from areas where supply and demand tend to be fragmented and lack transparency. Whilst platforms originally focused more on B2C relationships, today, more and more B2B relationships are becoming the main focus.

  Although the market for public sector financing is well established, it tends to be organised locally. This makes it difficult for investors in particular to access the market. In 2018, pbb launched its public finance platform **CAPVERIANT.** CAPVERIANT is a wholly owned subsidiary of pbb and is positioned as a Fintech within the Bank. The platform digitalises the market for public financing in Europe and brings together the borrower and lender sides: representatives from the public sector have the opportunity to present their projects to potential financing partners. In return, institutional investors can submit loan offers. At present, the platform is targeting the markets in Germany and France. CAPVERIANT is experiencing growing user numbers and a significant increase in the number of financing tenders.

  Of course, we are also looking into the question of whether, and if so, how and when **platforms for commercial real estate financing** will become available.

  Our digitalisation initiatives are also aimed at improving the **interfaces between ourselves and our clients**, and to increase the **efficiency of our internal processes**. A new portal linking our customers to pbb is currently being developed and is scheduled for market launch in the second half of 2020. We also use software robots in various places – intended to relieve our colleagues of the more time-consuming tasks associated with lower productivity.

- In addition, we plan to take further steps towards **aligning our core business with sustainable real estate financing**: We plan to introduce green loans and issue green bonds. This way, we hope to meet the requirements of a broad range of stakeholders in terms of sustainable finance.

5. TARGETS 2020

This brings me back to the outlook (CHARTS 11 and 12).

In view of current market and competitive conditions in **commercial real estate financing, we remain cautious in 2020 and will continue to pursue our conservative risk policy.**

- This is particularly evident in **new business**. Here we are aiming for a volume of between €8.0 billion and €9.0 billion in our Commercial Real Estate Finance business, thus matching the previous year's volume.

- We also anticipate a slight decline in **average gross new business margins** in this business segment – however, we will be doing everything we can to keep margins stable.

- In terms of **funding volume**, we are aiming for moderate growth.

We are also continuing to focus on a strong **operating performance**, while maintaining higher risk provisions due to the more cautious market outlook.

- In terms of **profit before taxes**, we are aiming for a figure between €180 million and €200 million, following our initial guidance of €170 million - €190 million for 2019.

- We also expect a stable development in the aggregate of **net interest income and net fee and commission income, loss allowance, and administrative expenses.** We expect prepayment fees to decline from the high levels of 2019.

With a view to future capital requirements, we believe that we are in a good position following the calibration of our RWAs to a level that is in line with the expected Basel IV requirements.

6. CONCLUSION

Dear Ladies and Gentlemen,

Let me summarise my comments:

- pbb is, and will remain, cautious in an environment that is challenging in terms of the development of the overall economy and real estate markets, as well as the current competitive situation. On top of this are concerns regarding the spread of the coronavirus: the consequences of this epidemic are still hard to assess. For the second year in a row, we have deliberately scaled back on **new business**, focusing more on **higher-margin business** and of course, on meeting our own **risk standards**.

  We will continue to follow this path in 2020.

- Our solid pre-tax result of €216 million in 2019 means that we have built on last year's strong performance.

  We want to continue this positive **operating performance** in 2020 and are aiming for pre-tax profit of between €180 million and €200 million.

- With higher **loss allowance** and **calibrating RWAs** to a level consistent with the expected Basel IV requirements, during 2019 we have made pbb even more resilient to market conditions.

  We assume that loss allowance will be stable at this higher level in 2020. Our strong capital base, even after recalibration of RWAs, remains one of pbb's greatest strengths.

- We have continued to make targeted investments in pbb's future.

  We will continue to pursue our **digitalisation initiatives** in a highly focused manner. Our new Commercial Real Estate Finance client portal will represent another major achievement for us.

- With a **dividend proposal** of €0.90 per share and a corresponding dividend yield of 6.2% or 7.9% – depending on the calculation basis – pbb confirms its position as a dividend stock.

  We **intend to pursue the same dividend policy with a regular dividend of 50% and a special dividend of 25% for the financial years 2020 to 2022**. We are committed to maintaining a stable dividend payout ratio over the long term, which we will review on a regular basis in light of these particular risks.

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Thank you very much for your attention. I now look forward to your questions.