



Volksbanken Raiffeisenbanken  
cooperative financial network

# HALF-YEARLY FINANCIAL REPORT 2019

30 June 2019

## DEVELOPMENT OF NEW BUSINESS

€ mn	1 Jan to 30 Jun 2019	1 Jan to 30 Jun 2018
Commercial Real Estate Investors	3,514	2,955
Housing Sector	340	464
Retail Customers/Private Investors	924	1,289
Public-Sector	292	374

## PORTFOLIO DEVELOPMENT

€ mn	30 Jun 2019	31 Dec 2018
Total assets	76,057	75,891
Mortgage loans	47,327	45,289
Originated loans to local authorities	11,236	11,789
Local authority lending*	12,350	12,608
Bank bonds	437	571
Mortgage-backed securities (MBS)	500	542
Pfandbriefe and other debt securities	49,309	49,995
Own funds	2,202	2,276
Total capital ratio (%)	13.3	13.3
Common equity tier 1 ratio (%)	8.8	9.0

## PROFIT AND LOSS ACCOUNT

€ mn	1 Jan to 30 Jun 2019	1 Jan to 30 Jun 2018
Net interest income	263.6	266.2
Net commission result	-8.2	-16.0
Administrative expenses	134.8	158.1
Net other operating income/expenses	2.5	2.5
Risk provisioning	-23.6	-48.6
Net financial result	0.4	34.3
Operating profit	99.9	80.3
Allocation to the fund for general banking risks	29.0	27.0
Taxes	33.9	18.2
Partial profit transfer	8.0	8.1
Profits transferred under a profit and loss transfer agreement	29.0	27.0

## NUMBER OF EMPLOYEES

	30 Jun 2019	31 Dec 2018
Average	872	873

\* Lending transactions with national governments and sub-sovereign entities as well as state-guaranteed corporate bonds.

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# LETTER FROM THE MANAGEMENT BOARD

**Dear Ladies and Gentlemen, dear business associates,**

DZ HYP's stable business development continued unchanged during the first half of 2019. We again performed well in an environment characterised by low interest rates, increased regulatory requirements and a challenging competitive field. The results reflect the Bank's success and sustainable business model with regard to both new business and earnings. During the period under review, we generated an operating profit of around €100 million (H1 2018: €80.3 million).

Concerning new business, the positive conditions on the real estate market presented us with opportunities that we were able to exploit during the reporting period. Low interest rates, in particular, continued to fuel sustained demand for real estate in a solid economic environment. In our four divisions, Commercial Real Estate Investors, Housing Sector, Retail Customers/Private Investors and Public-Sector, we generated new business worth a total of around €5 billion, on a par with the encouraging level seen in the same period of the previous year.

Our strong roots in the Cooperative Financial Network play a key role in this context. We have been collaborating closely with German cooperative banks, in a spirit of trust, for many years now and were able to successfully continue this positive cooperation in the first half of 2019. In Commercial Real Estate Finance, we saw a considerable increase in the volume of business conducted jointly with the cooperative banks. As part of our spring cooperative banks campaign, we once again made special offers for private home loan financing available to our customers. This campaign generated the highest turnover seen since regular campaigns were introduced back in 2013. Our cooperation with the Cooperative Financial Network – which is based on mutual trust – also proved effective with regard to loans to local authorities. Around 80 per cent of all new business in this area is intermediated by the cooperative banks.

DZ HYP also enjoys a good position in terms of its brand strength. The Berlin-based European Real Estate Brand Institute (EUREB Institute) awarded us the title of the strongest banking brand in the real estate sector as part of a survey of 22,000 real estate experts throughout Germany. The individuals surveyed mentioned transparency, regional expertise and high levels of customer loyalty as the key central characteristics that they value in DZ HYP. The award also confirms the competitive position of the Cooperative Financial Network, as we always present ourselves in collaboration with the German cooperative banks, meaning that the umbrella brand is an integral part of our brand identity.

We will continue to work intensively on developing the market in all four divisions as the year progresses, acting as a capable partner to our customers. The overall environment in the real estate industry remains favourable in 2019. We expect to see sustained demand for the time being in spite of rising prices and high construction costs. Local presence, decentralised market coverage and short decision-making channels are key success factors that enable us to respond quickly and flexibly to the wishes and requirements of our clients. Hand-in-hand with the cooperative banks, we believe that we enjoy a solid position as a competent financing partner.

Yours sincerely,



Dr Georg Reutter  
Chief Executive Officer



Dr Carsten Duerkop



Manfred Salber

Hamburg/Münster, September 2019

## ECONOMIC ENVIRONMENT

Economic development in Germany remained robust in the first half of 2019, although an economic slowdown is starting to emerge. Nevertheless, the labour market remained in good shape during the reporting period. The number of people unemployed in Germany fell to 2.2 million as at 30 June 2019, which equates to an unemployment rate of 4.9 per cent (H1 2018: 5.0 per cent), down slightly on the same period of the previous year. Demand for employees in the corporate sector remains at a high level. Construction investments once again reaped the benefits of the ongoing positive development in the real estate sector in the period under review, charting another year-on-year increase.

Given the trade conflicts, the mounting tension between the United States and Iran and the most recent developments in the United Kingdom, the economic outlook remains gloomy. Incoming orders have not yet made a recovery following the marked slump seen at the beginning of the year; both the production index and the export outlook have been on the decline for several months now. Thanks to the solid situation on the labour market, private consumption remains one of the main pillars propping up the economy, although the expiring catch-up effects in the automotive industry and fiscal measures are putting a damper on the domestic economy. The consumer climate is gradually clouding

over, although the propensity to buy is still at a high level. Consumers remain optimistic about their own financial situation.

Escalation of the trade dispute between China and the US dealt a blow to the euro area in the period under review. Although Europeans are not immediately affected by the tariffs being levied, and the impact on the European economy is not a direct one, the headwind coming from foreign trade is picking up. To date, this trend has not left any mark on the unemployment rate, which continued to recover in the period under review, albeit to a varying extent in the individual EMU countries. While the downward trend in registered unemployment remained a subdued development in France and Italy, the rate fell again in Spain. Domestic demand – and in particular private household consumption – remains one of the engines driving growth in Europe and is receiving an additional boost from a labour market that remains robust.

The confrontation between the European Union and the Italian government was a source of further uncertainty in the reporting period. By the end of the period under review, however, the situation had calmed down again with an agreement on new debt and the decision not to launch an excessive deficit procedure. Overall, these uncertainty factors are putting an increasing strain on German companies. The Ifo

business climate index fell in June for the third time running to 97.4 points, its lowest level since November 2014.

On the financial markets, the changes in expectations regarding monetary policy were recently reflected in dwindling yields on long-dated German government bonds, further narrowing the yield spread between the capital market and the money market. The spread is now only just above the zero mark, the lowest level seen in more than ten years. The German blue-chip DAX index showed positive development in the reporting period, clocking up gains of 17.4 per cent.

### Development of the real estate markets

The upward trend in the real estate industry that has been ongoing for ten years now continued in the period under review, also thanks to financing conditions that remain favourable. The slowdown in economic development in Germany that started to emerge in the first half of 2019 has not had any negative impact on investment activity so far. The service sector is performing well, ensuring sustained demand for real estate in the country's cities. As a result, Germany's major metropolitan areas are faced with a lack of housing and increased demand for office properties. Net immigration from abroad remains at a high level, providing additional demand impetus. To date, the supply side – shaped by a lack of skilled workers and capacity bottlenecks in the construction industry – has only been able to provide a scant response. Accord-

ingly, this has led to price increases that are spreading from the conurbations to the surrounding areas.

Transaction volumes on the commercial real estate investment market (excluding residential real estate) of €24.2 billion for the period ending on 30 June 2019 were down on the prior-year level (€25.6 billion). Including the residential real estate asset class, investment turnover came to €32.2 billion in the reporting period. The focus remained on the seven largest cities – Hamburg, Berlin, Düsseldorf, Cologne, Frankfurt, Stuttgart and Munich – which, at more than €17 billion, accounted for 58 per cent of transaction volumes. The performance figures paint a mixed picture. Whereas Berlin accounted for six out of the ten largest transactions in Germany's cities (+36 per cent), the decline was the most pronounced in Hamburg (–49 per cent) and Munich (–44 per cent). The proportion of foreign capital sources for the entire first half of the year stood at 34 per cent. Domestic investors retain a corresponding weight on the buyer side and are responsible for five out of the ten largest transactions.

Investors are still focusing on office properties, which account for a volume of €11.6 billion or 36 per cent (H1 2018: €11.4 billion or 45 per cent), followed by retail properties, with a volume of €4.8 billion or around 15 per cent (H1 2018: €4.6 billion or just under 18 per cent). The prime yield for top office properties averaged 3.1 per cent

and was thus down on the prior-year level (H1 2018: 3.2 per cent). Investor demand, the development in government bonds as a 'risk-free' alternative investment and expectations of further rent increases are all putting pressure on yields. Nothing has changed outside of the top locations of the seven largest cities, nor for properties of lesser quality. With shorter residual terms or vacancies, the yield is currently sitting at 3.9 per cent.

The ever closer links between the retail and logistics sectors led to rising prices for logistics properties, pushing the prime yield down to 3.9 per cent (H1 2018: 4.3 per cent) – the first time it has fallen below the four per cent threshold. As far as retail properties are concerned, the disparity between the individual segments that emerged at the end of 2018 is ongoing. While yields for shopping centres rose by 10 basis points to 4.2 per cent, yields for specialist retail centres were down due to the continued strong demand. At 4.3 per cent (H1 2018: 4.5 per cent), these yields are moving ever closer to the yields for shopping centres. The prime yields for individual specialist retail stores remained almost unchanged at 5.1 per cent (H1 2018: 5.2 per cent), as were yields for inner-city commercial buildings at 2.9 per cent (H1 2018: 2.9 per cent).

On the commercial residential investment market, the transaction volume fell by around 25 per cent to €8.1 billion as at 30 June 2019 (H1 2018: €11.3 billion). This is not due to a lack of demand, but

rather to a lack of supply. The number of transactions slid by more than 17 per cent. The market is dominated by smaller and medium-sized deals, which explains why almost 40 per cent of all transactions in the reporting period were in the range of €20 million to €100 million. The number of investors based in Germany has reached a new high, corresponding to more than 90 per cent of the capital invested (H1 2018: around 80 per cent). Open-ended mutual funds, special funds and municipal non-profit housing companies rank among the biggest net investors. Berlin remains the only market to have broken through the one billion euro threshold, albeit with a decline of almost 15 per cent. In Berlin, €1.5 billion was invested in apartments (H1 2018: €1.65 billion). The German capital was followed by Frankfurt am Main, where the figure was up by 5 per cent to €700 million (H1 2018: €920 million), and Hamburg, albeit with a total figure invested that dropped by more than a quarter (€550 million; H1 2018: €750 million).

The dynamic development on the residential real estate markets continued in the first half of the year. The rents agreed when tenancies are renewed have risen by an average of 52.6 per cent since 2010 in the seven largest German cities. The increase in the prices of owner-occupied apartments upon resale has been much more pronounced, averaging 117.6 per cent. Year-on-year increases in rental and price levels slowed again during the first half of 2019. Rental levels for re-lets in the cities included in the analysis rose by 1.7 per cent

on average during the period under review, compared to 2.0 per cent in the previous year. Demand-side pressure remains high in an environment characterised by insufficient supply. Overall, this means that the growth rate fell short of the 5.5 per cent average of the last five years. Hamburg recorded the highest growth in rental levels (2.7 per cent) during the period under review; the rate in Cologne (0.9 per cent) was the weakest.

Growth in resale prices for owner-occupied apartments in Germany's seven largest cities averaged 3.7 per cent in the reporting period. Nonetheless, individual cities posted clearly above-average increases in purchase prices, including Berlin (plus 6.7 per cent), Cologne (4.3 per cent) and Frankfurt (4.2 per cent). At the same time, prices per square metre in these high-growth markets were spread across a wide range, between €3,650 in Cologne and €4,950 in Frankfurt. Prices in Munich averaged €7,400 per square metre during the period under review. Overall, completions of residential property continued to fall short of requirements during the first half of 2019. As long as this situation persists, no decreases in rental levels or purchase prices are on the horizon.



# CREDIT BUSINESS

The overall conditions for the real estate markets were consistently positive in the first half of 2019, with the low interest rates, in particular, fuelling strong demand for real estate. The volume of new business in DZ HYP's Commercial Real Estate Investors, Housing Sector, and Retail Customers/Private Investors divisions totalled €4,778 million in the period under review (H1 2018: €4,708 million). Including business with public-sector, the volume of new commitments came to € 5,070 million (H1 2018: € 5,081 million). Factors in the Bank's success include its business model, which is geared towards sustainability and a long-term focus, and cooperation with its partners and clients in a relationship based on trust.

## Real estate finance

In the **Commercial Real Estate Investors division**, DZ HYP is a leading provider in Germany and a partner to the German cooperative banks. New business of €3,514 million was generated in the first six months of 2019 (H1 2018: €2,955 million). In line with the Bank's strategic direction, business with commercial real estate investors originated in its core German market accounted for the largest part at €3,321 million (H1 2018: €2,852 million). DZ HYP originated new business volume of €193 million in selected international markets during the period under review

(H1 2018: €103 million). The Bank's focus is on the core segments of office, housing and retail properties. DZ HYP is also involved in the specialist segments of hotels, logistics and real estate for social purposes within the scope of its credit risk strategy. Target clients are private and institutional investors, as well as commercial and residential real estate developers. DZ HYP considerably stepped up its cooperation within the Cooperative Financial Network in this division during the reporting period. Joint lending business with the cooperative banks totalled €2,277 million in the first half of 2019 (H1 2018: €1,554 million).

In the **Housing Sector division**, DZ HYP generated a new business volume of €340 million during the period under review (H1 2018: €464 million). In particular, the Bank provided long-term financing for investment projects focusing on new construction and modernisation measures. The Bank works with companies providing affordable housing for a substantial share of the population, including cooperative, municipal, church-owned and other housing enterprises across Germany. Together with cooperative banks, DZ HYP financed investment projects launched by housing companies worth €18 million in the reporting period (H1 2018: €42 million).

In the **Retail Customers/Private Investors division**, the volume of new com-

mitments entered into by DZ HYP came to €924 million (H1 2018: €1,289 million). Customer demand for long fixed-interest periods was supported by the ongoing low interest rates in the period under review. As part of the Cooperative Financial Network, DZ HYP also works closely with cooperative banks in this division. Joint customers include private developers and investors acquiring properties as owner-occupiers, or for investment purposes. The latter are targeted exclusively in the brokered or syndicated lending business with cooperative banks. The volume of new commitments (retail customers) intermediated via the core banking procedures of the Cooperative Financial Network and the Genospace and Bauфинex network portals amounted to €708 million in the reporting period (H1 2018: €896 million). In its business with private investors, the volume of new commitments entered into by DZ HYP amounted to €216 million (H1 2018: €393 million).

## Business with public-sector

Within the Cooperative Financial Network, DZ HYP supports cooperative banks in developing business with domestic local authorities as well as their legally dependent operations, which are serviced across Germany. DZ HYP originated new business volume of €292 million in its business with public-sector during the period under review (H1 2018: €374 million), of which €231 million (H1 2018: €270 million) was referred by cooperative banks and €61 million (H1 2018: €104 million) was

originated through direct business. More than 83 per cent of all transactions in this business area were referred by cooperative banks.

## Reduction of non-strategic portfolios

DZ HYP's non-strategic portfolio comprises the portfolio of mortgage-backed securities (MBS) and the non-strategic part of the sovereign/bank securities portfolio, which includes Portugal, Italy and Spain. The primary objective is to run the portfolio down carefully. In the first half of 2019, the non-strategic portfolio was wound down further as a result of disposals, repayments and maturities from €4.7 billion as at 31 December 2018 to €4.4 billion as at 30 June 2019. DZ HYP will continue to adhere to this strategy and the resulting portfolio reduction.

## Refinancing

The European covered bond market proved to be extremely robust in the first six months of 2019. In an environment characterised by lively activity, a total of 111 covered bonds in euro benchmark format with a total volume of €92.2 billion were placed on the primary market during the reporting period. This volume translates into an increase of 5.4 per cent as against the prior-year period (H1 2018: €87.5 billion) and represents the most lively issuance activity witnessed over the last eight years. German issuers made a particular contribution to this higher issue volume, followed by French, Dutch and Canadian issuers.

The greatest investor demand for covered bonds also came from the German-speaking countries, which accounted for a share of around 54 per cent.<sup>1</sup>

This market development can be traced back primarily to the change in the European Central Bank's 'narrative' during the first half of 2019. Faced with a slowing economy and lower inflation expectations, the ECB has postponed its anticipated interest rate turnaround until mid 2020 at the earliest. The ECB also announced a new targeted longer-term refinancing operation (TLTRO III) in the second quarter. These measures resulted in a drop in bank refinancing levels until mid 2019.

DZ HYP exploited the positive market environment by issuing a €750 million, ten-year Mortgage Pfandbrief at the end of January. In the second quarter, the Bank placed its first 15-year benchmark Mortgage Pfandbrief in an amount of €500 million. In addition, Mortgage Pfandbriefe with a volume of €547 million were issued via private placements in the first six months of 2019 (H1 2018: €770 million<sup>2</sup>).

As at 30 June 2019, DZ HYP Pfandbriefe with a total volume of €43.9 billion were outstanding (H1 2018: €44.9 billion), with €29.2 billion attributable to Mortgage Pfandbriefe (H1 2018: €28.7 billion).

Uncovered funding of €2,691 million (H1 2018: €2,022 million) was raised primarily within the Cooperative Financial Network.

<sup>1</sup> DZ BANK Research: Covered Bonds dated 8 July 2019.

<sup>2</sup> Excluding €500 million in short-term issues for the purpose of participating in Deutsche Bundesbank's long-term refinancing operations.

## NET ASSETS, FINANCIAL POSITION AND FINANCIAL PERFORMANCE

### Net assets

At €76.1 billion, DZ HYP's total assets are up by €0.2 billion in a year-on-year comparison, with an encouraging increase in the Real Estate Finance portfolio to €47.3 billion (31 December 2018: €45.3 billion). Originated local authority lending exposures declined slightly, to €11.2 billion, in the first half of 2019 (31 December 2018: €11.8 billion). The

public finance exposure also dropped to €12.4 billion in the first half of 2019 (31 December 2018: €12.6 billion). The exposure to bank bonds dropped back to €0.4 billion as planned (31 December 2018: €0.6 billion).

Exposures to countries and banks that are particularly affected by the debt crisis have developed as follows during the period under review (details excluding MBS):

Nominal amounts € mn	Sovereigns*		Banks		Total	
	30 Jun 2019	31 Dec 2018	30 Jun 2019	31 Dec 2018	30 Jun 2019	31 Dec 2018
Spain	1,371	1,396	110	260	1,481	1,656
Italy	1,672	1,681	–	–	1,672	1,681
Portugal	750	750	–	–	750	750
<b>Total</b>	<b>3,793</b>	<b>3,827</b>	<b>110</b>	<b>260</b>	<b>3,903</b>	<b>4,087</b>

\* Including state-guaranteed corporate bonds and sub-sovereign entities.

Loans and advances to banks consisted exclusively of covered bonds.

Discussions concerning the political, economic and financial stability of European countries resurfaced during the first half of 2019. Particular sources of uncertainty included the confrontation between the EU and the Italian government over sovereign debt and the escalating debate over the United Kingdom's withdrawal from the EU. In addition to the ECB's expansive monetary policy, stabilising factors included the financial situation in the Mediterranean states as a whole, in particular the agreement on new debt that was later reached between the EU and Italy and the accompanying decision not to launch an excessive deficit procedure. As a result of these developments, credit spreads in the countries particularly affected by the sovereign debt crisis narrowed overall in the first half of 2019. The postponement of the United Kingdom's withdrawal from the EU until 31 October 2019 also has given both governments and the corporate sector the opportunity to prepare for a potential no-deal Brexit.

The hidden burdens for DZ HYP's securities (excluding MBS) that are treated as fixed assets were down to €29.6 million as at 30 June 2019 (31 December 2018: €40.9 million). This contrasts with undisclosed reserves in the amount of €1,654.9 million (31 December 2018: €1,099.3 million). In contrast to valuation changes for securities induced by changes in credit risk, the changes in the value of securities held resulting from swap curve movements are neutralised through offsetting interest rate transactions (including

derivatives) as part of DZ HYP's interest rate risk management (overall bank management). Looking at the positive change in the value of securities due to credit risk alone, the securities portfolio (excluding MBS) recorded total hidden burdens of €828.2 million (31 December 2018: €898.1 million). Following a comprehensive assessment of the credit quality of these securities, DZ HYP has concluded that none of the securities are permanently impaired. This also applies to the portfolio of Italian government bonds, which do however have a significant impact on the reported hidden burdens. By way of example, DZ HYP's hidden burdens would increase by €194 million if Italy's credit spreads were to widen by 100 basis points.

There have been no new investments in mortgage-backed securities (MBS) since mid 2007. At €0.5 billion, MBS (which form part of the non-strategic portfolio) were unchanged compared to the previous year end (31 December 2018: €0.5 billion). MBS holdings are intensively monitored by means of a detailed risk management system, regular analyses of individual exposures, and comprehensive stress testing. The development of material risk factors has confirmed the stabilisation of this non-strategic portfolio, which has been ongoing for several years now. Hidden burdens on this exposure, in the imputed amount of €35.0 million (31 December 2018: €37.7 million), reflect to a lesser extent the default risk of the securities. Illiquid markets and stricter regulatory capital requirements are more significant factors.

These are offset by undisclosed reserves of €0.1 million (31 December 2018: €0.1 million). In this respect, DZ HYP anticipates a write-back over the remaining term of the MBS portfolio.

DZ HYP's financial position is sound.

### Equity

DZ HYP has used the so-called waiver option provided under section 2a of the German Banking Act (*Kreditwesengesetz* – 'KWG'; old version) with effect from the reporting date of 31 December 2012. According to section 2a (1), (2) and (5) of the KWG (as amended) in conjunction with section 6 (1) and (5) as well as section 7 of the EU Capital Requirements Regulation (CRR), the provisions of parts 2-5, as well as parts 7 and 8 of the CRR, do not need to be applied by DZ HYP on an individual basis, but are covered at DZ BANK Group level instead. Against the backdrop of the currently existing control and profit transfer agreement, DZ BANK allocates equity to DZ HYP as required within the framework of Group management. The capital base is also regularly strengthened by allocations to the fund providing for general banking risks pursuant to section 340g of the HGB.

### Liquidity position

Within the scope of liquidity management, DZ HYP differentiates between ongoing liquidity management and structural funding. Appropriate management systems are

in place for both types of liquidity. Liquidity management takes into account (and complies with) the limits of the internal liquidity risk model, DZ BANK's liquidity risk model, and the regulatory risk requirements.

### Financial performance

DZ HYP's financial performance in the first half of 2019 reflects the successful operating performance in the Real Estate Finance business, but is affected as expected by the costs of ongoing merger work. As there are again no identifiable risk costs, significant amounts may be allocated to general risk provisions from the distributable half-year results for 2019 whilst retaining the forecast prorata profit transfer.

Based on this assumption, DZ HYP's net interest income of €263.6 million for the first six months of 2019 is down slightly, namely by €2.6 million, on the figure achieved in the first half of last year (H1 2018: €266.2 million). This drop is due to the premium payment made as part of an open market operation. At €8.4 million, the first-time realisation of this operation in the first half of the previous year was considerably higher than the current income of €3.2 million in the first six months of 2019.

DZ HYP uses economic performance indicators to measure the Bank's profitability<sup>3</sup> as part of its economic management, and operative as well as strategic corporate planning.

<sup>3</sup> Alternative performance ratios within the meaning of the APM Guidelines issued by the European Securities and Markets Authority (ESMA).



#### NET INTEREST INCOME IN DETAIL

€ mn	30 Jun 2019	30 Jun 2018
<b>Interest income</b>	<b>979.0</b>	<b>1,013.3</b>
<b>Interest expense</b>	<b>715.5</b>	<b>747.2</b>
<b>Current income from participations</b>	<b>0.1</b>	<b>0.1</b>
<b>Net interest income</b>	<b>263.6</b>	<b>266.2</b>

The net commission result of –€8.2 million was up by an encouraging €7.8 million on the comparable figure for the previous year of –€16.0 million. At the same time, €15.9 million (H1 2018: €7.9 million) in commission income was generated from the lending business, which depends both on the respective product mix and disbursement timing. Moreover, €23.5 million (H1 2018: €22.6 million) was paid for brokerage services from cooperative banks within the Cooperative Financial Network.

Administrative expenses of €134.8 million in the first half of 2019, being the total of general administrative expenses and write-downs of intangible assets including depreciation of tangible fixed assets, were significantly lower than in the same period of the previous year (H1 2018: €158.1 million). A one-off effect on the bank levy relating to the merger is the main factor behind the lower figure. The bank levy due for the year amounted to

€10.3 million – €15.0 million lower than the previous year's figure of €25.3 million. As in the previous year, the 85 per cent/ 15 per cent rule was applied for the 2019 payment of contributions, so that a further €1.8 million of the total contribution of €12.1 million was deposited with Deutsche Bundesbank as cash collateral, in addition to the aforementioned €10.3 million. Significant progress made in implementing the merger also allowed cost reductions to be achieved compared with the first half of the previous year. The result includes costs for ongoing merger work of €24.7 million (H1 2018: €33.3 million).

Net other operating income/expenses are unchanged against H1 2018 at €2.5 million. As in the previous years, no material credit defaults occurred during the first half of 2019. The net aggregate of the result from risk provisioning and the measurement result from securities held as liquidity reserve are included in loan loss provisions<sup>4</sup>

<sup>4</sup> Equates to the income statement line items 'Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions'.

of –€23.6 million (H1 2018: –€48.6 million). In order to guard against potential credit defaults in the future, the positive balance was more than compensated by a material addition to general risk provisions pursuant to section 340f of the German Commercial Code (HGB), in accordance with prudent commercial judgement.

The net financial result<sup>5</sup> mainly includes net income of €0.3 million (H1 2018: €0.6 million) from MBS that was written down. In the first half of the previous year, the net financial result mainly comprised net income of €33.6 million from the sale of securities held as fixed assets which was related to the redemption of Registered Pfandbriefe and promissory note loans, within the scope of managing the cover assets pools.

DZ HYP's forecast long-term profitability continues to be affected by uncertainty as a result of the ongoing government debt crisis in a challenging political and macro-economic environment – also in the wake of discussions concerning the UK's exit from the EU. For this reason, amongst other factors (and exercising prudent commercial judgement) €29.0 million (H1 2018: €27.0 million) was allocated to the fund for general banking risks pursuant to section 340g of the HGB, to take account of particular risks facing the business area.

Tax expense in the amount of €33.9 million (H1 2018: €18.2 million) mainly comprises tax allocation amounting to €34.6 million (H1 2018: €31.2 million), resulting from the tax compensation agreement in place between DZ BANK and DZ HYP. In the same period of the previous year, tax income from other accounting periods of €16.4 million was reported due to a non-recurring effect from the early termination of the consolidated tax group between former WL BANK and DZ BANK.

Other tax expenses amounted to €0.2 million (H1 2018: €3.4 million). The drop is due to the recognition of merger-related property transfer tax that was still outstanding for the properties of the former WL BANK in the first half of the previous year.

After accounting for the notional servicing on silent partnership contributions, DZ HYP reported a higher profit after tax of €29.0 million compared with the previous year (H1 2018: €27.0 million), which would have to be transferred to DZ BANK under the control and profit and loss transfer agreement. However, the reported profit has not in fact been transferred, since the transfer of net income (determined in accordance with section 301 of the German Public Limited Companies Act (*Aktiengesetz* – 'AktG') is decisive in this respect.

<sup>5</sup> Equates to the income statement line items 'Income from write-ups to participating interests, shares in affiliated companies and securities held as fixed assets'.

## Integration into DZ BANK Group

As part of the merger of WL BANK into DG HYP was subsequently renamed DZ HYP, the control and profit transfer agreement with DZ BANK ended at the end of the 2018 financial year in accordance with section 307 of the AktG. The new control and profit and loss transfer agreement then concluded between DZ HYP and DZ BANK in the spring of 2019 was approved by the executive bodies of the two companies in the first half of 2019 in accordance with the requirements of the law governing public limited companies. The corresponding entry in the commercial register was made in June 2019.

# REPORT ON OPPORTUNITIES AND RISKS

Opportunities and risks are defined as unexpected deviations from the financial performance that DZ HYP is expected to achieve in the second half of 2019. As a subsidiary of DZ BANK, DZ HYP is a member of the Cooperative Financial Network – a network characterised by a high degree of solidity, strong credit quality, and a sustainable business model. The broadly diversified market positioning of the Cooperative Financial Network, in combination with Pfandbrief issuance, forms a strong basis for DZ HYP to conduct real estate and local authority lending business from a risk and earnings perspective. DZ HYP uses this ability to act, jointly with the German cooperative banks, as a reliable financing partner to its clients. Thanks to a robust domestic economy, the Bank's good market position benefits from a favourable fundamental environment for real estate.

The fact that the overall conditions for the real estate business and the business with public-sector remain positive also offers DZ HYP the opportunity to generate a new business volume in 2019 that is on a par with the successful 2018 financial year. DZ HYP expects to generate new real estate financing business of more than €9 billion

in the current financial year, with a volume of at least €700 million on the cards for the Public Sector division. The financial plans for 2019 include write-downs in Real Estate Finance running into the mid-double-digit millions. Therefore, opportunities for – and risks to – profitability in the current year concern the forecast risk provisioning in particular, whilst the material income components largely show a linear development. Results after taxes for 2019 are forecast to remain at the previous year's level and to exceed €100 million in the next few years.

As far as the capital market business is concerned, defaults in exposure to bank bonds and public finance exposure, in particular, would have a material impact on DZ HYP. This is why the Bank monitors the portfolio on an ongoing basis. No material defaults are expected as at 30 June 2019. During the 2019 financial year, the portfolio of exposures to countries at the European periphery, which is subject to persistent uncertainty on international financial markets due to the political and economic crisis in Italy, will remain a focal point. The overall lending volume in relation to Italy is shown below.

#### LENDING VOLUME IN ITALY

€ mn	Total 30 Jun 2019	Total 31 Dec 2018	Change in %
<b>MBS</b>	<b>11</b>	<b>25</b>	<b>-58.4</b>
<b>Country and regions</b>	<b>1,671</b>	<b>1,681</b>	<b>-0.6</b>
<b>Total</b>	<b>1,682</b>	<b>1,706</b>	<b>-1.4</b>

Furthermore, the portfolio of exposures to the United Kingdom is a focal point of checks, given the country's imminent exit from the EU (Brexit). Such analyses cover the entire economic environment (including the labour market, the real estate market and gross domestic product, for example). Ultimately, the internal stress calculations have not identified any increased write-

downs as a result of the MBS exposure to the UK. The monitoring of credit risk and collateral for individual exposures has not yielded any signs of material risks. Given its limited new business activities in the United Kingdom, DZ HYP does not anticipate any serious impact on its operating business from a potential Brexit. The table below shows the entire underlying exposure (to the UK):

#### EXPOSURE TO THE UK

€ mn	Total 30 Jun 2019	Total 31 Dec 2018	Change in %
<b>MBS</b>	<b>260</b>	<b>270</b>	<b>-3.8</b>
<b>Mortgage loans</b>	<b>235</b>	<b>279</b>	<b>-15.7</b>
<b>Bank bonds</b>	<b>-</b>	<b>129</b>	<b>-100.0</b>
<b>Derivatives</b>	<b>79</b>	<b>78</b>	<b>0.1</b>
<b>Total</b>	<b>574</b>	<b>756</b>	<b>-24.1</b>

The opportunities and risks associated, in particular, with the merger between DG HYP and WL Bank also have to be taken into account. The merger that resulted in the establishment of DZ HYP in the 2018 financial year is the next logical step in the process of consolidation within the Cooperative Financial Network, which had already been achieved at shareholder level prior to the merger. The merger to form a leading real estate financing bank and Germany's largest issuer of Pfandbriefe will give rise to significant opportunities for DZ HYP. In addition to pooling resources within the Cooperative Financial Network, merging the divisions will help to diversify risk. In addition, synergy effects are expected to be achieved as the need for double investments is eliminated, with the potential to generate savings by bundling and standardising structures and processes. These will be offset by merger costs that will be incurred in the short term.

# CONDENSED BALANCE SHEET

## ASSETS

€ mn	30 Jun 2019	31 Dec 2018
<b>Cash funds</b>	<b>1</b>	<b>1</b>
<b>Loans and advances to banks</b>	<b>3,771</b>	<b>4,357</b>
a) Mortgage loans	20	20
b) Loans to local authorities	269	319
c) Other loans and advances	3,482	4,018
<b>Loans and advances to customers</b>	<b>61,559</b>	<b>60,040</b>
a) Mortgage loans	44,912	42,890
b) Loans to local authorities	14,217	14,727
c) Other loans and advances	2,430	2,423
<b>Debt securities and other fixed-income securities</b>	<b>10,136</b>	<b>11,083</b>
a) Bonds and debt securities	10,037	10,464
aa) Public-sector issuers	6,892	6,938
ab) Other issuers	3,145	3,526
b) Own bonds issued	99	619
<b>Participations</b>	<b>1</b>	<b>1</b>
<b>Investments in affiliated companies</b>	<b>2</b>	<b>2</b>
<b>Trust assets</b>	<b>38</b>	<b>42</b>
<b>Intangible fixed assets</b>	<b>3</b>	<b>2</b>
<b>Tangible fixed assets</b>	<b>177</b>	<b>174</b>
<b>Other assets</b>	<b>213</b>	<b>29</b>
<b>Prepaid expenses</b>	<b>156</b>	<b>160</b>
<b>Total assets</b>	<b>76,057</b>	<b>75,891</b>

## LIABILITIES AND EQUITY

€ mn	30 Jun 2019	31 Dec 2018
<b>Liabilities to banks</b>	<b>27,897</b>	<b>26,916</b>
a) Outstanding registered Mortgage Pfandbriefe (Hypotheken-Namenspfandbriefe)	2,087	2,127
b) Outstanding registered Public Pfandbriefe (öffentliche Namenspfandbriefe)	1,035	1,087
c) Other liabilities	24,775	23,702
<b>Liabilities to customers</b>	<b>18,576</b>	<b>19,534</b>
a) Outstanding registered Mortgage Pfandbriefe (Hypotheken-Namenspfandbriefe)	6,123	6,528
b) Outstanding registered Public Pfandbriefe (öffentliche Namenspfandbriefe)	10,115	10,706
c) Other liabilities	2,338	2,300
<b>Securitised liabilities</b>	<b>26,710</b>	<b>26,487</b>
a) Mortgage Pfandbriefe (Hypothekenpfandbriefe)	21,087	20,484
b) Public Pfandbriefe (öffentliche Pfandbriefe)	3,587	3,625
c) Other debt securities	2,036	2,378
<b>Trust liabilities</b>	<b>38</b>	<b>42</b>
<b>Other liabilities</b>	<b>47</b>	<b>170</b>
<b>Deferred income</b>	<b>187</b>	<b>187</b>
<b>Provisions</b>	<b>274</b>	<b>245</b>
<b>Subordinated liabilities</b>	<b>70</b>	<b>81</b>
<b>Fund for general banking risks</b>	<b>496</b>	<b>467</b>
<b>Equity</b>	<b>1,762</b>	<b>1,762</b>
<b>Total equity and liabilities</b>	<b>76,057</b>	<b>75,891</b>
<b>Contingent liabilities</b>	<b>492</b>	<b>376</b>
<b>Other commitments</b>	<b>5,111</b>	<b>5,770</b>

## CONDENSED PROFIT AND LOSS ACCOUNT

€ mn	1 Jan to 30 Jun 2019	1 Jan to 30 Jun 2018
Interest income	979.1	1,013.4
Interest expenses	715.5	747.2
<b>Net interest income</b>	<b>263.6</b>	<b>266.2</b>
Commission income	21.2	13.6
Commission expenses	29.4	29.6
<b>Net commission result</b>	<b>-8.2</b>	<b>-16.0</b>
<b>Gross profit</b>	<b>255.4</b>	<b>250.2</b>
<b>Administrative expenses</b>	<b>134.8</b>	<b>158.1</b>
General administrative expenses		
Personnel expenses	45.8	47.1
Other administrative expenses	85.9	108.7
Amortisation/depreciation and write-downs of intangible and tangible fixed assets	3.1	2.3
<b>Net other operating income/expenses</b>	<b>2.5</b>	<b>2.5</b>
<b>Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions</b>	<b>23.6</b>	<b>48.6</b>
<b>Income from write-ups to participating interests, shares in affiliated companies, and investment securities</b>	<b>0.4</b>	<b>34.3</b>
<b>Result from ordinary activities</b>	<b>99.9</b>	<b>80.3</b>
Allocation to the fund for general banking risks	29.0	27.0
Income taxes	33.7	14.8
Other taxes	0.2	3.4
Profits transferred under partial profit transfer agreements	8.0	8.1
<b>Profits to be transferred under profit transfer agreements</b>	<b>29.0</b>	<b>27.0</b>

## CONDENSED NOTES TO THE FINANCIAL STATEMENTS

### General information on the preparation of the half-yearly financial report

DZ HYP's half-yearly financial report as at 30 June 2019 has been prepared in accordance with the provisions of the German Commercial Code (*Handelsgesetzbuch* – 'HGB'). Furthermore, the financial statements are prepared in accordance with the Regulation on the Accounting of Credit Institutions and Financial Services Institutions (*Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute* – 'RechKredV') and the German Banking Act (*Kreditwesengesetz* – 'KWG'); they fulfil the requirements of the German Public Limited Companies Act (*Aktiengesetz* – 'AktG') and the German Pfandbrief Act (*Pfandbriefgesetz* – 'PfandBG'). The scope of reporting is in line with requirements laid out in section 115 (2) to (4) of the German Securities Trading Act (*Wertpapierhandelsgesetz* – 'WpHG'). Regarding the scope of the condensed notes to the financial statements, DZ HYP voluntarily applied GAS 16 Half-yearly Financial Reporting, which implies

» that changes made to the accounting policies compared to the annual financial statements for 2018 have to be disclosed and clarified, and

» that, regarding the items disclosed in the condensed balance sheet and the condensed profit and loss account, all material changes compared to the disclosed comparative figures as well as the respective development during the reporting period have to be clarified.

Given the non-materiality of all subsidiaries, even if considered in aggregate, in accordance with section 290 (5) in conjunction with section 296 (2) of the HGB, the company has not prepared consolidated half-yearly financial statements.

All amounts have been quoted in euros, in accordance with section 244 of the HGB.

### Material changes in accounting policies

These half-yearly financial statements of DZ HYP as at 30 June 2019 are generally based on the same accounting policies as were applied in the annual financial statements as at 31 December 2018, meaning that there had been no material changes to accounting policies since then.

One change of presentation resulted from a change in the Bank's interest rate risk management approach, compared to the previous year: In 2018, the repurchase

of fixed-rate registered Pfandbriefe was primarily offset – within the scope of interest rate risk management – through sales of fixed-interest securities, with early termination of interest rate swaps only used to a minor extent. Consequently, in the previous year, gains or losses realised from the repurchase of Pfandbriefe, as well as from interest rate swaps terminated early due to such repurchases, were included in cross-offsetting in accordance with section 340f (3) of the HGB. Since the beginning of 2019, and in contrast to the previous year, the Bank's management approach has been to eliminate interest rate risk from Pfandbrief repurchases exclusively through early termination of interest rate swaps. Therefore, results realised from the repurchase of Pfandbriefe and early termination of interest rate swaps have since been reported in net interest income. The change led to a net amount of €0.3 million reported in net interest income, instead under the income statement item 'Write-downs and valuation allowances of loans and advances and specific securities, as well as additions to loan loss provisions'.

Following the integration of IT systems, provision tests (as defined in IDW RS BFA 3) in connection with the fair-value measurement of the interest-related banking book are now carried out under a single management approach. Given the systems environment as at 31 December 2018, banking books were managed independently at the Münster and Hamburg offices at that time.

### **Disclosures on securities recognised above their fair value**

As at 30 June 2019, the Bank did not recognise an extraordinary write-down in the aggregate amount of €64.6 million (31 December 2018: €78.6 million) for negotiable securities held as fixed assets with a carrying amount of €751.2 million (31 December 2018: €1,157.6 million) and a fair value of €686.6 million (31 December 2018: €1,079.0 million) not strictly measured at the lower of cost or market, due to the expected temporary nature of the impairment. This assessment is based on the observation that the euro area has become more stress-resistant due to the crisis mechanisms established in the recent past, and that the effects of individual stabilisation measures are becoming increasingly evident (such as bond acquisition programmes or low-interest rate policies).

The hidden burdens and reserves in the bank's portfolio of negotiable securities amount to net aggregate hidden reserves of €1,590.4 million (31 December 2018: €1,020.8 million). The aggregate hidden reserves were affected by changes in the swap curve (decline in overall market interest rate levels over recent years) in the amount of €2,453.5 million (31 December 2018: €1,956.5 million) and by the poorer credit rating for some securities compared to the date of acquisition, affecting hidden reserves with –€863.1 million (31 December 2018: –€935.7 million). Whilst DZ HYP

neutralises any changes in the value of securities held resulting from changes in swap curves, through offsetting primary or derivative interest rate transactions as part of interest rate risk management (overall bank management), any changes in the value of the securities due to credit risk directly affect the amount of hidden burdens or reserves. According to its current assumptions, DZ HYP does not expect any disruptions of interest or principal payments; after an isolated consideration, the Bank did not recognise any impairments in connection with credit risk-related valuation losses.

Please refer to the bank's interim management report (chapter 'net assets') for further information on the securities portfolio.

### **Report on material events after the reporting date**

No events of particular importance materialised during the adjusting period from 1 July to 20 August 2019 which would have required a materially different presentation of DG HYP's net assets, financial position and financial performance, had they occurred earlier.



# RESPONSIBILITY STATEMENT

To the best of our knowledge, and in accordance with the applicable reporting principles for half-yearly financial reporting, the interim condensed financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss 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 expected development of the company for the remaining months of the financial year.

Hamburg and Münster, 20 August 2019

DZ HYP AG



Dr Georg Reutter  
Chief Executive Officer



Dr Carsten Duerkop



Manfred Salber

# REVIEW REPORT

To DZ HYP AG, Hamburg and Münster

We have reviewed the interim condensed financial statements, comprising the condensed balance sheet, the condensed profit and loss account and the condensed notes to the financial statement, and the interim management report of DZ HYP AG, Hamburg and Münster, for the period from 1 January 2019 to 30 June 2019, which are part of the six-monthly financial report pursuant to Sec. 115 WpHG ['Wertpapierhandelsgesetz': German Securities Trading Act]. The preparation of the interim condensed financial statements in accordance with German commercial law and of the interim management report in accordance with the provisions of the WpHG applicable to interim management reports is the responsibility of the Company's management. Our responsibility is to issue a report on the interim condensed financial statements and the interim management report based on our review.

We conducted our review of the interim condensed financial statements and the interim management report in accordance with German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the review to obtain a certain level of assurance in our critical appraisal to preclude that the interim condensed financial statements are not prepared, in all material respects, in accordance with German commercial law and that the interim management report is not prepared, in all material respects, in accordance with the provisions of the WpHG applicable to interim management reports. A review is limited primarily to making inquiries of company personnel and applying analytical procedures and thus does not provide the assurance that we would obtain from an audit of financial statements. In accordance with our engagement, we have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our review, nothing has come to our attention that causes us to believe that the interim condensed financial statements are not prepared, in all material respects, in accordance with the provisions of German commercial law or that the interim management report is not prepared, in all material respects, in accordance with the provisions of the WpHG applicable to interim management reports.

Hamburg, 20 August 2019

Ernst & Young GmbH  
Wirtschaftsprüfungsgesellschaft

Mai	Meyer
Wirtschaftsprüfer	Wirtschaftsprüfer
[German Public Auditor]	[German Public Auditor]

This is a translation of the review report issued in German.  
The latter is the sole authoritative version.

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