

Second
Party
Opinion

Verification of the sustainability quality of
Münchener Hypothekbank eG's first
ESG Pfandbrief

Aim and scope of this verification

Münchener Hypothekbank eG commissioned oekom research to assist with the issue of its first ESG Pfandbrief, in order to provide a guarantee that this bond offers sustainable added value. The aim of the Pfandbrief issue is to refinance loans for housing cooperatives in Germany. The funds will be used to purchase, build, improve the energy efficiency of and maintain housing for more socially disadvantaged sections of society. Overall, this ESG Pfandbrief will help to support approximately 200 such cooperatives.

The funds from this bond will be used in the refinancing of loans which have already been granted and whose intended purpose meets the criteria specified below. Münchener Hypothekbank eG is planning a future programme of financing for housing cooperatives of between €50 million and €100 million per annum, which will be based on the same sustainability criteria of this first ESG Pfandbrief. Accordingly, upon expiry of the five-year term of the first ESG Pfandbrief, funds to the amount of the first ESG Pfandbrief would once more be reinvested.

oekom research's remit included the following services

- Defining a framework concept with social and environmental criteria for assessing the sustainability of the housing cooperatives
- Checking compliance with criteria and the use made of the loans granted
- Checking Münchener Hypothekbank eG's sustainability performance on the basis of the oekom Corporate Rating

Overall assessment of this ESG Pfandbrief

Overall, this ESG Pfandbrief is a product which can be assessed as positive from a sustainability point of view.

The emphasis here is on social aspects. The refinanced loans are used to encourage the construction of cooperative housing, the social added value of which comes from the provision of housing which is low-cost and at the same time user-friendly and comes with a guarantee of permanent rights of residence. This is of particular benefit to socially disadvantaged groups. In addition, the housing cooperatives create democratic structures and help to counteract the effects of housing speculation, exorbitant rents and vacant properties. In the case of new housing, many housing cooperatives undertake to build sustainably, and a portion of the loan will be used for improving energy efficiency to KfW standards.

In future, environmental criteria should ideally be given even greater consideration and applied more rigorously for loans and ESG Pfandbrief issuances linked to these. Indeed, energy consumption of residential buildings plays an important role in climate protection. Thus, refurbishing existing housing to make it more energy-efficient, as well as building energy-efficient and environmentally optimised new housing, are essential for making housing projects more sustainable. High energy standards and concomitant low energy consumption in turn ease the burden on the tenants, who as a rule have limited financial resources, and are thus also relevant from the social point of view.

Münchener Hypothekbank eG is a company which has been awarded "Prime" status in the oekom Corporate Rating: for sustainable investors, this is an important quality seal of bond issuers.

Sustainable Pfandbrief Framework

The Sustainable Pfandbrief Framework serves as a structure for ensuring the sustainability quality – i.e. the social and environmental added value – of the loans to be refinanced through the ESG Pfandbrief issue. It comprises two elements: firstly the definition of categories of projects offering social and/or environmental added value, and secondly the specific sustainability criteria by means of which therefore the sustainability performance of the ESG Pfandbrief issue can be clearly identified and verified.

The sustainability criteria are complemented by specific and measurable indicators, which make it possible to set ambitious targets and to enable quantitative measurement of the sustainability performance of the ESG Pfandbrief issue. These also facilitate accurate and comparable reporting.

Furthermore, the sustainability criteria are to be applied to subsequent ESG Pfandbrief issues and will thus ideally allow monitoring of gradual improvement in the sustainability performance of the projects financed.

Details of the individual criteria and indicators can be found in Annex 1 “Sustainable Pfandbrief Framework“.

Verification of the refinanced loans

Methods

oekom research has verified whether the loans to housing cooperatives that are to be refinanced meet the criteria listed in the above Framework. Overall, Münchener Hypothekenbank eG finances 200 housing cooperatives, with a total loan volume of around €500 million. This first ESG Pfandbrief issue is valued at €300 million.

In order to check compliance with the criteria, we analysed the ten largest debtors, whose loans, totalling more than €300 million, account for over two-thirds of the volume of the first ESG Pfandbrief issue. In order to confirm the assumption that the performances for smaller borrowers were comparable, sample checks were then also carried out on three smaller debtors.

The verifications were carried out using documents provided to oekom research on a confidential basis by Münchener Hypothekenbank eG (excerpts from statutes, financial statements, management reports and audit reports).

Findings

- Funding and support for non-profit-oriented and democratically managed housing organisations in Germany
 - ✓ 100% of the verified cooperatives, representing more than two-thirds of the total loan sum, have statutes which provide for democratic codetermination rights for their members.
 - Abstention from profit maximisation was laid down in writing in the statutes of only two of the cooperatives checked, and abstention from speculation in residential property in that of only one of these two cooperatives.
- Socially responsible rental structures
 - ✓ 100% of the analysed large cooperatives undercut local reference rents by an average of over 20%. Here, rents were on average 26.5% below reference rents. For the three smaller cooperatives, they were as much as 28.3% below.
 - ✓ For 100% of the debtors we checked, the average monthly operating costs as an additional financial burden for the tenants were more than 5% below the average figure for the three largest German housing construction companies (2013: €2.36 per square metre). The average monthly running costs for the analysed cooperatives amounted to €2.10 per square metre. For the three smaller cooperatives, this average was even lower, at €1.80 per square metre.

- Permanent right of residence for the tenants
 - ✓ 100% of the cooperatives verified have statutes giving their members permanent/lifelong right of residence.

- Creation/provision of housing
 - ✓ For 100% of the debtors we analysed, average vacancy rates lay below 3.50%. The average vacancy rate for the cooperatives stood at 1.15%. For the three smaller cooperatives, this average was somewhat higher, at 1.95%. The reference value for Germany, i.e. the vacancy rate quoted by the Federal Statistical Office, stands at 8.6% (2010). This figure is recorded by the Federal Statistical Office every four years.

- User-friendly building construction
 - ✓ For 90% of the analysed debtors, average annual expenditure on maintenance/refurbishment stood at over €20 per square metre. The average figure for all the borrowers checked was €27.50 per square metre. In comparison, the average for the three largest housing companies in Germany stood at €16.92 per square metre.
 - One of the analysed debtors had an annual expenditure on maintenance/refurbishment of €13.10 per square metre, and for the three smaller cooperatives the average annual expenditure on maintenance/refurbishment was €15.93 per square metre.

- Energy efficiency
 - Only 40% of the analysed debtors had data available on monthly heating costs per square metre (as a guide to primary energy consumption). These costs were below €0.90 per square metre for only half the debtors – although in these cases they were significantly below this figure. The reported average monthly heating costs were €0.81 per square metre. This is a modest figure compared with the national average (Heizspiegel [heating survey] 2013: monthly average €0.90/€1.30 per square metre for gas/oil heating.
 - ✓ The percentage of the amount loaned that is linked to KfW loans for energy-saving refurbishments stands at an average of 13.6% for the verified debtors. For two of the ten housing analysed cooperatives, the percentage of the amount borrowed that is linked to KfW loans for energy-saving refurbishments stands at over 80%.
 - For six of the ten analysed housing cooperatives, the percentage of the amount borrowed that is linked to KfW loans for energy-saving refurbishments stands at 0%, and for two others it is in single figures.

Verification of the issuer's sustainability performance

In the oekom Corporate Rating, Münchener Hypothekbank eG scores a C and is classified as "Prime". This means that the company performs well in terms of sustainability, both compared to others in the industry and compared against oekom research's industry-specific requirements. Therefore, in oekom research's view the company meets the requirements for sustainable investments.



This rating, as at 1 September 2014, makes Münchener Hypothekbank eG one of the three top-rated companies in its sector: "Financials/Mortgage & Public Sector Finance". Within this sector, oekom research has identified the following key sustainability issues in terms of companies' sustainability management:

- sustainability standards in lending
- client and product responsibility
- employee relations and work environment
- sustainability reporting

For each of these four key issues, Münchener Hypothekbank eG achieved a rating that was significantly above the average for the industry. The company has not committed any violations in the areas of controversial business practices or controversial areas of business, and thus does not breach any of the exclusion criteria which are frequently applied by investors.

Details on the rating of the issuer can be found in Annex 2 "Issuer rating results".

oekom research AG
Munich, 1 September 2014

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About oekom research

oekom research is one of the world's leading rating agencies in the field of sustainable investment. The agency analyses companies and countries with regard to their environmental and social performance. oekom research has extensive experience as a partner to institutional investors and financial service providers, identifying issuers of securities and bonds which are distinguished by their responsible management of social and environmental issues. More than 100 asset managers and asset owners routinely draw on the rating agency's research in their investment decisionmaking. oekom research's analyses therefore currently influence the management of assets valued at over 600 billion euros.

As part of our Green Bond Services, we provide support for companies and institutions issuing sustainable bonds, advise them on the selection of categories of projects to be financed and help them to define ambitious criteria. We verify the compliance with the criteria in the selection of projects and draw up an independent second party opinion so that investors are as well informed as possible about the quality of the loan from a sustainability point of view.

Contact: oekom research AG, Goethestraße 28, 80336 Munich, Germany, tel: +49/(0)89/544184-90, e-mail: info@oekom-research.com

Annex

- Annex 1: Sustainable Pfandbrief Framework
- Annex 2: Issuer rating results

Annex 1: Sustainable Pfandbrief Framework

Objectives

The Sustainable Pfandbrief Framework serves as a structure for verifying the sustainability quality – i.e. the social and environmental added value – of the loans to be refinanced through the ESG Pfandbrief issuance. It comprises firstly the definition of categories of projects offering social and/or environmental added value and secondly the specific sustainability criteria by means of which this added value and therefore the sustainability performance of the ESG Pfandbrief issue can be clearly identified and verified.

The sustainability criteria are complemented by specific indicators which make it possible to set ambitious targets, enable quantitative measurement of the sustainability performance of the ESG Pfandbrief issue, and can be used for comprehensive reporting.

Furthermore, the sustainability criteria are also to be applied to subsequent ESG Pfandbrief issuances and will thus allow for monitoring the improvement in the sustainability performance of the projects financed.

At the time of the first issuance of the ESG Pfandbrief, social criteria are the principal focus of the concept. However, for reasons of completeness and credibility, it is desirable that a minimum level of environmental criteria also be taken into account at the earliest possible date, not least because the projects are concerned with housing, an area where there is a particularly great need for action to implement the energy transition.

Project categories

The proceeds from the ESG Pfandbrief issuance will be fully used to refinance loans to German housing cooperatives.

During the five-year term of the first ESG Pfandbrief, appropriate new financing of housing cooperatives to the amount of the revenues of the Pfandbrief issue (approx. €50 to 100 million per annum) will also be provided.

Housing cooperatives are as a rule non-profit organisations whose aim is the provision of safe, user-friendly and socially sustainable housing.

As debtors, the housing cooperatives use these funds to finance property-related projects in Germany.

These include in particular the following categories of projects offering social and/or environmental added value:

- Purchase of plots for social housing/construction of new cooperative housing
- Social housing/construction of new cooperative housing
- Purchase of existing housing for first use as social housing/cooperative housing
- Refurbishment of existing housing to make it more energy-efficient
- Further refurbishment/maintenance work to preserve and improve the social and environmental quality of the residential space in housing cooperative properties

Opportunities and risks associated with the project categories

The opportunities presented by the project categories listed above arise from the creation of social and/or environmental added value through the promotion of socially beneficial housing organisations and rent structures and of environmentally favourable and user-friendly types of building construction.

From the sustainability point of view, housing projects are also always exposed to certain risks. These include

- the possible misuse of property as an object of speculation
- urgently needed housing standing vacant
- excessive rental price movements
- construction materials that are damaging to the environment and/or to human health
- antiquated technical installations with adverse effects on health or the environment
- refurbishment of older buildings with high energy consumption to make them more energy-efficient being left undone

Defining qualitative sustainability criteria and assessing and monitoring these using quantitative indicators will ensure that the opportunities associated with the project categories are exploited to the optimum and the risks minimised or removed altogether.

Qualitative sustainability criteria and quantitative indicators

- Funding and support for non-profit-oriented and democratically managed housing organisations in Germany
 - Quantitative indicator: percentage of loan amount going to housing cooperatives which have incorporated this in their statutes
- Socially responsible rental structures
 - Quantitative indicator: percentage of loan amount going to housing cooperatives whose rents are on average at least 20% below the local rent level as a reference rent (in all cases net rents per square metre)
 - Quantitative indicator: percentage of loan amount going to housing cooperatives where the average monthly running costs as an additional financial burden for the tenants were 5% or more below the average figure for the three largest German housing construction companies (2013: €2.36 per square metre)
- Permanent right of residence for the tenants
 - Quantitative indicator: percentage of loan amount going to housing cooperatives which have incorporated permanent/lifelong right of residence for tenants in their statutes
- Creation/provision of housing
 - Quantitative indicator: percentage of loan amount going to housing cooperatives whose vacancy rates lie below 3.5% (Federal Statistical Office's reference value for the whole of Germany: 8.6% (2010); figures are recorded only every four years)
- User-friendly building construction
 - Quantitative indicator: percentage of total loan amount going to housing cooperatives where the average annual expenditure on maintenance/refurbishment is more than €20 per square metre

- Energy efficiency

Ideally, the primary energy consumption and heat transfer coefficient indicators should meet current standards and be comprehensively documented and reported. In the absence of specific data, the following indicators can be taken as points of reference:

- Quantitative indicator: percentage of total loan amount going to housing cooperatives where monthly heating costs are on average less than €0.90 per square metre (“Heizspiegel” 2013 average for natural gas heating)
- Quantitative indicator: percentage of total loan amount going to housing cooperatives where the proportion of the individual loan sum in each case that is linked to KfW loans for energy-saving refurbishments stands at over 10%

Outlook for subsequent issuances:

- Recommended additional indicators in the area of energy efficiency

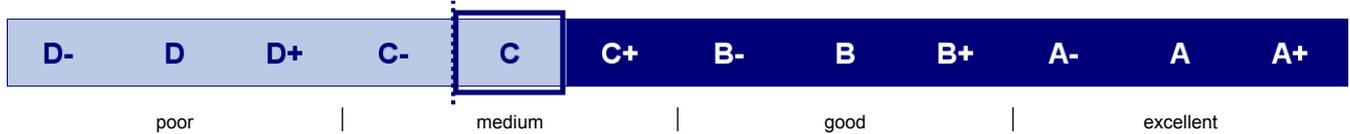
- Quantitative indicator: percentage of total amount lent to housing cooperatives that is used for new-build projects that have a primary energy consumption below 60 kWh/m² and a heat transfer coefficient (U-value) below 0.2 W/m²K (EnEV [German energy-saving ordinance] requirement for new builds)
- Quantitative indicator: percentage of total amount lent to housing cooperatives that is used for housing that as a minimum meets the German Energy Saving Ordinance 2009 (EnEV) (i.e. was built after 29 April 2009)
- Quantitative indicator: percentage of total amount lent to housing cooperatives that is used for energy-saving refurbishments of existing housing, the figures for which are subsequently no more than 40% above those cited above for new builds

oekom Corporate Rating

Muenchener Hypothekenbank eG

Industry: Financials/Mortgage & Public Sector Finance
 GICS Industry: #N/A
 Country: Germany
 ISIN:
 Bloomberg Ticker: 1032Z GR Equity

Status **Prime**
 Rating **C**
 Prime Threshold **C**



Competitive Position

Industry Leaders

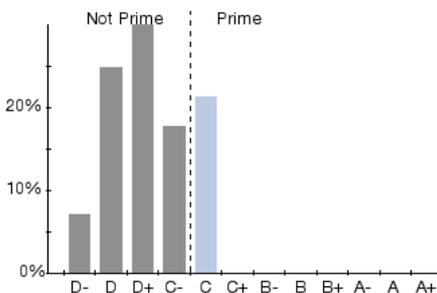
(in alphabetical order)

- Kommunalkredit Austria AG (AT) C
- Muenchener Hypothekenbank eG (DE) C
- SBAB Bank AB (SE) C

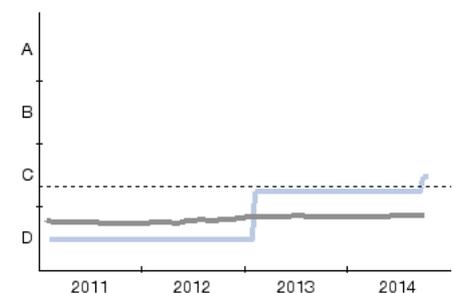
■ Company ■ Industry

Distribution of Ratings

(57 companies in the industry)



Rating History



Key Issues

Key Issue Performance



Strengths and Weaknesses

- + almost entire loan portfolio is allocated in countries with high environmental and social minimum standards
- + some green loans for public sector and commercial customers
- + some measures regarding responsible treatment of customers with debt repayment problems
- + various options to encourage work-life balance
- no strict and comprehensive general environmental and social guidelines for the credit rating process with regard to commercial and public sector customers
- no strict and comprehensive general environmental and social guidelines for the credit rating process with regard to private customers

Controversy Monitor

Company

Controversy Score 0
 Controversy Level Minor



Industry

Maximum Controversy Score -1
 Controversy Risk Minor



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Muenchener Hypothekenbank eG

Methodology - Overview

oekom Corporate Rating The oekom Universe comprises more than 3,400 companies (mostly companies in important national and international indices, but also small & mid caps drawn from sectors with links to sustainability as well as significant non-listed bond issuers).

The assessment of the social and environmental performance of a company is generally carried out with the aid of approx. 100 social and environmental criteria, selected specifically for each industry. All criteria are individually weighted, evaluated and aggregated to yield an overall score (Rating). In case there is no relevant or up-to-date company information available on a certain criterion, it is graded with a D-.

In order to generate a comprehensive picture of each company, our analysts collect information relevant to the rating both from the company itself and from independent sources. During the rating process, considerable importance is attached to cooperating extensively with the company under evaluation. Companies are regularly given the opportunity to comment on the results and provide additional information.

An external rating committee assists the analysts at oekom research with the content-related design of industry-specific criteria and carries out a final plausibility check of the rating results at the end of the rating process.

Controversy Monitor The oekom Controversy Monitor is a tool for assessing and managing reputational and financial risks associated with companies' negative environmental and social impacts.

The controversy score is a measure of the number and extent of the controversies in which a company is currently involved: all controversial business areas and business practices are assigned a negative score, which varies depending on the significance and severity of the controversy. Both the score of the portrayed company and the maximum score obtained in the industry are displayed.

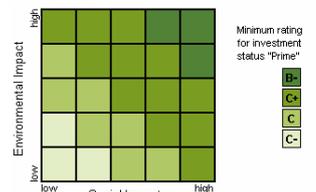
For better classification, the scores are assigned to different levels: minor, moderate, significant and severe. The industry level relates to the average controversy score.

Only controversies, for which reliable information from trustworthy sources is available, are recorded. It should be noted that large international companies are more often the focus of public and media attention and available information is often more comprehensive than for less prominent companies.

Distribution of Ratings Overview of the distribution of all company ratings of an industry from the oekom Universe (company portrayed in this report: light blue). The industry-specific Prime threshold (vertical dotted line) is also shown.

Industry Classification The social and environmental impacts of industries differ. Therefore, subject to its relevance, each industry analysed is classified in a Sustainability Matrix.

Depending on this classification, the two dimensions of the oekom Corporate Rating, i.e. the Social Rating and the Environmental Rating, are weighted and the sector-specific minimum requirements for the oekom Prime Status (Prime threshold) are defined (absolute best-in-class approach).



Industry Leaders List (in alphabetical order) of the top three companies in an industry from the oekom Universe at the time of generation of this report.

Key Issue Performance Overview of the company's performance with regard to important social and environmental issues that are key to the industry, compared to the industry average.

Rating History Trend in the company's rating over time and comparison to the average rating in the industry.

Rating Scale Companies are rated on a twelve-point scale from A+ to D-:
 A+: the company shows excellent performance.
 D-: the company shows poor performance.
 Overview of the range of scores achieved in the industry (light blue) and display of the industry-specific Prime threshold (vertical dotted line).

Sources of Information Data for the Bloomberg Ticker, Company Name, Country, GICS Industry and ISIN was sourced from Bloomberg.

Status & Prime Threshold Companies are categorised as Prime if they achieve/exceed the minimum sustainability performance requirements (Prime threshold) defined by oekom for a specific industry (absolute best-in-class approach) in the oekom Corporate Rating. Prime companies rank among the leaders in that industry.

Strengths & Weaknesses Overview of selected strengths and weaknesses of a company with regard to relevant social and environmental criteria.

Please note that all data in this report relates to the point in time at which the report was generated.