

Directors' Commentary to the results
of PKO Bank Hipoteczny SA
for the three-month period ended 31 March 2021

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The only binding version is the original Polish version.

DIRECTORS' COMMENTARY TO THE RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2021



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1. SUMMARY OF THE FIRST QUARTER OF 2021

1.1. THE MOST IMPORTANT EVENTS IN THE FIRST QUARTER OF 2021

PKO Bank Hipoteczny SA (Bank) specializes in granting residential mortgage loans to individual customers and purchasing receivables in respect of such loans. The Bank acquires loans for its portfolio based on strategic cooperation with PKO Bank Polski SA.

PKO Bank Hipoteczny SA is the leader of the Polish mortgage bank market in terms of total assets and the balance of residential mortgage loans. The Bank is Poland's largest issuer of mortgage covered bonds on the Polish market. It was the only bank in Poland to carry out benchmark issues of EUR-denominated mortgage covered bonds, five issues in total until 31 March 2021. The outstanding mortgage covered bonds issued by the Bank account for approximately 66% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

THE COVID - 19 PANDEMIC

In connection with the COVID-19 pandemic, in the first quarter of 2021 PKO Bank Hipoteczny SA continued the actions taken in 2020 aimed at increasing the customers' and employees' safety and ensuring prudent management of PKO Bank Hipoteczny:

- in the first quarter of 2021, the Bank consistently pursued the rotational shift work system, and in March 2021 as a result of the third wave of the pandemic the decision was taken to temporarily instruct all employees to work remotely;
- in the first quarter of 2021 the Bank continued to suspend repayments of mortgage loans (non-statutory moratoria) to a limit of six consecutive instalments for those customers who applied for the suspension by the end of September 2020.

Further developments related to the COVID-19 pandemic and its impact on the Bank's operations are uncertain and difficult to estimate, therefore, the Bank is monitoring the situation on a current basis and will adapt the actions taken.

PKO BANK HIPOTECZNY SA STRATEGY FOR THE YEARS 2020-2022

In the first quarter of 2020, the Bank's Management Board adopted and the Supervisory Board approved the updated PKO Bank Hipoteczny SA Strategy for the years 2020-2022.

The Strategy covers the following:





- the Bank's mission and strategic goals;
- the Bank's market position;
- the Bank's operating model;
- the Bank's strategic operating directions;
- the Bank's financial position in the years 2020-2022.

The Bank prepared the updated strategy for the years 2020-2022 due to:

- a) updating the PKO Bank Polski Group strategy which redefines the role of PKO Bank Hipoteczny within the Group;
- b) the new strategy horizon developed by PKO Bank Polski (for 2020-2022), therefore the strategy horizon of PKO Bank Hipoteczny SA was extended to 2022;
- c) changes in the regulatory environment, mainly the new regulatory requirement as to minimum own funds and eligible liabilities (MREL), which has a significant impact on the planned funding structure of the Group.

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The Bank defined the following goals in its new strategy:

 <p>Issue of green mortgage covered bonds and taking sustainable growth actions</p>	 <p>Optimal use of PKO Bank Hipoteczny SA and PKO Bank Polski SA assets and competences to achieve synergy within the PKO Group</p>	 <p>Maintenance of a safe risk level in the Bank's operations, in particular with respect to the loan portfolio and the capital ratios</p>	 <p>Diversification of the sources of funding of the Bank and the PKO Group by maintaining the ability to acquire long-term funding in the form of mortgage covered bonds for crediting real estate</p>
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The effects of the present epidemic situation on the macroeconomic position of Poland and the position of PKO Bank Hipoteczny SA may include a reduction in revenue streams, an increase in provisions and problems with access to funding. Consequently, the strategy will be reviewed and possibly updated annually, and the annual financial plans will be adjusted accordingly.

LOAN PORTFOLIO

The Bank's operations comprise both granting new residential mortgage loans and purchasing such loans from PKO Bank Polski SA. In the first quarter of 2021, the Bank's total assets amounted to over PLN 27 billion, of which PLN 24.6 billion represented a high quality portfolio of residential mortgage loans.

MORTGAGE COVERED BONDS ISSUED

The Bank did not issue any mortgage covered bonds in the first quarter of 2021. As at the end of March 2021, the Bank was the leader of the Polish mortgage banking market in terms of the balance of outstanding mortgage covered bonds and the balance of residential mortgage loans. The outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 17.3 billion as at 31 March 2021.

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2. EXTERNAL OPERATING CONDITIONS

Macroeconomic environment Residential real estate market Housing loan market Mortgage covered bond market Regulatory and legal environment Factors which will influence the future financial performance of the Bank

2.1. MACROECONOMIC ENVIRONMENT

Macroeconomic factors affecting the Polish economy in the first quarter of 2021:

GROSS DOMESTIC PRODUCT

The GDP growth rate affects both the residential real estate market and the mortgage loan market. An appropriately high GDP growth rate translates into new jobs and higher wages, and, consequently, into consumers' purchasing power and creditworthiness.

In the first quarter of 2021 business activity was to a large extent determined by the pandemic and the waves of tightening and loosening pandemic restrictions. The tightening translated to the largest extent into private consumption and the retail and services sectors. Industrial processing and foreign trade were to a large extent dependent on the trends of the pandemic, and activity in these areas gradually increased despite the increasing problems in many industries with the availability of production components.

UNEMPLOYMENT AND WAGES AND SALARIES

With the tightening of pandemic policies anti-crisis actions were extended which led to the further hibernation of the labour market. The registered unemployment rate increased to 6.5% in January and February, in accordance with the seasonal trend, and the harmonized unemployment rate dropped to 3.1% and was the lowest in the EU. At the beginning of 2021 the increase in the unemployment rate is of a seasonal nature and does not indicate the situation on the domestic labour market.

Average employment in the enterprise sector dropped in February 1.7% y/y, and average wages and salaries increased by 4.5% y/y.

INFLATION

Price changes affect consumer purchasing power and the level of interest rates. The high inflation level, which is not compensated by an increase in wages and salaries, has a negative impact on bank customers' creditworthiness (lower real disposable income), which in turn has a negative effect on the value of residential loans granted.

Increased belief in the revival of the global economy led to increases in the costs of raw materials, including oil. In connection with increases in administered prices it once again translated into an increase in CPI in Poland which amounted to 3.2% y/y in March compared with 2.4% y/y as at the end of 2020.

INTEREST RATES

The National Bank of Poland (NBP) upheld its lenient approach to monetary policy and its declaration that maintaining unchanged interest rates (reference rate: 0.1%) is the most probable scenario for the upcoming quarters of the year. The NBP emphasized the temporary nature of the increase in inflation and its nature which is independent of the monetary policy in Poland. It underlined the high uncertainty of the revival prospects and the negative demand gap, which close up the space for interest rate increases. After the wave of weakening of the PLN in March, the note on the insufficient adaptation of the exchange rate of the PLN to the monetary policy and the pandemic crisis disappeared from the communique issued after the meeting of the Monetary Policy Council (RPP).

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2.2. RESIDENTIAL REAL ESTATE MARKET

RESIDENTIAL REAL ESTATE MARKET – IMPACT OF THE CORONAVIRUS PANDEMIC ON PRICES

The impact of the Coronavirus pandemic on the conditions on the residential real estate market was significantly lower than expected. Despite the disturbing crisis phenomena in the economy caused by lower activity due to restrictions in domestic and international business imposed to stop the spread of the pandemic, the growth trend in prices on the residential real estate market did not change. Only the rate of growth dropped.

PRIMARY MARKET

NBP data shows that in 2020 the transaction prices of apartments in Warsaw increased by 8%, in six large cities¹ by 7%, and in ten medium-sized cities² by 8%. In the previous year, prices in particular segments increased by 10-11%.

Data relating to transaction prices drawn from developer contracts registered in the PKO BP SA Group database shows that the rate of growth in the first quarter of 2021 was similar to the rate observed in 2020. In each of the above-mentioned segments prices increased by 2% on a q/q basis. The same quarterly rate of increase was noted throughout the country. In the first quarter of 2021 year to year residential real estate price increases amounted to 9% in Warsaw and in six large cities, 7% in ten medium-sized cities and 8% throughout the country.

SECONDARY MARKET

The data published by the NBP shows that in 2020 the largest drops in the rate of growth on the secondary market were in Warsaw (3% on an annual basis compared with 12% in the previous year). In the segment of six large cities prices increased by 8% on an annual basis (compared with 10% in 2019), and in the segment of ten medium-sized cities by 10% on an annual basis (compared with 13% in the previous year).

Transactions registered in the PKO BP SA Group's database in the first quarter of 2021 indicate that in Warsaw the rate of growth accelerated to 7% on an annual basis, and in six large cities to 13% on an annual basis. In the segment of ten medium-sized cities prices increased a little more slowly than in 2020 (7% on an annual basis). On an annual basis and on a country scale prices increased by 8%.

RESIDENTIAL REAL ESTATE MARKET – IMPACT OF THE CORONAVIRUS PANDEMIC ON MARKET ACTIVITY

Restrictions related to the Coronavirus pandemic led to a temporary drop in activity both on the primary and on the secondary residential market, which culminated in the second quarter of 2020. In further quarters, even those afflicted by the second and third wave of increases in the number of infected persons and the related restrictions, all market participants (including buyers and sellers, intermediaries and notaries) when applying prudent precautions adapted the form of presentation of offers and conducting the sales process to the new conditions enforced by the binding restrictions. The good condition in which the development industry entered the difficult period of the pandemic was particularly important as it allowed the development companies to make rational decisions and to quickly adapt their operating mechanisms, including investments, to new solutions such as "virtual walks" in the process of selecting properties.

PRIMARY MARKET

According to Jones Lang LaSalle agency (JLL) data the number of apartments sold on the six largest markets³ dropped to 6.9 thousand in the second quarter of 2020 (i.e. in the first months after the outbreak of the pandemic in Poland) which was a 54% drop compared with the corresponding quarter of the previous year. However, in the second half of the previous year the market experienced the revival so awaited by developers. On the six largest markets a total of 27.2 thousand apartments were sold and although this result was 19% worse than in the second half of 2019, taking into account the circumstances, the result was a positive surprise and meant the return of a supply-demand balance to the primary market.

¹ Kraków, Wrocław, Poznań, Gdynia, Gdańsk, Łódź

² Bydgoszcz, Białystok, Katowice, Kielce, Lublin, Olsztyn, Opole, Rzeszów, Szczecin, Zielona Góra

³ Warszawa, Kraków, Wrocław, Tricity, Poznań, Łódź

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In the first quarter of 2021 the positive trend of the primary residential real estate market's reaction to the drops caused by the economic lockdown continued. The results of development companies listed on the WSE were a positive surprise in the first quarter of 2021, as some of the best in history and lower only with respect to two quarters of the record year 2017. The sales volume exceeding 7 thousand apartments was almost better by one-quarter than the results of the first quarter of the previous year – which was the last period not to experience the drops caused by the outbreak of the pandemic.

SECONDARY MARKET

The database of the PKO BP SA Group indicates a drop in activity of the secondary residential real estate market in 2020 on a scale even slightly higher than on the primary market. The market only reacted and noted an increase in sales in the first quarter of 2021; in March sales were close to the level from before the pandemic.

RESIDENTIAL DEVELOPMENTS – IMPACT OF THE PANDEMIC ON INVESTOR ACTIVITY

The data relating to residential real estate development activity (in particular the number of building permits issued and developments started) include some of the most sensitive indicators of the conditions on the residential real estate market. The monthly data published by the Polish Statistics (GUS) on the number of apartments for which building permits were issued and the number of apartments whose construction started show that the restriction of investor activity only took place in the first two or three months of the pandemic. In further months the observed volumes were close to the levels noted in the record year 2019 (with respect to the number of permits issued December even brought about a 72-percent increase; however, this did not follow from the conditions on the market but from regulatory factors – since the beginning of 2021 more stringent standards with respect to the energy effectiveness of buildings became binding).

The results for the two months of 2021 indicate maintained volumes of started residential developments at a level similar to the corresponding period of 2020 (the results for these months were not yet impacted by the pandemic) and 11% higher than in the first two months of 2019. The number of residential building permits issued during the first two months of 2021 was 35% higher than in 2020; however, this was still the effect of an increased number of applications filed at the end of 2020 in connection with the approaching regulatory changes referred to above.

IMPACT OF THE PANDEMIC ON CONSUMER SENTIMENTS AND INTERNAL DEMAND

In the second quarter of 2020 we saw an accumulation of negative economic phenomena related to the Coronavirus pandemic, caused mainly by freezing certain areas of business activities and restricting the freedom of movement. The uncertainty about the development of the pandemic and its impact on the financial position of households led to a rapid deterioration in consumer sentiments. The values of the current consumer confidence indicator (*bieżący wskaźnik ufności konsumenckiej – BWUK*) and the leading

consumer confidence indicator (*wyprzedzający wskaźnik ufności konsumenckiej – WWUK*)⁴ dropped in April 2020 to -36.4 and -47.7 respectively. Such low values of the indices have not been noted since 2003. In further months consumer sentiments improved and the ratios made up for the major portion of the losses, stabilizing at approx. -15 (BWUK) and -16 (WWUK). Only the second wave of the pandemic once again caused consumer uncertainty to increase – in November the ratios dropped once again to -29.2 (BWUK) and -30.1 (WWUK). The third wave of the pandemic which appeared in the first quarter of 2021 did not have a material impact on consumer sentiments, which have slowly improved since December 2020 and in March 2021 reached a level of -23 (BWUK) and -20.2 (WWUK).

The relatively stable situation on the labour market impacts internal demand – the increase in unemployment caused by the pandemic crisis turned out to be insignificant. At the same time the increase in wages and salaries is higher than inflation (approx. 4.5% annually), which in the face of the record low interest rates also stimulates internal demand in the residential real estate segment.

⁴ Consumer economic indices published by GUS.

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CONCLUSION

Irrespective of the fact that the epidemic situation in Poland had a material impact on the weakening of the economy and the drop in the number of transactions on the real estate market, the impact of these turbulences on price trends of residential real estate was limited. In the upcoming quarters maintaining the increase trend in residential real estate prices is probable, at a relatively high scale of turnover both on the primary and secondary markets. Improving the epidemic situation which should lead to the revival of the economy and reinforcement of the labour market on the one hand, and maintaining low interest rates in conditions of higher inflationary pressure which stimulate both credited purchases by lowering finance costs, and cash purchases due to the lower attractiveness of deposits, which encourage the search for alternative forms of investing savings, on the other, should be a positive incentive for the demand for residential real estate.

If a limited rate of increase in prices is maintained, the situation on the residential real estate market should be stable in the longer term, and the potential return to price increase rates from before the pandemic will increase the risk of a price bubble, which would result in a significant adjustment which could lead to a crisis in the development industry.

2.3. RESIDENTIAL LOAN MARKET

Based on the NBP data, the banks' receivables in respect of residential mortgage loans in Poland were PLN 478.0 billion as at 28 February 2021, up 5.3% y/y. The balance of loans in PLN as at 28 February 2021 was PLN 362.6 billion (75.9% of the total amount of the banks' receivables in respect of residential loans in Poland) and it increased by 9.6% y/y.

The total balance of residential loans in relation to the Gross Domestic Product expressed at market prices stood at 20.7% as at the end of the fourth quarter of 2020. This amount is much below the average for the European Union, which according to 2019 data is 47.4%. This indicates a great potential for further growth of the residential loan market in Poland.

2.4. MORTGAGE COVERED BOND MARKET

As at 31 March 2021, four mortgage banks were operating in Poland:

- PKO Bank Hipoteczny SA;
- mBank Hipoteczny SA;
- Pekao Bank Hipoteczny SA;
- ING Bank Hipoteczny SA.

The Polish mortgage covered bond market is relatively small and moderately liquid. At the end of March 2021, the total value of outstanding mortgage covered bonds issued by Polish mortgage banks amounted to approx. PLN 26.1 billion, i.e. PLN 1.0 billion less than at 31 March 2020. As at the end of February 2021, outstanding mortgage covered bonds issued by Polish banks represented 5.4% of the amount of residential loans granted by banks.

PKO Bank Hipoteczny SA is the largest issuer of mortgage covered bonds in Poland. As at 31 March 2021, the value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 17.3 billion, which accounted for approx. 66% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

The Bank did not issue any mortgage covered bonds in the first quarter of 2021.

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2.5. REGULATORY AND LEGAL ENVIRONMENT

In the first quarter of 2021 no new legal or regulatory solutions became binding which would have a significant impact on the operations of PKO Bank Hipoteczny SA. Nevertheless, during the period legislative work began on amendments to the act that is most important for the operations of PKO Bank Hipoteczny SA, i.e. on the draft act on the amendments to the act on mortgage covered bonds and mortgage banks, and certain other acts, which is to implement the directive of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

2.6. FACTORS WHICH WILL INFLUENCE THE FUTURE FINANCIAL PERFORMANCE OF THE BANK

Significant factors and threats which may affect the Bank's results over at least the following quarter of 2021 include:

In the global economy:

- acceleration of anti-COVID-19 vaccinations which will enable loosening the restrictions and the return to normal business activities;
- the process of the global economy recovering from the deep recession caused by the pandemic, including the countries which were the main export markets for Polish entrepreneurs;
- continuation of the expansive monetary policy by key central banks by maintaining interest rates at a historical low;
- risk of further virus mutations which will reduce the effectiveness of vaccinations and lead to new waves of the pandemic and strengthening anti-pandemic restrictions;
- risk of a wave of insolvencies of some countries;
- situation on the foreign mortgage covered bonds markets;

In the Polish economy:

- quick revival of business activity supported, among other things, by the nature of the fiscal impulse and a drop in savings caused by the pandemic;
- the process of adapting the economy to the post-pandemic reality – employment and operations restructuring in industries most afflicted by the chronic negative effects of the pandemic, which thanks to the revival of demand at a macro level should have the nature of “creative destruction”, but temporarily may cause turbulences on local labour markets, commencing the process of repayment of the repayable portion of aid under the Financial Shield;
- probable stabilization of NBP interest rates at a record low, possible further activity of the NBP on the foreign exchange market;
- situation on the residential market in Poland;
- situation on the residential loan market in Poland;
- situation on the Polish mortgage covered bonds market;
- investor demand for mortgage covered bonds and unsecured bonds issued by the Bank;
- PKO Bank Polski SA Group's policy with respect to managing the finance structure and liquidity.

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3. FINANCIAL RESULTS OF THE BANK

Key financial indicators of PKO Bank Hipoteczny SA
Statement of financial position of PKO Bank Hipoteczny SA
Income statement of PKO Bank Hipoteczny SA

3.1. KEY FINANCIAL INDICATORS OF PKO BANK HIPOTECZNY SA

	31.03.2021	31.12.2020	Change
Total assets (PLN million)	26,879.6	27,310.5	-430.9
ROA ⁵	0.1%	0.3%	-0.2 p.p
ROE ⁶	1.9%	4.0%	-2.1 p.p
Total capital ratio	18.9%	18.7%	+0.2 p.p
Leverage ratio (LR)	7.5%	7.4%	+0.1 p.p
Cost to income ratio (C/I) ⁷	23.8%	23.3%	+0.5 p.p

3.2. STATEMENT OF FINANCIAL POSITION OF PKO BANK HIPOTECZNY SA

in PLN million	31.03.2021	31.12.2020
Cash and balances with the Central Bank	0.0	0.0
Amounts due from banks	0.0	0.0
Derivative hedging instruments	1,234.8	1,154.7
Securities	1,072.3	1,241.8
Loans and advances to customers	24,562.1	24,902.7
Other assets ⁸	10.4	11.3
TOTAL ASSETS	26,879.6	27,310.5

in PLN million	31.03.2021	31.12.2020
Amounts due to banks	2,864.1	3,575.1
Derivative hedging instruments	0.4	0.5
Liabilities in respect of mortgage covered bonds issued	17,319.2	17,205.6
Liabilities in respect of bonds issued	4,508.0	4,337.1
Other liabilities and provisions ⁹	108.1	99.0
Equity	2,079.8	2,093.2
TOTAL LIABILITIES AND EQUITY	26,879.6	27,310.5

As at 31 March 2021, the total assets of PKO Bank Hipoteczny SA were PLN 26,879.6 million, down 2% compared with the end of 2020. Residential mortgage loans were the key component of the Bank's assets. Their carrying

⁵ Annualized ratio expressed as the quotient of the net profit (loss) for the period and the average balance of assets at the beginning and end of the reporting period and of the interim monthly periods.

⁶ Annualized ratio calculated by dividing the net profit (loss) for the period by the average balance of equity at the beginning and end of the reporting period and of the interim monthly periods.

⁷ Annualized ratio excluding tax on certain financial institutions.

⁸ Includes the following items of the statement of financial position: intangible assets, property, plant and equipment and other assets.

⁹ Includes the following items of the statement of financial position: amounts due to customers, other liabilities, current tax liabilities, deferred income tax provision and provisions.

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amount, taking into account provisions for expected credit losses recognized as at 31 March 2021, amounted to PLN 24,562.1 million, of which new loans amounted to PLN 12,091.8 million, whereas loans purchased from PKO Bank Polski SA amounted to PLN 12,470.3 million.

On the liabilities side, the share of mortgage covered bonds accounted for 64% of total assets as at the end of March 2021. In the first quarter of 2021, PKO Bank Hipoteczny SA did not carry out any issues of mortgage covered bonds.

The carrying amount of mortgage covered bonds as at the end of March 2021 amounted to PLN 17,319.2 million which represents a 1% increase compared with the end of 2020 due to the effect of the EUR/PLN exchange rate on the valuation of EUR-denominated mortgage covered bonds.

As at 31 March 2021, financial liabilities to PKO Bank Polski SA constituted a significant item of the Bank's equity and liabilities. These were liabilities in respect of renewable overdrafts and credit limit, liabilities in respect of the purchase of receivables, liabilities in respect of mortgage covered bonds and bonds acquired by PKO Bank Polski SA, and other amounts due to PKO Bank Polski SA. Their total balance was PLN 2,740.9 million. Short- and medium-term bonds issued by the Bank were also a significant source of funding the Bank's operations. As at 31 March 2021, they amounted to PLN 4,508.0 million, up 4% compared with the end of 2020.

3.3. INCOME STATEMENT OF PKO BANK HIPOTECZNY SA

PLN million	01.01.2021 – 31.03.2021	01.01.2020 – 31.03.2020	Change y/y (PLN million)
Net interest income	76.0	84.4	(8.4)
Net fee and commission income	(2.0)	(0.2)	(1.8)
Net gain/(loss) on financial instruments measured at fair value through profit or loss	0.0	0.0	0.0
Net foreign exchange gains/ (losses)	0.2	5.6	(5.4)
Net income/(expense) on modification	0.2	(0.2)	0.4
Net allowances for expected credit losses	0.1	(14.3)	14.4
Net other operating income and expenses	0.0	(0.1)	0.1
Administrative expenses	(12.4)	(13.7)	1.3
Regulatory charges	(24.5)	(24.9)	0.4
Tax on certain financial institutions	(21.7)	(22.6)	0.9
Operating profit/(loss)	15.9	14.0	1.9
Profit before tax	15.9	14.0	1.9
Income tax expense	(6.2)	(5.0)	(1.2)
Net profit	9.6	9.0	0.6

In the first quarter of 2021, PKO Bank Hipoteczny SA generated a net profit of PLN 9.6 million, up PLN 0.6 million compared with the corresponding period of 2020.

In the analysed period, the Bank earned interest income of PLN 126.4 million. It comprised mainly income from residential mortgage loans of PLN 123.6 million, and income on debt securities. In the same period, the Bank incurred interest expense of PLN 50.4 million. Interest expense resulted mainly from mortgage covered bonds issued (including costs of hedging transactions). The related interest expense was PLN 37.5 million. In addition, the Bank incurred interest expense of PLN 6.7 million on loans received and the overdraft limits used, PLN 5.9 million on bonds issued and PLN 0.4 million on the liability for the deferred payment for receivables purchased from PKO Bank Polski SA.

The Bank's turnover in the first quarter of 2021 (understood as the total value of interest income and fee and commission income) amounted to PLN 128.3 million. The realized turnover was generated entirely from the Bank's operations in Poland.

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In the first quarter of 2021, the Bank incurred a net fee and commission loss of PLN 2.0 million. This item comprised, among other things, costs of bond issue programmes of PLN 1.6 million, costs of credit lines of PLN 1.3 million, costs of insuring loans of PLN 0.6 million and costs of expert valuations of the mortgage lending value of real estate (MLV), as prepared by real estate appraisers of PLN 0.2 million. The Bank also recognized fee and commission income from customers including, among other things, fees for real estate valuations and real estate inspections and commission for early full or partial loan repayments. The total fee and commission income amounted to PLN 1.9 million.

In the first quarter of 2021, the Bank incurred administrative expenses of PLN 12.4 million. Non-personnel expenses of PLN 7.9 million, including costs related to services rendered by PKO Bank Polski SA of PLN 6.4 million under an outsourcing agreement, were a significant component of administrative expenses. Costs of employee benefits, whose amount during the reporting period was PLN 3.8 million, were also a significant component of administrative expenses.

In the first quarter of 2021, the Bank also incurred regulatory expenses totalling PLN 24.5 million. The main item of such expenses was the cost of the compulsory restructuring fund of the Bank Guarantee Fund of PLN 21.1 million which means a decrease of PLN 1.5 million compared to same period of 2020. The high level of regulatory charges had a negative impact on the Bank's profitability.

Tax on certain financial institutions, which amounted to PLN 21.7 million in the reporting period, was a significant cost of the Bank's activities.

The Bank's net allowances for expected credit losses amounted to PLN 0.1 million in the first quarter of 2021. The fact that the Bank did not recognize any additional allowances for expected credit losses in the first quarter of 2021 is due to amortization of the portfolio (the carrying amount of the loan portfolio diminished) and the improving macroeconomic forecasts. In addition, in the first quarter of 2021, the Bank did not observe a significant deterioration in the loan portfolio quality measured by the scale of non-performing loans, which is partly due to the fact some customers were still taking advantage of the moratoria granted in 2020.

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4. BUSINESS OF PKO BANK HIPOTECZNY SA

Sales of residential mortgage loans under the agency model
Acquisition of receivables under residential mortgage loans
Mortgage covered bonds

4.1. SALES OF RESIDENTIAL MORTGAGE LOANS UNDER THE AGENCY MODEL

PKO Bank Hipoteczny SA has been granting residential mortgage loans in Polish zloty since 1 April 2015. New residential mortgage loans are sold under the agency model, through Poland's largest network of branches, agents and intermediaries, organized by PKO Bank Polski SA. The Bank accepts apartments and single-family homes as collateral.

In 2020, implementing the updated strategy for the years 2020–2022, the Bank limited sales of residential mortgage loans. This decision had no impact on the Group's total sales of residential mortgage loans. Therefore, in the first quarter of 2021, the Bank granted PLN 101.6 million worth of residential mortgage loans, which is a drop of 61.8% compared with the corresponding period of 2020.

In accordance with the Act on the subsidization of interest on bank loans granted to entrepreneurs affected by COVID-19 and on simplified arrangement approval proceedings due to COVID-19 ("Shield 4.0"), the Bank continues to offer the possibility of suspending the exercising of a loan agreement for borrowers who lost their jobs or another main source of income after 13 March 2020. At the same time, by the end of the first quarter of 2021, the Bank stopped suspending the repayment of loans (under the so-called non-legislative moratoria) up to the limit of 6 suspended instalments.

In accordance with Recommendation S of the Polish Financial Supervision Authority, the Bank grants loans for which the loan-to-value ratio does not exceed 80%. Where a low down payment insurance policy was used, the Bank approved loans for which this ratio was not higher than 90%. Starting from the second quarter of 2020, the Bank limited the possibility of granting loans for which the loan-to-value ratio exceeded 80%. Furthermore, starting from 1 February 2021, if a low down payment insurance policy was used, the Bank started to grant loans with the loan-to-value ratio again exceeding 80%, provided that the loan is secured with a mortgage on a residential real estate.

Moreover, in compliance with the Polish act on Mortgage Covered Bonds and Mortgage Banks, the Bank only grants loans whose value in relation to the mortgage lending value of the real estate does not exceed 100%.

The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of granting loans secured by mortgages.

CRITERIA	AGENCY MODEL
Loan amount/market value of the real estate	Max 90% ¹⁰
Loan amount/mortgage lending value of the property	Max 100%
Legal title to the real estate	Ownership or perpetual usufruct
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Purpose	Residential

¹⁰ Starting from 1 April 2021, the Bank restored the possibility of granting a loan with the loan-to-value ratio not exceeding 90% if a low down payment insurance policy is used, irrespective of the type of real estate to be used as primary mortgage collateral.

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4.2. ACQUISITION RESIDENTIAL MORTGAGE LOAN RECEIVABLES

The purchase of residential mortgage loans receivables based on a framework agreement signed in 2015 with PKO Bank Polski SA is an important element of the business of PKO Bank Hipoteczny SA.

In the first quarter of 2021, PKO Bank Hipoteczny SA acquired from PKO Bank Polski SA a portfolio of receivables for residential mortgage loans totalling PLN 158,0 million. The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of acquiring the mortgage loans.

CRITERIA	POOLING MODEL
Loan amount/mortgage lending value of the property	Max 100%
Legal title to the real estate	Ownership or perpetual usufruct
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Days past due or impairment indicators	None
Purpose	Residential

4.3. MORTGAGE COVERED BONDS

The key objective of PKO Bank Hipoteczny SA concerning funding is issuing mortgage covered bonds which are the main source of long-term funding for loans secured with real estate.

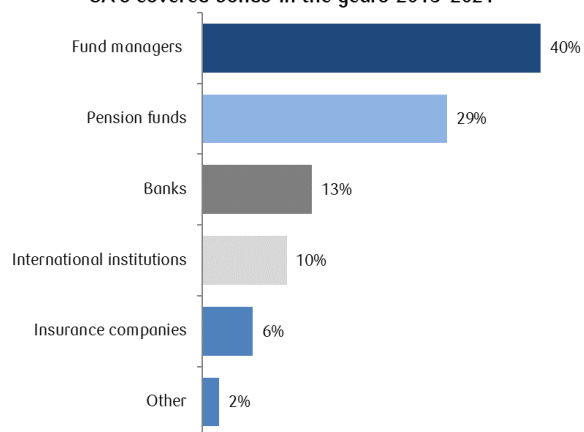
DOMESTIC ISSUES OF MORTGAGE COVERED BONDS

From the beginning of its operations, PKO Bank Hipoteczny SA has issued thirteen series of Polish mortgage covered bonds, including two issues of green mortgage covered bonds.

The total value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA for the domestic market (at the nominal value) as at the end of March 2021 was PLN 4,355.0 million.

All series of domestic mortgage covered bonds issued are traded on the Warsaw Stock Exchange parallel market and on the BondSpot regulated market. They are also accepted in repo transactions by the National Bank of Poland.

Chart: Purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2021

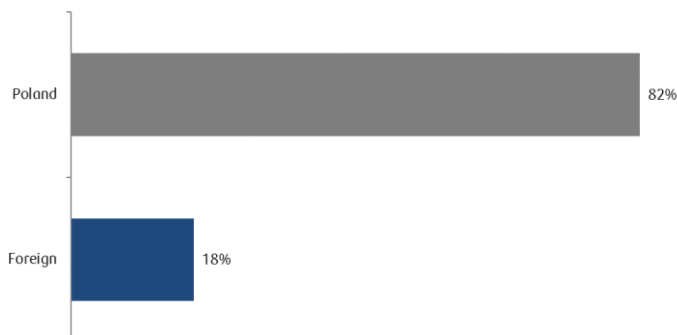


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In the first quarter of 2021, PKO Bank Hipoteczny SA did not carry out any domestic issues of mortgage covered bonds.

Chart: Geographical distribution of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2021



Outstanding PLN-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to 31 March 2021:

Series	Mortgage covered bond number (ISIN)	Issue date	Redemption date	Series value (PLN million)	Interest rate	Currency	Rating of the issue	Listing
2	PLPKOHP00025	27.04.2016	28.04.2021	500	WIBOR 3M +0.65%	PLN	Aa1	Bondspot, WSE parallel market
3	PLPKOHP00033	17.06.2016	18.06.2021	500	WIBOR 3M +0.59%	PLN	Aa1	Bondspot, WSE parallel market
4	PLPKOHP00041	28.04.2017	18.05.2022	500	WIBOR3M +0.69%	PLN	Aa1	Bondspot, WSE parallel market
5	PLPKOHP00058	22.06.2017	10.09.2021	265	2.69%	PLN	Aa1	Bondspot, WSE parallel market
6	PLPKOHP00066	27.10.2017	27.06.2023	500	WIBOR3M +0.60%	PLN	Aa1	Bondspot, WSE parallel market
7	PLPKOHP00074	27.04.2018	25.04.2024	700	WIBOR3M +0.49%	PLN	Aa1	Bondspot, WSE parallel market
8	PLPKOHP00082	18.05.2018	29.04.2022	100	WIBOR3M +0.32%	PLN	Aa1	Bondspot, WSE parallel market
9	PLPKOHP00090	27.07.2018	25.07.2025	500	WIBOR3M +0.62%	PLN	Aa1	Bondspot, WSE parallel market
10	PLPKOHP00108	24.08.2018	24.08.2028	60	3.4875%	PLN	Aa1	Bondspot, WSE parallel market
11	PLPKOHP00116	26.10.2018	28.04.2025	230	WIBOR3M +0.66%	PLN	Aa1	Bondspot, WSE parallel market
12	PLPKOHP00132	10.06.2019	30.09.2024	250	WIBOR 3M +0.60%	PLN	Aa1	Bondspot, WSE parallel market
13	PLPKOHP00199	02.12.2019	02.12.2024	250	WIBOR 3M +0.51%	PLN	Aa1	Bondspot, WSE parallel market

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INTERNATIONAL ISSUES OF MORTGAGE COVERED BONDS

From the beginning of its operations, PKO Bank Hipoteczny SA has issued seven series of international mortgage covered bonds, including five benchmark issues and two private placement issues.

The total value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA for the international markets (at the nominal value) as at the end of March 2021 was EUR 2,779.0 million.

All series of international mortgage covered bonds issued are traded on the Luxembourg Stock Exchange and, except for series 2 and 5, on the parallel market of the Warsaw Stock Exchange. They have also been accepted in repo transactions by the European Central Bank.

In the first quarter of 2021, PKO Bank Hipoteczny SA did not carry out any international issues of mortgage covered bonds.

Chart: Geographical distribution of purchasers of EUR-denominated covered bonds of PKO Bank Hipoteczny SA's in the years 2016-2021

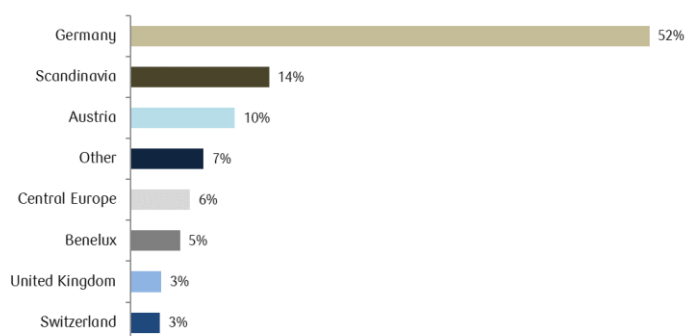
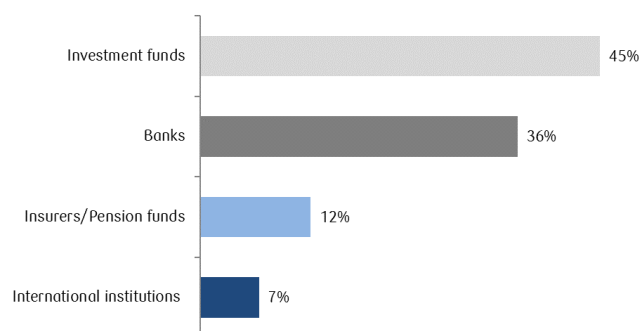


Chart: Purchasers of EUR-denominated issues of PKO Bank Hipoteczny SA's covered bonds in the years 2016-2021



Outstanding EUR-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to 31 March 2021:

Series	Mortgage covered bond number (ISIN)	Issue date	Redemption date	Series value (EUR million)	Coupon	Price	Currency	Rating of the issue	Listing
1	XS1508351357	24.10.2016	24.06.2022	500	0.125%	99.702%	EUR	Aa1	LuxSE, WSE parallel market
1 tranche 2	XS1508351357	08.03.2019	24.06.2022	100	0.125%	99.489%	EUR	Aa1	LuxSE, WSE parallel market
2	XS1559882821	02.02.2017	02.02.2024	25	0.82%	100.00%	EUR	Aa1	LuxSE
3	XS1588411188	30.03.2017	24.01.2023	500	0.625%	99.972%	EUR	Aa1	LuxSE, WSE parallel market
4	XS1690669574	27.09.2017	27.08.2024	500	0.75%	99.906%	EUR	Aa1	LuxSE, WSE parallel market

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5	XS1709552696	02.11.2017	03.11.2022	54	0.467%	100.00%	EUR	Aa1	LuxSE
6	XS1795407979	22.03.2018	24.01.2024	500	0.75%	99.892%	EUR	Aa1	LuxSE, WSE parallel market
7	XS1935261013	28.01.2019	23.11.2021	500	0.250%	99.933%	EUR	Aa1	LuxSE, WSE parallel market
7 tranche 2	XS1935261013	01.03.2019	23.11.2021	100	0.250%	100.145%	EUR	Aa1	LuxSE, WSE parallel market

The funds raised from the issues of covered bonds have been used by PKO Bank Hipoteczny SA to grant residential mortgage loans and to purchase receivables from such loans from PKO Bank Polski SA.

BOND ISSUES – BOND ISSUE PROGRAMME AGREEMENT CONCLUDED WITH PKO BANK POLSKI SA

On 30 September 2015, PKO Bank Hipoteczny SA concluded an agreement for an Own Bond Issue Programme with PKO Bank Polski SA. In the first quarter of 2021, the Bank issued a total of PLN 2,472.0 million worth of bonds under the programme. The balance of short- and medium-term bonds issued was PLN 4,297.0 million as at 31 March 2021. The Bank intends to continue seeking funding under this Programme.

BOND ISSUES – PUBLIC PROGRAMME

On 12 October 2020, after the Polish Financial Supervision Authority approved the Base Bond Issue Prospectus on 8 October 2020, PKO Bank Hipoteczny SA signed a Programme Agreement, relating to the Public Bond Issue Programme established on 11 April 2019, with PKO Bank Polski SA, also acting through its branch, the Brokerage Office in Warsaw.

In the first quarter of 2021, PKO Bank Hipoteczny SA did not issue bonds under the Public Bond Issue Programme.

The balance of bonds issued and outstanding was PLN 215.0 million as at 31 March 2021. All series were admitted to and introduced to trading on a regulated market of the WSE (parallel market) The Bank intends to continue seeking funding under this Programme.

Series	Covered bond number (ISIN)	Issue date	Redemption date	Series value (PLN million)	Coupon	Currency	Rating of the issue	Listing
1	PLPKOHP00140	11.07.2019	12.07.2021	50	WIBOR3M +0.60%	PLN	None	LuxSE, WSE parallel market
2	PLPKOHP00165	28.08.2019	30.08.2021	45	WIBOR3M +0.60%	PLN	None	LuxSE, WSE parallel market
3	PLPKOHP00173	17.10.2019	18.10.2021	40	WIBOR3M +0.60%	PLN	None	LuxSE, WSE parallel market
4	PLPKOHP00181	18.12.2019	20.12.2021	30	WIBOR3M +0.60%	PLN	None	LuxSE, WSE parallel market

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The only binding version is the original Polish version.

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5	PLPKOHP00207	27.11.2020	02.06.2021	50	0.60%	PLN	None	LuxSE, WSE parallel market
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BOND ISSUES – OTHER

In the first quarter of 2021, PKO Bank Hipoteczny SA did not issue any unsecured bonds on the basis of an individual agreement.

On 24 February 2020, PKO Bank Hipoteczny SA redeemed bonds issued on the basis of unsecured bond issue agreement concluded with a European financial institution with a nominal value of PLN 350 million.

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5. OTHER INFORMATION

LIST OF DIRECT OR INDIRECT HOLDERS OF SIGNIFICANT BLOCKS OF SHARES WITH AN INDICATION OF THE NUMBER OF SHARES HELD AND THE NUMBER OF VOTES ATTACHED TO THESE SHARES

As at 31 March 2021 the share capital of PKO Bank Hipoteczny SA amounted to PLN 1,611,300,000 and comprised 1,611,300,000 shares with PLN 1 nominal value. The shares are paid up in full. The share capital not change in relation to the end of 2020. The PKO Bank Hipoteczny SA shares are non-preference shares. The holders of PKO Bank Hipoteczny SA shares do not have any control rights due to holding such shares. Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna is the shareholder holding 100% of shares in PKO Bank Hipoteczny SA.

Structure of the share capital of PKO Bank Polski SA as at 31 March 2021:

Series	Type of shares	Number of shares	Nominal value per share	Number of votes at GSM	Amount paid in for shares
A	Ordinary registered shares	300,000,000	PLN 1	300,000,000	PLN 300,000,000.00
B	Ordinary registered shares	200,000,000	PLN 1	200,000,000	PLN 200,000,000.00
C	Ordinary registered shares	200,000,000	PLN 1	200,000,000	PLN 200,000,000.00
D	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
E	Ordinary registered shares	150,000,000	PLN 1	150,000,000	PLN 150,000,000.00
F	Ordinary registered shares	150,000,000	PLN 1	150,000,000	PLN 150,000,000.00
G	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
H	Ordinary registered shares	95,000,000	PLN 1	95,000,000	PLN 95,000,000.00
I	Ordinary registered shares	100,000,000	PLN 1	100,000,000	PLN 100,000,000.00
J	Ordinary registered shares	131,500,000	PLN 1	131,500,000	PLN 131,500,000.00
K	Ordinary registered shares	84,800,000	PLN 1	84,800,000	PLN 84,800,000.00
	TOTAL	1,611,300,000		1,611,300,000	PLN 1,611,300,000.00

Shareholder	31.03.2021		31.12.2020	
	Number of shares	Share in the number of votes at the GSM	Number of shares	Share in the number of votes at the GSM
Powszechna Kasa Oszczędności Bank Polski SA	1,611,300,000	100%	1,611,300,000	100%

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IDENTIFICATION OF PROCEEDINGS PENDING BEFORE COURTS, ARBITRATION BODIES OR PUBLIC-ADMINISTRATION AUTHORITIES

As at 31 March 2021, no proceedings were pending before courts, arbitration bodies or public administration bodies concerning liabilities or receivables whose value constituted at least 10% of PKO Bank Hipoteczny SA's equity.

INFORMATION ON LOAN GUARANTEES OR OTHER GUARANTEES ISSUED BY THE BANK OR ITS SUBSIDIARY – IN AGGREGATE TO A SINGLE ENTITY OR ITS SUBSIDIARY, IF THE TOTAL AMOUNT OF THE EXISTING GUARANTEES IS EQUIVALENT TO AT LEAST 10% OF THE ISSUER'S EQUITY

In the first quarter of 2021 and in 2020, PKO Bank Hipoteczny SA did not grant any loan or credit guarantees to a single entity or a subsidiary of such an entity with a total value equivalent to at least 10% of the Bank's equity.

SUBSEQUENT EVENTS

On 6 April 2021, Mr Jakub Papierski submitted his resignation from the position of member of the Bank's Supervisory Board effective as of the date of the Ordinary General Shareholders' Meeting approving the financial statements for the financial year 2020.

On 13 April 2021, the Ordinary Shareholders Meeting of the Bank:

- appointed Mr Jan Emeryk Rościszewski to the Supervisory Board for a joint four-year term of office.
- decided to transfer the whole net profit earned in 2020 to the Bank's supplementary capital.