

Directors' Commentary  
to the financial results  
of PKO Bank Hipoteczny SA  
for the three-month period  
ended 31 March 2020

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## **DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020**

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### **1. SUMMARY OF THE FIRST QUARTER OF 2020**

#### **1.1. THE MOST IMPORTANT EVENTS IN THE FIRST QUARTER OF 2020**

PKO Bank Hipoteczny SA ("the Bank") specializes in granting residential mortgage loans to individual customers and purchasing receivables in respect of such loans. The Bank obtains loans for its portfolio based on its 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 regular issuer of mortgage covered bonds on the domestic market. It was the only bank in Poland to carry out benchmark issues of euro-denominated mortgage covered bonds. The total number of such issues until 31 March 2020 was five. The outstanding mortgage covered bonds issued by the Bank account for approximately 63% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

#### **COVID-19 PANDEMIC**

The Bank took actions aimed at improving the safety of its customers and employees and ensuring prudent management of the Bank in connection with the COVID-19 pandemic:

- In March 2020 it was decided that most employees would work remotely.
- The Bank introduced special solutions for mortgage borrowers and allowed them to suspend the repayment of three consecutive loan instalments in 2020.
- Although the Bank does not have complete knowledge on the effect of the pandemic on the macroeconomic situation and other banking sector entities, it recognized in its financial statements for the first quarter of 2020 a provision for a forecast deterioration in the quality of the loan portfolio due to COVID-19.

The COVID-19 pandemic has an adverse effect on a number of things, including business activity in Poland and the functioning of financial markets. This will certainly have an adverse effect on the Bank's results in the subsequent quarters. However, the Bank maintains good liquidity and capital levels, above the regulatory requirements.

It is uncertain and difficult to estimate how the COVID-19 situation will develop and continue to affect the Bank's operations; therefore, the Bank intends to monitor the situation and adjust its actions accordingly.

#### **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 defines the following:

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

The Bank prepared the updated strategy for the years 2020 – 2022 taking into account the following circumstances:

- a) the updated strategy of the PKO Bank Polski Group, which redefined the role of PKO Bank Hipoteczny in the Group;
- b) the time horizon of the new strategy prepared by PKO Bank Polski (the years 2020 – 2022), which made PKO Bank Hipoteczny SA extend its strategy horizon up to the year 2022;

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- c) changes in the regulatory environment, including mainly the new minimum requirement for own funds and eligible liabilities (MREL), which has a significant effect on the planned financing structure of the Group.

The Bank defined the following strategic objectives in its new strategy:

- diversification of the sources of financing of the Bank and the PKO Group through maintaining the ability to obtain long-term financing in the form of covered bonds for the purposes of mortgage lending;
- maintaining a safe level of risk in the Bank's operations, in particular with respect to the loan portfolio and capital ratios;
- making optimum use of the assets and competences of PKO Bank Hipoteczny SA and PKO Bank Polski SA in order to achieve synergies within the PKO Group;
- issuing green mortgage covered bonds and taking actions in the area of sustainable development.

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 financing. 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 2020, the Bank's total assets amounted to nearly PLN 28 billion, of which PLN 25.8 billion represented a high quality portfolio of residential mortgage loans. This means that there was a 3% increase in total assets compared with the end of 2019. At the same time, the stability and safety of operations were maintained.

### **MORTGAGE COVERED BONDS ISSUED**

The Bank did not issue any mortgage covered bonds in the first quarter of 2020. As at the end of March 2020, 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.

## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020

## 2. EXTERNAL BUSINESS CONDITIONS

Macroeconomic environment  
Residential real estate market  
Residential 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 national economy in the first quarter of 2020:

#### GROSS DOMESTIC PRODUCT

The GDP growth rate affects both the residential real estate market and the mortgage loan market. A sufficiently high GDP growth rate translates into new jobs and higher wages, and, consequently, into consumers' purchasing power and creditworthiness. The data published by the Central Statistical Office of Poland (hereinafter: "GUS") in April 2020 show that Poland's GDP grew by 4.1% in 2019 compared with 5.3% in 2018. The available data shows that in January-February 2020 the economic growth rate accelerated after a slow-down recorded in 2019.

However, March brought a visible deterioration resulting from the restrictions imposed due to the pandemic. We estimate that the annual GDP growth rate decreased significantly in the first quarter of 2020 to 0.5% compared with 3.2% in the fourth quarter of 2019. At the same time, the forecasts for the following quarters and the whole year 2020 deteriorated significantly. In view of the economic crisis which occurred in the last weeks of March and the prospect that the restrictions imposed on economic activity will be maintained in the following months, it can be estimated that GDP will drop significantly (by 5-10% y/y) in the second quarter of 2020.

#### UNEMPLOYMENT AND WAGES

Based on the data published by the GUS, the number of unemployed registered with employment offices in Poland stood at 909.4 thousand at the end of March 2020, down 75.3 thousand, or 7.6%, compared with March 2019. The unemployment rate as at the end of March 2020 was 5.4%, which means that the downward trend slowed down a little compared with the corresponding period of the previous year (-0.5 p.p.). The number of people employed at the end of the fourth quarter of 2019 was 16,467 thousand, up 0.4% y/y, according to GUS's Labour Force Survey (BAEL). At the same time, the average monthly wage in the enterprise sector in the first quarter of 2020 was PLN 5,367.5, up 7.0% y/y, based on GUS data.

The deterioration in the situation on the labour market at the end of March has not yet been reflected in the recorded data for March. The rapid deterioration in the situation on the labour market, which is visible in the sparse information available for the last weeks of March (e.g. companies' declaring reductions in employment) will fully manifest itself no sooner than in the coming months.

#### INFLATION

Price changes affect the consumers' purchasing power and the level of interest rates. A high level of inflation, which is not offset with an increase in incomes, has an adverse effect on the creditworthiness of the banks' customers (lower real disposable incomes), which in turn has a negative effect on the amount of residential loans granted.

The CPI inflation increased in the first months of 2020 way above the upper limit of acceptable deviation from the Central Bank's inflation goal to reach 4.7% y/y in February (the highest level since November 2011). In March, CPI inflation decreased slightly to 4.6% y/y. The base inflation ratio was 3.6% y/y in March (the highest level since April 2002). This should be considered the high point of the inflation trend.

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### INTEREST RATES

The Monetary Policy Council (MPC) did not change the base interest rates of the National Bank of Poland (NBP) in the first two months of 2020 and its members usually spoke about the high probability of interest rate stabilization at least until the end of the year 2020.

The rapid deterioration in economic prospects and perturbations on the Polish financial market (including a decrease in the treasury bond market liquidity) gave rise to the following actions of the NBP Management Board and the MPC:

- a reduction in interest rates (the reference rate: down by 50 base points to 1.00% and the Lombard rate: down by 100 base points to 1.50%);
- a reduction in the mandatory reserve rate (from 30 April) from 3.5% to 0.5% and a simultaneous increase in the interest rate on the mandatory reserve from 0.5% to 1.0%;
- implementation of repo operations to provide banks with liquidity;
- purchase of bonds on the secondary market, introduction of a bill discount facility for banks (with an interest rate of 1.10%) for the purposes of financing loans offered to non-financial entities.

Moreover, the Financial Stability Committee decided to decrease the systemic risk buffer from 3% to 0%. The actions taken are aimed at stabilizing the economic situation and supporting the banking sector and the enterprise sector.

Additionally, the interest rate decrease may help reduce the costs of servicing the residential mortgage loans taken previously. At a brief one-day meeting on 8 April the MPC reduced the interest rates again by 50 bp. As a result, the reference rate dropped to a new historic low of 0.50%.

### 2.2. RESIDENTIAL REAL ESTATE MARKET

In 2019, the rate of growth of transaction prices exceeded 10% in annual terms. The residential real estate market was characterized by a high level of activity accompanied by strong demand (enhanced by low interest rates), the good situation on the labour market (low unemployment, high rate of growth in wages and salaries) and optimism among consumers.

In the first quarter of 2020, despite some clear indications of a general economic slowdown and a decline in consumer optimism, the residential real estate market did not stop growing. The prices continued to grow fast and the market participants remained very active.

### THE SECONDARY MARKET

According to the PKO Bank Polski Group's own data, the residential real estate prices on the secondary market increased by 13% in the first quarter of 2020 in relation to the first quarter of 2019 and the number of transactions grew by approx. 5%. In rural districts the average price increase in the period under discussion was 11%, and in urban districts it was 15% (Warsaw: 15%; 6 large cities: 14%; other cities/towns: 17%). This means that the price growth rate increased by about 1-2 percentage points in relation to the year 2019.

### THE PRIMARY MARKET

According to the JLL REAS data, in the six metropolitan areas with the biggest turnover (Warsaw, Tri-City (Gdańsk, Gdynia, Sopot), Poznań, Kraków, Wrocław, Łódź) the real estate prices continued to grow in the first quarter of 2020 at a rate similar to that observed in 2019. Compared with the first quarter of 2019, the biggest price growth rate was recorded in Kraków (26%) and the lowest in Poznań (6%). At the same time, the number of apartments sold (18.9 thousand) was 7% higher than in the previous quarter and 14% higher than in the first quarter of the previous year. It was similar to the result obtained in the record-breaking fourth quarter of 2017 when the Apartment for Young People (Mieszkanie dla Młodych) programme was still available. At the same time, developers offered only 13,000 new apartments for sale, i.e. 26% less than in the fourth quarter of 2019 and 23% less than a

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year ago. In total, 60,000 apartments were offered for sale in the last four quarters, which represents the lowest supply in 5 years. Due to the fact that the number of apartments sold was so much higher than the number of newly offered ones, at the end of the first quarter of 2020 the offer decreased by 12% in relation to the fourth quarter of 2019 and 13% in relation to the first quarter of 2019. The number of apartments remaining on offer was 44,300. It was the lowest number since the end of the second quarter of 2014. The proportion of finished apartments in the developers' offer remained low at 8%.

### THE PANDEMIC SITUATION

The present economic situation is exceptional. The same can be said about the residential real estate market. The effect of the restrictions imposed in order to stop the pandemic on the market situation is hard to determine. At the moment, it is still unknown how long the "unfreezing" of various sectors of the economy will take and what impact the present events will have on macroeconomic factors (both direct and indirect, resulting from the developments in other countries, in particular the most important economic partners of Poland). We do not yet know the scale or the effects of the protective measures adopted by the Polish authorities, other countries or the EU. The psychological effects of the present struggle and the resulting sociological phenomena are equally hard to predict.

All these unknown factors will affect the behaviour of both the demand and the supply side of the residential real estate market in the second half of the year. However, it seems unlikely that the impact of the present crisis on the residential real estate market will be comparable to that observed in connection with the financial crisis of 2008. The Polish property developer segment is now stronger financially and institutionally. It is also wiser, having gained experience in previous years. The number of apartments on offer is moderate in relation to the demand potential and their characteristics are usually well adapted to the actual needs of the Poles. The projects introduced by developers are smaller and they allow more flexible sales management. It seems, though, that the demand potential will be limited at least for some time, which may prevent the residential real estate prices from growing further or even cause a certain price adjustment, at least in the most sensitive segments (including in particular those associated with investment demand).

A slight downward trend in consumer prosperity (which was at its historic high before) was noticeable even before the outbreak of the pandemic (i.e. in the fourth quarter of 2019 and the first quarter of 2020) despite the good situation on the labour market. This means that the consumers began to experience the first effects of an economic slowdown. The consumer optimism data recorded in April, i.e. after the restrictions aimed at limiting the spread of the coronavirus had been imposed, demonstrated how much the consumers were afraid of the effect of the pandemic on their financial situation. Both the current consumer confidence index (showing the evaluation of the present situation) and the leading consumer confidence index (showing the evaluation of the expected situation) dropped rapidly to -36 and -47, respectively (such low values were previously recorded 18 years ago, in 2002). Most probably, this is a temporary effect of the "fear of the unknown", i.e. a situation that the consumers have never experienced before. As the consumers get used to the situation and the government lifts the restrictions, the level of optimism should return to much higher levels, although it should not be expected to get close to the record-breaking levels of 2019. In the short term, the uncertainty described above may make the investors postpone their purchase decisions until the situation stabilizes. In the longer term, it should ease the pressure on residential real estate price increases observed in recent years.

### 2.3. RESIDENTIAL LOAN MARKET

Based on the NBP data, the banks' receivables in respect of residential mortgage loans in Poland were PLN 462.8 billion as at 31 March 2020, up 9.3% y/y. The balance of loans in PLN as at 31 March 2020 was PLN 334.0 billion (72.2% of the total amount of the banks' receivables in respect of residential mortgage loans in Poland) and it increased by 12.5% y/y.

At the same time, the situation on the residential loan market could have changed significantly in March 2020. The Credit Information Bureau (BIK) data suggests that the demand for residential mortgage loans decreased. On an average business day, the banks and credit unions sent enquiries to the BIK concerning residential mortgage loans for an amount which is 3.1% lower y/y. Due to the time-consuming nature of the process of granting

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residential mortgage loans, the decrease in demand may not yet be visible in the March data, but it will show in the statistics for the second quarter. The data for April 2020 shows a significant drop: the banks and credit unions made inquiries about residential mortgage loans for an amount which is 27.6% lower y/y.

### **2.4. MORTGAGE COVERED BOND MARKET**

As at 31 March 2020, four mortgage banks were operating in Poland, namely:

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

The Polish covered bond market is relatively small and moderately liquid. At the end of March 2020, the total value of outstanding mortgage covered bonds issued by Polish mortgage banks amounted to PLN 27.1 billion, i.e. PLN 2.9 billion more than as at 31 March 2019. As at the end of March 2020, mortgage covered bonds issued by Polish banks represented 5.9% of the amount of residential mortgage loans granted by banks.

PKO Bank Hipoteczny SA is the largest issuer of mortgage covered bonds in Poland. As at 31 March 2020, the value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 17.0 billion, which accounted for approx. 63% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

In the first quarter of 2020, neither PKO Bank Hipoteczny SA nor the other Polish mortgage banks issued any mortgage covered bonds.

### **2.5. REGULATORY AND LEGAL ENVIRONMENT**

In the first quarter of 2020, the following legal and regulatory solutions affecting the operations of PKO Bank Hipoteczny SA came into force:

<b>SUPPORT FOR BORROWERS</b>	The Act amending the Act on support to residential loan borrowers in a difficult financial situation and certain other acts of 4 July 2019 – the Act extends the possibility of obtaining support from the Borrower Support Fund.
<b>BANKRUPTCY LAW</b>	The Act on amending the Bankruptcy Law and certain other acts of 30 August 2019 – the Act introduces new consumer bankruptcy principles, including the circumstances of filing for consumer bankruptcy.
<b>DEMATERIALIZATION OF SHARES</b>	The Act on amending the Commercial Companies Code and certain other acts of 30 August 2019 – the Act introduces obligatory share dematerialization and the obligation to choose a third party entity maintaining the shareholders register; the third party will also be allowed to settle the company's financial liabilities to the shareholders in respect of the shares.
<b>COVID-19 PREVENTION</b>	The Act on specific solutions aimed at preventing, counteracting and fighting COVID-19, other contagious diseases and the resulting crises – an extensive regulation enacted in response to the COVID-19 pandemic, which affects the current operation of the bank, including the pending litigation.

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

The ongoing COVID-19 pandemic has a growing adverse effect on the economic activity, which may result in a deterioration in the customers' financial standing and, consequently, a decrease in their interest in residential

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loans and a deterioration in the repayment rate of the existing residential loans, which in turn may have an adverse effect on the loan portfolio quality.

The fact that the Monetary Policy Council decreased the interest rates to their historic low translated into a lower interbank WIBOR rate. For the borrowers, it means lower loan instalments, and for the banks – a lower profitability and lower financial results.

However, the Bank maintains good liquidity and equity levels, above the regulatory requirements. In the Bank's opinion, the actions of the National Bank of Poland, including redemption of Treasury bonds, bill discount facility and repo operations may help the Bank to improve its liquidity.

Other significant factors and threats which may affect the Bank's results over at least the following quarter of 2020 include:

- the situation on the residential market in Poland;
- the situation on the residential mortgage loans market in Poland;
- legislative changes, including the changes to BRRD (MREL);
- the possibility and timing of further transfers to the Bank of portions of the portfolio of residential mortgage loans granted by PKO Bank Polski SA;
- the situation on the Polish and international financial market;
- demand of investors for mortgage covered bonds and own bonds issued by the Bank.

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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,

	31.03.2020	31.12.2019	Change
Total assets (in PLN millions)	27,964.2	27,253.3	710.9
ROA <sup>1</sup>	0.1%	0.4%	-0.3 p.p.
ROE <sup>2</sup>	1.8%	5.0%	-3.2 p.p.
Total capital ratio	17.0%	16.6%	+0.4 p.p.
Leverage ratio (LR)	6.9%	6.7%	+0.2 p.p.
Cost to income ratio (C/I) <sup>3</sup>	23.8%	24.6%	-0.8 p.p.

#### 3.2. STATEMENT OF FINANCIAL POSITION OF PKO BANK HIPOTECZNY SA

in PLN millions	31.03.2020	31.12.2019
Cash and balances with the Central Bank	0.0	0.0
Amounts due from banks	0.0	0.0
Derivative hedging instruments	900.2	173.3
Securities	1,227.0	1,240.2
Loans and advances to customers	25,819.2	25,821.1
Other assets <sup>4</sup>	17.8	18.7
<b>TOTAL ASSETS</b>	<b>27,964.2</b>	<b>27,253.3</b>

in PLN millions	31.03.2020	31.12.2019
Amounts due to banks	4,926.7	4,811.3
Derivative hedging instruments	0.6	46.1
Mortgage covered bonds issued	17,045.8	16,240.0
Unsecured bonds issued	3,924.8	4,060.0
Other liabilities and provisions <sup>5</sup>	96.5	95.9
Equity	1,969.8	2,000.0
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>27,964.2</b>	<b>27,253.3</b>

As at 31 March 2020, the total assets of PKO Bank Hipoteczny SA were PLN 27,964.2 million, up 3% compared with the end of 2019. Residential mortgage loans were the key component of the Bank's assets. Their carrying

<sup>1</sup> 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.

<sup>2</sup> 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.

<sup>3</sup> Annualized ratio excluding tax on certain financial institutions.

<sup>4</sup> Including the following items of the statement of financial position: intangible assets, property, plant and equipment and other assets.

<sup>5</sup> Including the following items of the statement of financial position: amounts due to customers, other liabilities, current income tax liabilities, deferred income tax provision and provisions.

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amount, taking into account the provisions for expected credit losses recognized as at 31 March 2020, was PLN 25,819.2 million, of which new loans amounted to PLN 12,281.1 million, whereas loans purchased from PKO Bank Polski SA amounted to PLN 13,538.1 million.

On the liabilities side, mortgage covered bonds represented 61% of total assets as at the end of March 2020. The Bank did not issue any mortgage covered bonds in the first quarter of 2020. At the same time, due to the effect of the EUR/PLN exchange rate on the valuation of euro-denominated mortgage covered bonds, the carrying amount of mortgage covered bonds as at the end of March 2020 was PLN 17,045.8 million (a 5% increase in relation to the end of 2019).

As at 31 March 2020, 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, liabilities in respect of derivatives and other amounts due to PKO Bank Polski SA. Their total amount was PLN 4,854.2 million. Short-term bonds issued by the Bank were another significant source of funding the Bank's operations. As at 31 March 2020, their balance was PLN 3,924.8 million, down 3% compared with the end of 2019.

### 3.3. INCOME STATEMENT OF PKO BANK HIPOTECZNY SA

in PLN millions	01.01.2020 – 31.03.2020	01.01.2019 – 31.03.2019	Change y/y (in PLN millions)
Net interest income	84.4	71.9	12.5
Net fee and commission income	(0.2)	(1.0)	0.8
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)	5.6	(0.6)	6.2
Net gain/(loss) on modification	(0.2)	0.1	(0.3)
Net allowances for expected credit losses	(14.3)	0.2	(14.5)
Net other operating income and expense	(0.1)	0.0	(0.1)
Administrative expenses	(13.7)	(12.2)	(1.5)
Regulatory charges	(24.9)	(24.4)	(0.5)
Tax on certain financial institutions	(22.6)	(18.6)	(4.0)
<b>Operating profit</b>	<b>14.0</b>	<b>15.4</b>	<b>(1.4)</b>
<b>Profit before tax</b>	<b>14.0</b>	<b>15.4</b>	<b>(1.4)</b>
Income tax expense	(5.0)	(10.7)	5.7
<b>Net profit</b>	<b>9.0</b>	<b>4.7</b>	<b>4.3</b>

In the first quarter of 2020, PKO Bank Hipoteczny SA generated a net profit of PLN 9.0 million, up PLN 4.3 million compared with the corresponding period of 2019.

Since the first quarter of 2020, the Bank started to calculate income tax expense using the tax rate that would be applicable to the expected profit before tax for the whole year, i.e. using the estimated average annual effective income tax rate applicable to income before tax in the interim period.

In order to calculate the average annual effective income tax rate, the forecast income before tax for the whole financial year and the permanent differences between the carrying amounts of assets and liabilities and their tax bases must be used. The forecast annual effective tax rate used to calculate the income tax expense in the first quarter of 2020 was 35.71%.

The Bank generated interest income of PLN 231.4 million in the analysed period. It comprised mainly the income on residential mortgage loans amounting to PLN 224.9 million and income on debt securities. The Bank generated interest expenses of PLN 147.0 million in the period. Interest expense resulted mainly from mortgage covered

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bonds issued and the costs of hedging transactions. The related interest expense totalled PLN 97.3 million. The Bank also incurred interest expenses of PLN 24.9 million on loans received and the overdraft facility used, PLN 3.7 million on the liability resulting from deferred payment for the purchase of receivables from PKO Bank Polski SA, and PLN 21.0 million on bonds issued.

The Bank's turnover (understood as the sum of interest income and fee and commission income) amounted to PLN 234.2 million in the first quarter of 2020. The total turnover was generated in the territory of Poland.

In the first quarter of 2020, the Bank also incurred regulatory expenses in the total amount of PLN 24.9 million. The main item of such expenses was the contribution to the resolution fund of the Bank Guarantee Fund of PLN 22.5 million (PLN 0.4 million more than in 2019). The increase in the regulatory expenses adversely affected the Bank's profitability ratios.

In the first quarter of 2020, the Bank incurred administrative expenses of PLN 13.7 million. Non-personnel expenses of PLN 9.0 million, including costs related to services rendered by PKO Bank Polski SA under an outsourcing agreement in the amount of PLN 7.3 million, were a significant component of administrative expenses. Costs of employee benefits, whose amount during the reporting period was PLN 4.0 million, were also a significant component of administrative expenses. The increase in administrative expenses compared with the corresponding period of 2019 was mainly caused by an increase in the costs of services provided by PKO Bank Polski SA under the outsourcing agreement (+PLN 1.9 million), which mainly resulted from an increase in the number of loans on the Bank's balance sheet.

Tax on certain financial institutions, which amounted to PLN 22.6 million in the reporting period, was a significant cost of the Bank's activities.

The Bank's costs resulting from write-downs for expected credit losses amounted to PLN 14.3 million in the first quarter of 2020.

As at 31 March 2020, an additional COVID-19-related write-down was recognized for a forecast deterioration in loan portfolio quality in the amount of PLN 9 million. The Bank considered the negative macroeconomic scenarios, whose base version assumes recession and increased unemployment.

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## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020

### 4. THE OPERATIONS 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.

The Bank limited the sales of residential mortgage loans in the first quarter of 2020 as part of the preparations for the implementation of the updated strategy for the years 2020 – 2022. This decision shall not affect the total sales of residential mortgage loans by the Group. Consequently, in the first quarter of 2020 the Bank granted PLN 266.0 million worth of residential mortgage loans, which is a decrease of 67.3% compared with the first quarter of 2019.

At the end of the first quarter of 2020, due to the epidemiological situation in Poland, the Bank introduced special solutions for mortgage borrowers and allowed them to suspend the repayment of up to three consecutive loan instalments in 2020.

In accordance with the provisions of Recommendation S of the Polish Financial Supervision Authority, the Bank grants loans for up to 80% of the real estate value. Where the required down payment financed from a loan was insured, the Bank approved loans for which this ratio was not higher than 90%. Due to the COVID-19 pandemic, the Bank started to work on changing its lending policy and the mortgage loan offer with a view to limiting the granting of loans where the ratio of the loan amount to the market value of the property exceeds 80%.

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 mortgage loans.

CRITERIA	AGENCY MODEL
Loan amount / market value of the real estate	Max 80% <sup>6</sup>
Loan amount/mortgage lending value of the property	Max 100%
Legal title to the real estate	Ownership or perpetual lease
Loan collateral	Mortgage recorded as the first item in Section IV of the Land and Mortgage Register
Currency	PLN
Purpose	Residential

#### 4.2. ACQUISITION OF RECEIVABLES UNDER RESIDENTIAL MORTGAGE LOANS

Acquisition of receivables under residential mortgage loans from PKO Bank Polski SA based on the framework agreement signed in 2015 is an important element of the business operations of PKO Bank Hipoteczny SA.

<sup>6</sup> Until the end of the first quarter of 2020, the Bank accepted granting loans for which this ratio did not exceed 90%, provided that the debt-financed required own contribution was insured.

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In the first quarter of 2020, PKO Bank Hipoteczny SA acquired from PKO Bank Polski SA a portfolio of receivables in respect of residential mortgage loans in the total amount of PLN 154.0 million. The following table shows the main criteria applied by PKO Bank Hipoteczny SA in the process of acquiring residential 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 item 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 in the area of financing is the issue of mortgage covered bonds which are the main source of long-term financing for loans secured with real estate.

#### DOMESTIC ISSUES OF MORTGAGE COVERED BONDS

From the beginning of its operations, PKO Bank Hipoteczny SA 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 2020 was PLN 4,385.0 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.

The PKO Bank Hipoteczny SA did not carry out any domestic issues of mortgage covered bonds in the first quarter of 2020.

Chart: Purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2019

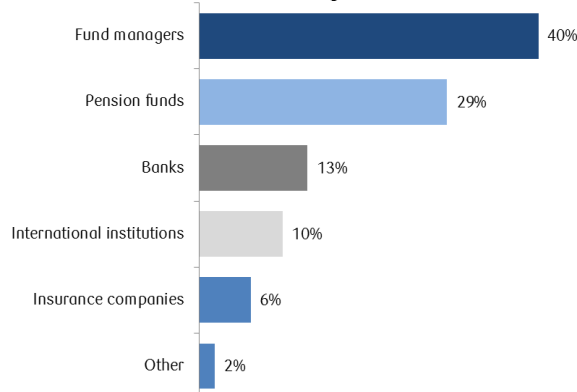
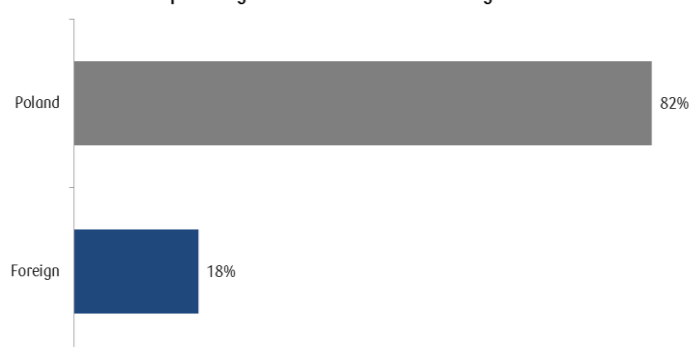


Chart: Geographical distribution of purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2019



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## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020

PLN-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to and including 31 March 2020:

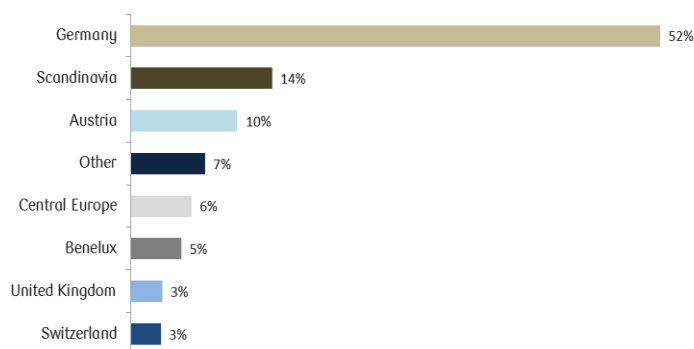
Series	Mortgage covered bond number (ISIN)	Issue date	Redemption date	Series value (in PLN millions)	Interest rate	Currency	Rating	Listing
1	PLPKOHP00017	11.12.2015	11.12.2020	30	WIBOR3M +0.75%	PLN	Aa3	BondSpot, WSE parallel market
2	PLPKOHP00025	27.04.2016	28.04.2021	500	WIBOR3M +0.65%	PLN	Aa3	BondSpot, WSE parallel market
3	PLPKOHP00033	17.06.2016	18.06.2021	500	WIBOR3M +0.59%	PLN	Aa3	BondSpot, WSE parallel market
4	PLPKOHP00041	28.04.2017	18.05.2022	500	WIBOR3M +0.69%	PLN	Aa3	BondSpot, WSE parallel market
5	PLPKOHP00058	22.06.2017	10.09.2021	265	2.69%	PLN	Aa3	BondSpot, WSE parallel market
6	PLPKOHP00066	27.10.2017	27.06.2023	500	WIBOR3M +0.60%	PLN	Aa3	BondSpot, WSE parallel market
7	PLPKOHP00074	27.04.2018	25.04.2024	700	WIBOR3M +0.49%	PLN	Aa3	BondSpot, WSE parallel market
8	PLPKOHP00082	18.05.2018	29.04.2022	100	WIBOR3M +0.32%	PLN	Aa3	BondSpot, WSE parallel market
9	PLPKOHP00090	27.07.2018	25.07.2025	500	WIBOR3M +0.62%	PLN	Aa3	BondSpot, WSE parallel market
10	PLPKOHP00108	24.08.2018	24.08.2028	60	3.4875%	PLN	Aa3	BondSpot, WSE parallel market
11	PLPKOHP00116	26.10.2018	28.04.2025	230	WIBOR3M +0.66%	PLN	Aa3	BondSpot, WSE parallel market
12	PLPKOHP00132	10.06.2019	30.09.2024	250	WIBOR3M +0.60%	PLN	Aa3	BondSpot, WSE parallel market
13	PLPKOHP00199	02.12.2019	02.12.2024	250	WIBOR3M +0.51%	PLN	Aa3	BondSpot, WSE parallel market

### INTERNATIONAL ISSUES OF MORTGAGE COVERED BONDS

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

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 2020 was EUR 2,779.0 million.

Chart: Geographical distribution of purchasers of EUR-denominated covered bonds of PKO Bank Hipoteczny SA's in the years 2016-2019



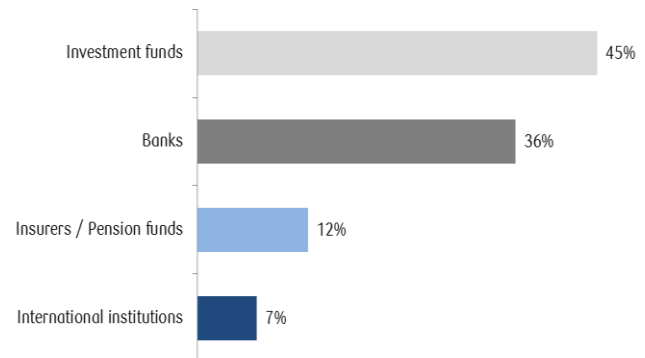
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All series of international mortgage covered bonds issued are traded on the Luxembourg Stock Exchange and, except for series 2 and 5, on the parallel market of the Warsaw Stock Exchange. They are also accepted in repo transactions by the European Central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

The PKO Bank Hipoteczny SA did not carry out any international issues of mortgage covered bonds in the first quarter of 2020.

Chart: Purchasers of EUR-denominated issues of PKO Bank Hipoteczny SA's covered bonds in the years 2016-2019



EUR-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to and including 31 March 2020:

Series	Mortgage covered bond number (ISIN)	Issue date	Redemption date	Series value (in EUR millions)	Coupon	Price	Currency	Rating	Listing
1	XS1508351357	24.10.2016	24.06.2022	500	0.125%	99.702 %	EUR	Aa3	LuxSE, WSE parallel market
2	XS1559882821	02.02.2017	02.02.2024	25	0.82%	100.00 %	EUR	Aa3	LuxSE
3	XS1588411188	30.03.2017	24.01.2023	500	0.625%	99.972 %	EUR	Aa3	LuxSE, WSE parallel market
4	XS1690669574	27.09.2017	27.08.2024	500	0.75%	99.906 %	EUR	Aa3	LuxSE, WSE parallel market
5	XS1709552696	02.11.2017	03.11.2022	54	0.467%	100.00 %	EUR	Aa3	LuxSE
6	XS1795407979	22.03.2018	24.01.2024	500	0.75%	99.892 %	EUR	Aa3	LuxSE, WSE parallel market
7	XS1935261013	28.01.2019	23.11.2021	500	0.250%	99.933 %	EUR	Aa3	LuxSE, WSE parallel market
7 tranche 2	XS1935261013	01.03.2019	23.11.2021	100	0.250%	100.145 %	EUR	Aa3	LuxSE, WSE parallel market
1 tranche 2	XS1508351357	08.03.2019	24.06.2022	100	0.125%	99.489 %	EUR	Aa3	LuxSE, WSE parallel market

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

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## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020

### ISSUES OF BONDS – THE ISSUE PROGRAMME AGREEMENT CONCLUDED WITH PKO BANK POLSKI SA.

On 30 September 2015, PKO Bank Hipoteczny SA signed the Short-Term Bond Issue Programme Agreement with PKO Bank Polski SA. In the first quarter of 2020, the Bank issued bonds with a total nominal value of PLN 957.0 million under the Programme. The balance of issued short-term bonds was PLN 3,421.0 million as at 31 March 2020. The Bank intends to continue seeking financing in the form of short-term bond issues.

### ISSUES OF BONDS - THE PUBLIC PROGRAMME

On 11 April 2019, PKO Bank Hipoteczny SA established the Public Own Bond Issue Programme. The Polish Financial Supervision Authority approved the Base Prospectus for PKO Bank Hipoteczny SA Bonds on 31 May 2019.

In the first quarter of 2020, PKO Bank Hipoteczny SA did not issue any bonds as part of the Public Own Bond Issue Programme; however, it redeemed bonds with a total nominal value of PLN 161.5 million.

The balance of issued bonds as at 31 March 2020 was PLN 165.0 million. All series were admitted and introduced to trading on the WSE regulated market (the parallel market).

Series	Bond number (ISIN)	Issue date	Redemption date	Series value (in PLN millions)	Coupon	Currency	Rating	Listing
1	PLPKOHP00140	11.07.2019	12.07.2021	50	WIBOR3M +0.60%	PLN	None	WSE parallel market
2	PLPKOHP00165	28.08.2019	30.08.2021	45	WIBOR3M +0.60%	PLN	None	WSE parallel market
3	PLPKOHP00173	17.10.2019	18.10.2021	40	WIBOR3M +0.60%	PLN	None	WSE parallel market
4	PLPKOHP00181	18.12.2019	20.12.2021	30	WIBOR3M +0.60%	PLN	None	WSE parallel market

### ISSUES OF BONDS - OTHER

On 20 February 2020, PKO Bank Hipoteczny SA signed an agreement with a European financial institution for an issue of unsecured bonds based on a variable interest rate with a total nominal value of PLN 350.0 million and the redemption date on 24 February 2021 and redeemed unsecured bonds with a nominal value of PLN 350 million.

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## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020

### 5. OTHER INFORMATION

#### LIST OF DIRECT AND 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 2020, the share capital of PKO Bank Hipoteczny SA amounted to PLN 1,611,300,000 and comprised 1,611,300,000 shares with a nominal value of PLN 1 each. The shares are fully paid. The share capital has not changed since the end of 2019. The issued shares of PKO Bank Hipoteczny SA are non-preference shares. The shares of PKO Bank Hipoteczny SA do not give any special controlling rights to their holders. 100% of the shares of PKO Bank Hipoteczny SA are held by Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna.

The structure of the share capital of PKO Bank Hipoteczny SA as at 31 March 2020 is presented below:

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	31.03.2020		31.12.2019	
	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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## **DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE THREE-MONTH PERIOD ENDED 31 MARCH 2020**

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### **INFORMATION ON PROCEEDINGS PENDING AT COURT, BEFORE AN ARBITRATION INSTITUTION OR A PUBLIC ADMINISTRATION BODY**

As at 31 March 2020, no proceedings were under way before courts, arbitration institutions 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 2020 or throughout 2019, PKO Bank Hipoteczny SA did not grant any loan guarantees or other guarantees to a single entity or a subsidiary of such an entity with an aggregate value equivalent to at least 10% of the Bank's equity.