

Directors' Commentary  
to the financial results  
of PKO Bank Hipoteczny SA  
for the nine-month period  
ended 30 September 2020

## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE NINE-MONTH PERIOD ENDED 30 SEPTEMBER 2020

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

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

PKO Bank Hipoteczny SA (Bank) specialises 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 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, five issues in total until 30 September 2020. The outstanding mortgage covered bonds issued by the Bank account for approximately 65% 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.
- At the end of the first quarter the Bank introduced special solutions for mortgage borrowers and allowed them to suspend the repayment of three consecutive loan instalments in 2020. In subsequent months the Bank expanded the possibility of suspending repayment to six loan instalments;
- 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 third quarter of 2020 a provision for a projected 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 equity 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 is monitoring the situation on an on-going basis and modifying 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 mortgage 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 third quarter of 2020, the Bank's total assets amounted to over PLN 27 billion, of which PLN 25.3 billion represented a high quality portfolio of residential mortgage loans. This means that there was a 1% 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 three quarters of 2020. As at the end of September 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. As at 30 September 2020, the value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 17.0 billion.

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## 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
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### 2.1. MACROECONOMIC ENVIRONMENT

Macroeconomic factors affecting the national economy in the third 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. In the second quarter of 2020 the national economy was in recession and GDP decreased by 8.2% y/y (data from before the benchmark adjustment). Individual consumption and investments noted two-digit slumps (10.9% y/y each).

In the third quarter the economy partially revived as a result of "defreezing" consumer demand and restoring the operation of international added value chains. Monthly data showed that both industry and commerce started improving. In construction, the activity was below normal, as local government expenditure was limited. We assess that in the third quarter of 2020 GDP increased by approx. 8% q/q, which would improve the annual pace of growth of GDP to -1.9% y/y.

#### UNEMPLOYMENT AND WAGES

The labour market's reaction to the recession caused by the pandemic was mitigated by the Anti-crisis Shield and the Polish Development Fund (PFR) Financial Shield. In the period June-September the unemployment rate stabilized at 6.1%, after a higher than seasonal increase in the number of unemployed in the spring (120 thousand in the second quarter). Despite the seasonal increase in unemployment in the fourth quarter, at the end of the year it should not be higher than 7.0%, which would mean that despite the slowing of business activities the labour market remained "in hibernation".

The average employment in the enterprises sector improved and was -1.5% y/y in August up from -3.3% y/y in June, which reflected the companies' withdrawal from the Anti-crisis Shield instruments (which allowed reducing the hours worked on a job contract to less than full time) and the end of paying out care allowances. At the same time, the number of employees in the enterprise sector (not translated to FTE) was 0.8% lower in August than in the prior year (the same relates to June). During the epidemic, "hoarding" jobs is prevalent (the drop in the number of employees was much smaller than the drop in production), as a consequence, productivity dropped and wage dynamics are significantly lower than before the pandemic (+4.1% y/y in August compared with +7.7% y/y in February).

#### 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.

In 2020 the CPI inflation exceeded the ceiling of the Central Bank's inflation goal. In September, inflation was at 3.2% y/y, compared with 3.3% in June, but despite its high levels, it was much lower than at the beginning of the year. The base inflation ratio continues to exceed 4% y/y due to the previous increases in administered prices and the prices of services which have been temporarily pushed up by the sanitary fees. In the following months the disinflationary effects of the crisis caused by the pandemic and the expected drop in food prices should curb the inflation.

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### INTEREST RATES

After the unprecedented loosening of the monetary policy in the period March-May, the Monetary Policy Council is now stabilizing its parameters and is seeing the positive effect of its efforts on business activity. During the pandemic, in coordination with fiscal actions, interest rates were significantly reduced and additional tools were introduced to support the economy. The reference rate was lowered by 140 bp in total, to a new historic minimum of 0.1%. The largest impact on the economy from among the other tools is introducing the possibility to purchase Treasury bonds or securities guaranteed by the State Treasury on the secondary market. Under the quantitative easing (QE) programme, until the end of September the NBP purchased bonds (State Treasury, Polish Development Fund and BGK) with a value of PLN 104 billion (including PLN 7.8 billion in the third quarter).

Lowering the interest rates may contribute to a reduction in the costs of servicing debt with respect to residential loans already drawn.

## 2.2. RESIDENTIAL REAL ESTATE MARKET

### SITUATION ON THE RESIDENTIAL REAL ESTATE MARKET BEFORE THE PANDEMIC

In 2019, the rate of growth of transaction prices was relatively high and 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. Prices continued to grow fast and the market participants remained very active.

### 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*)<sup>1</sup> dropped in April 2020 to -36.4 and -47.7 respectively. Such low values of the indices have not been noted since 2003.. Consumers felt the improvement of the economic situation and decrease in uncertainty, therefore consumer sentiment ratios improved, however without reaching their former values, thanks to the increases noted between May and July 2020, and stabilized from August to September at the level of approx. -15 (BWUK) and -16 (WWUK). This level is lower than before the outbreak of the pandemic (since 2017 the ratios had been positive), however, they are close to the level observable at the beginning of economic revival which took place in 2014 – 2018.

The limited impact of the pandemic on the Polish labour market has a positive effect on the stabilization of the economic conditions, including the situation on the real estate market. Despite economic perturbations, the increase in the number of registered unemployed was relatively small, and the unemployment rate increased only slightly, to 6.1%, and remained at this level from June to September 2020. The pace of growth of average wages in the enterprise sector decreased from 6-7% before the pandemic to 1.2% in May 2020; however, in the consecutive months wages increased at a rate of approx. 4% y/y. The gradual improvement in consumer sentiments together with a stable labour market translate into the regeneration of market demand, as shown by the volume of retail sales, which after the April drop of 23% y/y, grew in consecutive months to reach a level slightly higher in July and August 200 than in the corresponding months of 2019. Taking into consideration the above trends we may expect demand on the residential real estate market will be somewhat smaller than in the period of strong revival preceding the outbreak of the pandemic, but nevertheless at a level ensuring avoiding a lack of balance between supply and demand. However, it should be clear that there still is a risk of deterioration

<sup>1</sup> Consumer confidence indices published by GUS.

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in the market conditions in the event of an unfavourable development of the Coronavirus pandemic leading to the necessity of introducing new restrictions which would have a negative impact on the economy.

### IMPACT OF THE PANDEMIC ON ACTIVITY ON THE REAL ESTATE MARKET

The economic conditions that prevailed in the face of the Coronavirus pandemic led to a significant decrease in purchaser activity on the residential real estate market in the second quarter of 2020. The data published by advisory firms which monitor the situation on the primary market shows a large drop in the sales of apartments by developers on the six largest markets in the second quarter of 2020. According to RedNet Property Group the drop was 46% q/q, and according to JLL as much as 64% q/q.

### IMPACT OF THE PANDEMIC ON PRICES ON THE REAL ESTATE MARKET

However, the drop in sales volumes on the residential real estate market had no material impact on changes in price trends. According to GUS (Polish Statistics) data, in the second quarter of 2020 prices of apartments increased on an average by 2% q/q and 10.9% y/y. It should be emphasized that a faster pace of growth in prices was noted on the secondary market: 3.2% q/q and 15.4% y/y, compared with 0.4% q/q and 5.3% y/y on the primary market.

### SECONDARY MARKET

According to the data published by the NBP, in the second quarter of 2020 average prices on the secondary market increased compared with the first quarter by 1% in Warsaw, 3% in the segment of 6 large cities and by 5% in the segment of 10 medium-sized cities. In effect the annual pace of increase in prices in particular segments remained at a high level: 7% (Warsaw), 13% (6 large cities) and 15% (10 medium-sized cities) respectively. The data from the real estate database of the PKO BP Group indicate that in the third quarter of 2020 the pace of growth in transaction prices of residential real estate on the secondary market remained at a level similar to that in the second quarter. However, on the other hand, information from public analyses by firms engaged in trading in real estate, relating to offer prices in the third quarter show that the increase trend is slowing.

### PRIMARY MARKET

NBP data shows that the rate of growth of prices on the primary market slowed down in the second quarter of the year. In Warsaw the average price dropped by 4% q/q, therefore the annual rate of growth dropped from 12% y/y to 6% y/y. In the six large cities segment the average price remained at a level similar to that in the first quarter and in the ten medium-sized cities in dropped by 1% q/q. In both segments the annual rate of growth of prices decreased from 10% y/y to 7% y/y. Somewhat different conclusions may be drawn from RedNet Property Group data; they show a small increase in average transaction prices on the primary market in Warsaw and in the six large cities in the second quarter of 2020 compared to the first quarter, therefore, the annual rate of growth of prices in Warsaw was 9%, and in the six large cities segment – 14%. The report published by the portal bankier.pl (maintained in cooperation with otodom.pl) shows that the price increase trend has been maintained in the third quarter of 2020. In August 2020 the average offer prices on the primary markets of the nine largest cities were at least 10% higher than in August 2019.

To conclude, it should be emphasized that irrespective of the fact that the epidemic conditions in Poland had a large impact on the impairment of the economy and a drop in the number of transactions concluded on the real estate market, these turbulences had a limited influence on the residential real estate prices. Some symptoms of weakening of the high growth dynamics which were visible before the pandemic may be noted. In the foreseeable future we can expect that the demand for residential real estate will drop to a certain extent compared to the situation from before the pandemic, and this should translate into stopping the rate of price increases. The most probable scenario stipulates stabilization or a small adjustment of prices, first on the primary, and then on the secondary market. However, the scale of the potential adjustment should not exceed 5%.

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### 2.3. RESIDENTIAL MORTGAGE LOAN MARKET

Based on the NBP data, the banks' receivables in respect of residential mortgage loans in Poland were PLN 470.9 billion as at 30 September 2020, up 6.3% y/y. The balance of loans in PLN as at 30 September 2020 was PLN 349.6 billion (74.2% of the total amount of the banks' receivables in respect of residential loans in Poland) and it increased by 10.5% y/y.

At the same time, at the end of the third quarter, a dynamic increase in the number of loan applications is visible (almost 20% r/r). Sales of new loans (according to BIK – the Credit Information Bureau) remain approx. 25% lower than in the previous year, which is a noticeable improvement compared with the period from June to August, when they dropped even by approx. 40-50% y/y (as a result of a drop in the number of loan applications in the spring). This results from the time-consuming lending process and suggests that the fourth quarter may bring about a significant revival on the residential real estate market.

### 2.4. MORTGAGE COVERED BOND MARKET

As at 30 September 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 September 2020, the total value of outstanding mortgage covered bonds issued by Polish mortgage banks amounted to about PLN 26.1 billion, i.e. PLN 1.4 billion more than at 30 September 2019. As at 30 September 2020, outstanding mortgage covered bonds issued by Polish banks represented 5.6% 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 30 September 2020, the value of outstanding mortgage covered bonds issued by PKO Bank Hipoteczny SA amounted to PLN 17.0 billion, which accounted for approx. 65% of the total value of outstanding mortgage covered bonds issued by Polish mortgage banks.

In the three quarters of 2020 PKO Bank Hipoteczny SA did not issue any mortgage covered bonds.

### 2.5. REGULATORY AND LEGAL ENVIRONMENT

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

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#### DEMATERIALIZATION OF SHARES

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. Due to the lasting COVID-19 epidemic, the date for the first call for the shareholders to file the share document was postponed to 30 September 2020.

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

The ongoing COVID-19 pandemic has an 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 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 negative impact on 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 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 markets;
- investors' demand 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

	30.09.2020	31.12.2019	Change
Total assets (in PLN millions)	27,473.7	27,253.3	220.4
ROA <sup>2</sup>	0.3%	0.4%	-0.1 p.p
ROE <sup>3</sup>	3.7%	5.0%	-1.3 p.p
Total capital ratio	17.6%	16.6%	1.0 p.p
Leverage ratio (LR)	7.1%	6.7%	0.4 p.p
Cost to income ratio (C/I) <sup>4</sup>	23.5%	24.6%	-1.1 p.p

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

in PLN millions	30.09.2020	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	934.5	173.3
Securities	1,237.0	1,240.2
Loans and advances to customers	25,289.2	25,821.1
Other assets <sup>5</sup>	13.0	18.7
<b>TOTAL ASSETS</b>	<b>27,473.7</b>	<b>27,253.3</b>

in PLN millions	30.09.2020	31.12.2019
Amounts due to banks	4,641.0	4,811.3
Derivative hedging instruments	0.7	46.1
Liabilities in respect of mortgage covered bonds issued	16,978.3	16,240.0
Liabilities in respect of bonds issued	3,651.3	4,060.0
Other liabilities and provisions <sup>6</sup>	109.3	95.9
Equity	2,093.1	2,000.0
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>27,473.7</b>	<b>27,253.3</b>

<sup>2</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>3</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>4</sup> Annualized ratio excluding tax on certain financial institutions.

<sup>5</sup> Including the following items of the statement of financial position: intangible assets, property, plant and equipment and other assets.

<sup>6</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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As at 30 September 2020, the total assets of PKO Bank Hipoteczny SA were PLN 27,473.7 million, up 1% compared with the end of 2019. Residential loans were the key component of the Bank's assets. Their carrying amount, taking into account provisions for expected credit losses recognized as at 30 September 2020, amounted to PLN 25,289.2 million, of which new loans amounted to PLN 12,250.3 million, whereas loans purchased from PKO Bank Polski SA amounted to PLN 13,038.9 million.

On the liabilities side, mortgage covered bonds represented 62% of total assets as at the end of September 2020. The Bank did not issue any mortgage covered bonds in the third quarter of 2020. Whereas, 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 September 2020 was PLN 16,978.3 million (a 5% increase in relation to the end of 2019).

As at 30 September 2020, financial liabilities to PKO Bank Polski SA were a significant item in the Bank's liabilities and equity. These were liabilities in respect of loans and overdrafts received up to the available limit, liabilities in respect of the purchase of receivables, liabilities in respect of mortgage covered bonds and other bonds, liabilities in respect of derivatives and other amounts due to PKO Bank Polski SA. The total amount of these liabilities was PLN 4,441.2 million. Bonds issued by the Bank were also a significant source of funding the Bank's operations. As at 30 September 2020, they amounted to PLN 3,651.3 million, down 10% compared with the end of 2019.

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

in PLN millions	01.01.2020 – 30.09.2020	01.01.2019 – 30.09.2019	Change y/y (in PLN millions)
Net interest income	252.9	233.4	19.5
Net fee and commission income	(3.0)	(3.9)	0.9
Net gain/(loss) on financial instruments measured at fair value through profit or loss	0.1	0.0	0.1
Net foreign exchange gains/(losses)	5.8	3.4	2.4
Net income/(expense) on modification	(2.6)	0.4	(3.0)
Net allowances for expected credit losses	(26.8)	(10.0)	(16.8)
Net other operating income and expenses	(0.1)	0.0	(0.1)
Administrative expenses	(38.0)	(37.9)	(0.1)
Regulatory charges	(25.5)	(24.6)	(0.9)
Tax on certain financial institutions	(67.3)	(60.9)	(6.4)
<b>Operating profit</b>	<b>95.5</b>	<b>99.9</b>	<b>(4.4)</b>
<b>Profit before tax</b>	<b>95.5</b>	<b>99.9</b>	<b>(4.4)</b>
Income tax expense	(39.0)	(34.7)	(4.3)
<b>Net profit</b>	<b>56.5</b>	<b>65.2</b>	<b>(8.7)</b>

In the third quarter of 2020, PKO Bank Hipoteczny SA generated a net profit of PLN 56.5 million, down PLN 8.7 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 third quarter of 2020 was 40.83%.

In the analysed period, the Bank generated interest income of PLN 573.3 million, comprising primarily income from residential mortgage loans in the amount of PLN 556.1 million, and income from debt securities. The Bank

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incurred interest expenses of PLN 320.4 million in the period. Interest expense resulted mainly from mortgage covered bonds issued and the costs of hedging transactions. The related interest expense totalled PLN 217.0 million. The Bank also incurred interest expenses of PLN 57.1 million on loans received and the overdraft facility used, PLN 40.4 million on bonds issued and PLN 5.9 million on the liability resulting from deferred payment for the purchase of receivables from PKO Bank Polski SA.

The Bank's turnover (understood as the sum of interest income and fee and commission income) amounted to PLN 580.0 million in the three quarters of 2020. The total turnover was generated in the territory of Poland.

In the three quarters of 2020, the Bank also incurred regulatory expenses in the total amount of PLN 25.5 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 three quarters of 2020, the Bank incurred administrative expenses of PLN 38.0 million. Non-personnel expenses of PLN 25.0 million, including costs related to services rendered by PKO Bank Polski SA under an outsourcing agreement of PLN 20.6 million, were 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 costs of services provided by PKO Bank Polski SA (up PLN 3.1 million), which mainly resulted from an increase in the value of the loan portfolio in the Bank's balance sheet. Costs of employee benefits, whose amount during the reporting period was PLN 10.9 million, were also a significant component of administrative expenses.

Tax on certain financial institutions, which amounted to PLN 67.3 million in the reporting period, was also a significant component of the administrative expenses.

Allowances for expected credit losses during the three quarters of 2020 amounted to PLN 26.8 million.

As at 30 September 2020 an additional COVID-19-related allowance was recognized for a forecast deterioration in loan portfolio quality in the amount of PLN 12.4 million. The Bank considered the negative macroeconomic scenarios, whose base version assumes recession and increased unemployment.

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## 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 2020 as part of the preparations for the implementation of the updated strategy for the years 2020–2022. This decision will not affect the total sales of residential mortgage loans by the Group. Consequently, in the third quarter of 2020 the Bank granted PLN 185.0 million worth of residential mortgage loans, which is a decrease of 82.4% compared with the corresponding period 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 the following quarters the Bank modified the former rules and expanded the possibility to suspend repayment from three to six loan instalments. In addition, the Bank adopted the "The banks' position on the standardization of principles for offering support tools to customers of the banking sector" developed under the aegis of the Polish Bank Association, a non-legislative moratorium within the meaning of the EBA Guidelines on legislative and non-legislative moratoria on loan repayments applied in the light of the COVID-19 crisis.

In addition, in accordance with the Act of 19 June 2020 on subsidization of interest on bank loans granted to entities affected by COVID-19 and simplified arrangement approval proceedings due to COVID-19 ("Shield 4.0"), the Bank also implemented the possibility of suspending exercising a loan contract for borrowers who lost their jobs or another main source of income after 13 March 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%. In the second quarter of 2020, the Bank limited the possibility of granting 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 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>7</sup>
Loan amount/mortgage lending value of the real estate	Max 100%
Legal title to the real estate	Ownership or perpetual lease
Loan collateral	Mortgage recorded as the first in Section IV of the Land and Mortgage Register
Currency	PLN
Purpose	Residential

<sup>7</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.

## DIRECTORS' COMMENTARY TO THE FINANCIAL RESULTS OF PKO BANK HIPOTECZNY SA FOR THE NINE-MONTH PERIOD ENDED 30 SEPTEMBER 2020



### 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. In the third quarter of 2020, PKO Bank Hipoteczny SA acquired a portfolio of receivables in respect of residential mortgage loans totalling PLN 187.9 million from PKO Bank Polski SA. 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 real estate	Max 100%
Legal title to the real estate	Ownership or perpetual lease
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 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.

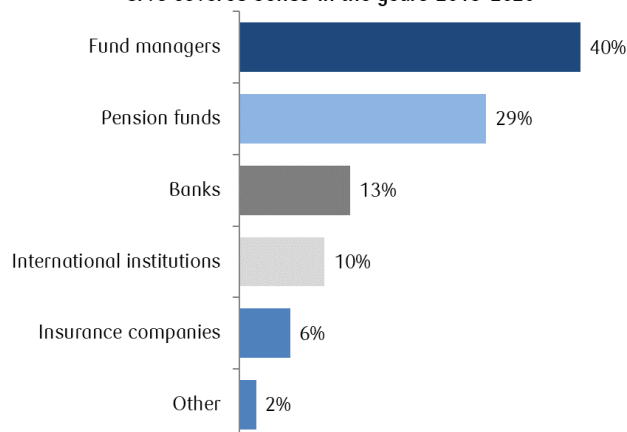
#### DOMESTIC ISSUES OF MORTGAGE COVERED BONDS

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 September 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.

Chart: Purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2020

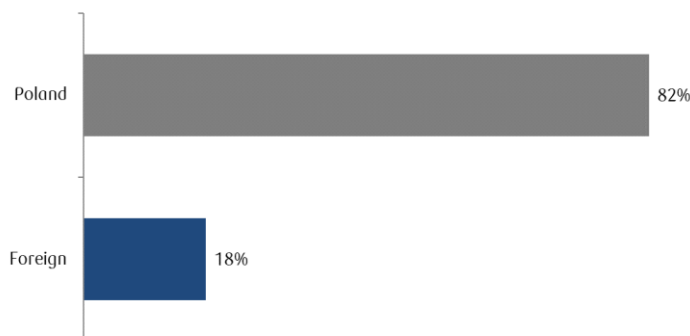


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In the three quarters of 2020 PKO Bank Hipoteczny SA did not issue any mortgage covered bonds.

Chart: Geographical distribution of purchasers of domestic issues of PKO Bank Hipoteczny SA's covered bonds in the years 2015-2020



PLN-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to 30 September 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

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### 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 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 September 2020 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 are also accepted in repo transactions by the European Central Bank.

In the three quarters of 2020 PKO Bank Hipoteczny SA did not issue any international mortgage covered bonds.

Chart: Geographical distribution of purchasers of EUR-denominated covered bonds of PKO Bank Hipoteczny SA's in the years 2016-2020

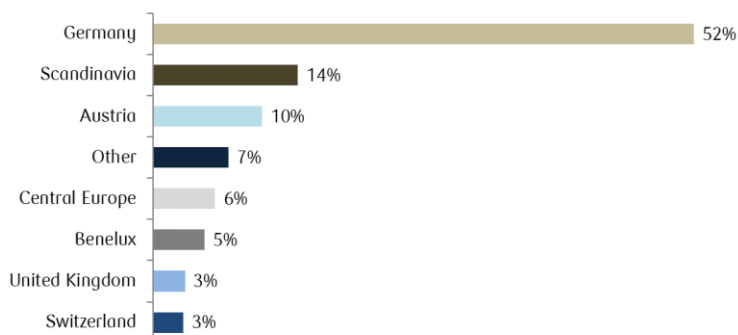
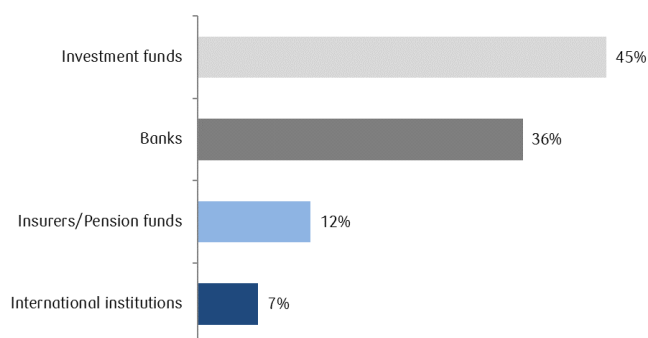


Chart: Purchasers of EUR-denominated issues of PKO Bank Hipoteczny SA's covered bonds in the years 2016-2020



EUR-denominated issues of mortgage covered bonds of PKO Bank Hipoteczny SA carried out up to 30 September 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



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1 tranche 2	XS1508351357	08.03.2019	24.06.2022	100	0.125%	99.489%	EUR	Aa3	LuxSE, WSE parallel market
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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.

### 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. During the three quarters of 2020, the Bank issued bonds with a total nominal value of PLN 3,997.5 million under the Programme. The balance of issued short-term bonds was PLN 3,142.5 million as at 30 September 2020. The Bank intends to continue seeking financing in the form of short-term bond issues.

### ISSUES OF BONDS – THE PUBLIC PROGRAMME

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

The balance of issued and outstanding bonds was PLN 165.0 million as at 30 September 2020. 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

In 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 a redemption date on 24 February 2021, and redeemed unsecured bonds with a nominal value of PLN 350.0 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 30 September 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 paid up in full. 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. Powszechna Kasa Oszczędności Bank Polski Spółka Akcyjna holds 100% of the shares in PKO Bank Hipoteczny SA.

The structure of the share capital of PKO Bank Hipoteczny SA as at 30 September 2020 is presented below:

Series	Type of shares	Number of shares	Nominal value of one share	Number of votes at the 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	30.09.2020		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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**INFORMATION ON PROCEEDINGS PENDING IN COURTS, BEFORE AN ARBITRATION INSTITUTION OR A PUBLIC ADMINISTRATION BODY**

As at 30 September 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**

During the three quarters 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 a total value equivalent to at least 10% of the Bank's equity.