Louis Hagen
Chairman of the Supervisory Board
Deutsche Pfandbriefbank („**pbb**“)
Parkring 28
85748 Garching

London, 14 December 2023

Dear Mr Hagen,

Petrus Advisers is one of the most relevant market participants in the pbb stock. Since its IPO, pbb has failed to create any shareholder value[1]. We have criticised your blind growth strategy and bloated cost structures for some time, while at the same time warning of credit risks in your US office loan portfolio ("**US office**") and exposure to real estate developments. Unfortunately, pbb’s current management has a poor track record of reading market trends and understanding the resulting risks. In November 2022, Andreas Arndt still praised the US office market as the key growth area for pbb[2]. At that point, a downturn of that market had already settled in – originating in the US – which has since accelerated to reach severe levels of distress. pbb's involvement in the real estate development business is another example of poor judgment: In November 2023, a few weeks before the actual SIGNA bankruptcy, Andreas Arndt was still talking down the credit risks in pbb's development portfolio[3].

We summarise our assessment as follows: we currently see significantly more risk of further loan loss provisions in pbb's EUR 3.9bn US office portfolio and EUR 3.5bn development portfolio than expected progress from improvement initiatives taken by pbb[4].

In a tradition of regularly getting things wrong, your team has ended the dialogue with us. For us, this represents an alerting sign of both missing transparency and problem awareness at pbb. This is particularly sensitive in light of numerous and worrying warning signals and challenges we see at pbb:

(1) Building up the US office portfolio right into the CRE crisis
For years, pbb had failed to expand from the low-margin German market into other geographies. The expansion of the US office portfolio from EUR 0.8bn[5] in 2017 to EUR 1.9bn by the end of 2020 came very late. Despite the foreseeable increase in ‘working from home’, pbb's US office portfolio has since doubled to around EUR 4bn. The result is disastrous: the share of NPLs[6] as per Q3 2023 stands at an incredible 14.4% of the US loan volume[7]. Yet, the transparency you provide on your US office portfolio is poor. We hear in the market that pbb is marking loan values much more aggressively than other syndicate banks. At the same time, the NPL coverage ratio of pbb's overall portfolio stands at a meagre 24% as of Q3 2023 and for the US office portfolio as low as 16%[8]. That compares to European banks at 36% on average[9]. We are concerned that significantly larger provisions may be necessary.

(2) No provisions for development loans
Real estate developers across pbb’s relevant markets have been struggling since 2022. A large wave of insolvencies is looming in Germany and Austria with the first dominos falling (e.g. SIGNA, Gerch, Development Partner, Euroboden, etc.). Your lending business with real estate developers amounts to EUR 3.5bn. In response to specific

[1] *Total shareholder return since its IPO in 2015 is -7% per 11 December 2023.*
[2] *Andreas Arndt Q3 2022 earnings call: „as we also announced and communicated earlier this year in our growth initiatives, New York, i.e. United States, remains on the agenda as one of the target markets”.*
[3] *Andreas Arndt Q3 2023 earnings call: „All in all, I'm personally not so much worried about development loans”.*
[4] *E.g. cost cutting programme, exit of Capveriant, increase in fee and commission income via investment management initiatives.*
[5] *At that time, pbb had not yet published any figures on asset classes per region. The EUR 0.8bn therefore relates to the entire US loan book.*
[6] *Non-performing loans.*
[7] *Refers to the entire US portfolio, as no more detailed figures are available at asset class level.*
[8] *Quotes from Q3 2023 earnings call: Borja Ramirez Segura (Citi Analyst): “Thank you. So, if I understood well, your stage 3 loans in the US have a coverage ratio of 16%, 1-6, of provisions.“ Andreas Arndt: “Yes.”.*
[9] *Per Citi Research.*

questions from Petrus Advisers in the past, Andreas Arndt confirmed several times that pbb had no SIGNA exposure. However, public sources confirm at least two SIGNA financings by pbb: Alte Akademie in Munich and Andaz Hotel in Vienna. pbb has so far not built any provisions to cover these or related risks[10]. Here, too, we fear negative surprises for pbb.

(3) Questionable usage of management overlay

The latest quarterly reports give the impression that your quarterly financials were heavily 'massaged'. In Q3 2023, a loss at Group level was only avoided by the release of EUR 17m in provisions for legal disputes combined with the release of EUR 28m in management overlay. pbb's management overlay was thus fully utilised in Q3 – making pbb an outlier compared to European banks. At the same time, pbb's management announced the rebuilding of management overlay in the coming quarters. We are surprised by such 'interventions', which incidentally do not seem to reflect the ECB's intention either[11].

(4) Increasing pressure on funding

Our concerns regarding risks on pbb's balance sheet also seem to be shared by debt markets. Access to funding has proven to be difficult and expensive for pbb in recent quarters. At the same time, existing pbb wholesale instruments trade at significantly higher yields than the competition[12]. Covered bonds (i.e. Pfandbriefe) – the backbone of pbb's business model – also trade at significantly higher yields than comparable issues of your German peers[13]. As pbb has not developed a solid deposit business and is currently paying around 4% for term deposits (5-year) [14], this part of the funding mix cannot provide any relief either.

The Supervisory Board under your leadership decided to select a new CEO, who last dealt with challenges in the commercial real estate sector back in 2010[15]. pbb's challenges are obvious and severe. Recently, pbb has almost always been wrong, reacted too slowly and too late. We call on you to create transparency and communicate clearly and early, especially in this difficult environment. The upcoming and overdue change in management offers a good opportunity for this, which must not be missed.

Sincerely,

Klaus Umek
Managing Partner

Till Hufnagel
Partner

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[10] *Andreas Arndt Q3 2023 earnings call: "Now, as far as development loans in Europe are concerned, we can say up until now, the situation for the bank is that we have no written provisioning for development loans".*

[11] *See an ECB blog on this topic: "Overlays are a useful tool to address emerging risks, but only when they are delivered with strong governance and transparency, are supported by evidence and are built on sound methodologies."; (https://www.bankingsupervision.europa.eu/press/blog/2023/html/ssm.blog230526~29af0452d6.en.html).*

[12] *Bloomberg and Factset per 11 December 2023. The premium that the market is demanding from pbb compared to Aareal is currently c. 110bps for senior preferred bonds and even c. 170bps for AT1s.*

[13] *https://www.pfandbrief.de/site/de/vdp/statistik/statistik/spread.html#. Per 11 December 2023.*

[14] *Vs. 2.7% 5Y EUR Swap Rate.*

[15] *https://www.pfandbriefbank.com/en/media/press/detail/kay-wolf-folgt-andreas-arndt-als-vorstandsvorsitzender-der-deutsche-pfandbriefbank-ag.html.*