Risk Report

As an international real estate investor, property owner and project developer, IMMOFINANZ is exposed to a variety of general and branch-specific risks in its business operations. An integrated risk management process provides the Group with a sound basis for the timely identification of potential risks and the assessment of the potential consequences.

Based on the hedging and management instruments currently in use, no material risks can be identified at the present time that could endanger the company's standing as a going concern. An overall evaluation of the risk situation for the 2019 financial year showed no major changes. The uncertainty factors for IMMOFINANZ and for the entire market environment in the 2020 financial year have increased significantly as a result of the Covid-19 pandemic. The possible effects of Covid-19 are addressed at the end of this risk report.

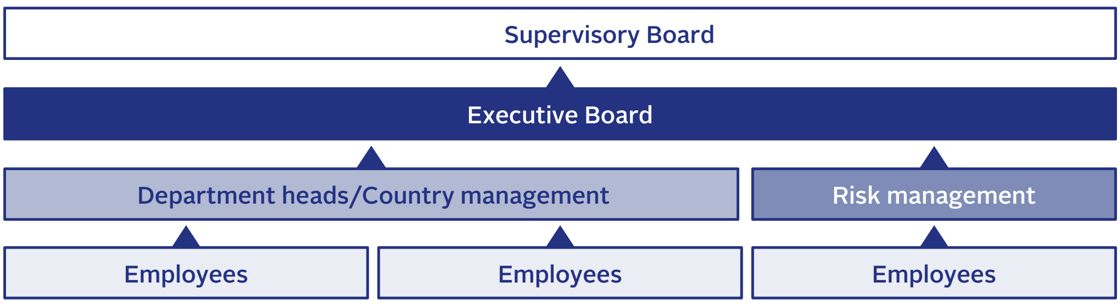
IMMOFINANZ has anchored the procedures for handling risk in a Group-wide risk management system, which is integrated in business practices and reporting paths and has a direct influence on processes and strategic decisions. Risk management takes place at all levels through internal guidelines, reporting systems and the internal control system (ICS) which is monitored by the internal audit department.

Structure of risk management

The goal of risk management is to implement the strategy defined by the Executive Board with a minimum of risk. This implementation transfers the Group's strategic goals to the operating processes in which the measures for the identification, prevention and management of risks are embedded.

The structure of risk management is based on the rules of the Austrian Corporate Governance Code and the integrated framework of the COSO ERM*, an internationally accepted framework concept for the design of risk management systems.

RESPONSIBILITIES AND REPORTING PATHS



The Executive Board, as a whole, is responsible for risk management in the IMMOFINANZ Group and defines the corporate goals and related risk strategy.

Risk management is a staff function which reports directly to the Chief Financial Officer (CFO). It monitors the corporate risks that are not related to specific business areas, aggregates risk data and reports, and actively supports the business areas and country organisations in the identification of risks and economically feasible countermeasures. Risk management reports regularly to the CFO and each quarter to the Supervisory Board.

At the business area and country organisation levels, the heads of the respective business area or country organisation are responsible for risk management. Risk positions are reported to the Executive Board at least once each quarter by the business area managers and at least twice per year by the country management. Acute risks are reported immediately to the Executive Board.

* Committee of Sponsoring Organisations of the Treadway Commission – Enterprise Risk Management; www.coso.org

Risk management process

The identification of risks is the first step in the risk management process. Every employee is responsible for identifying risks in his or her area of activity. These risks are recorded in a risk catalogue, evaluated and flow into the budgeting process. Risk reporting also includes a review to ensure that all risks are covered.

The business area heads and country managers also use early warning indicators, e.g. visitor frequency measurements or tenant surveys, wherever appropriate.

The identified risks are managed according to their nature and potential effects and, where possible, avoided or directly addressed. In cases where this is not possible, the risks are minimised with economically reasonable measures, transferred to third parties or carried by IMMOFINANZ and monitored continuously.

These risks are aggregated and reported to the Executive Board as part of regular risk communications. Acute material risks must be reported immediately

Risk classification

The recorded risks are classified under the following categories: market risk, property-specific risks and business and other risks.

The following section describes the risk areas that are considered significant for IMMOFINANZ and explains the measures implemented to manage the related individual risks. Financial risk factors are described in section 7.2 to the consolidated financial statements.

Market and property-specific risks

The development of the real estate markets is dependent on cyclical and macroeconomic factors. The related risks include events on the global financial and capital markets as well as political, micro- and macroeconomic issues in the countries where IMMOFINANZ is active. These factors can have a significant effect on the market value of properties, earnings and development plans as well as investment and sales activities.

Concentration risk and the risk associated with the property portfolio are addressed through the diversification of property investments by sector and region. IMMOFINANZ focuses on two commercial asset classes – office and retail – in Austria, Germany and CEE. In addition to the diversification of the portfolio by sector and region, a differentiated tenant structure is also important for minimising risk. IMMOFINANZ has a balanced and diversified tenant mix.

Major market and property-specific risks

Description of risk	Effects	Measures
Rental risks	– Loss of income due to vacancies	– Proactive rental management (close cooperation with tenants, high service orientation, continuous optimisation of offering and tenant mix)
	– Default on rental payments due to deterioration of economic environment or tenant bankruptcies	– Continuous monitoring of rental status, credit evaluation of tenants, security deposits, diversification of tenants
	– Decline in rental income due to intense competition	– Selection of attractive locations, granting of incentives for tenants
	– Rental price reductions or costly incentives to retain tenants	– Review and release of rental contracts and incentives as per corporate approval guidelines, granting of rental price reductions for a limited period
	– Inflation risk	– Index clauses in rental contracts
	– Reduction in income through limitations on use	– Investments in quality and maintenance management, selection of professional service providers
Project development risks	– A location turns out to be suboptimal in relation to demand, competitive behaviour or economic power	– Market, competitive and site analyses, if necessary exit from certain regions
	– Delays in initial rentals	– Definition of minimum pre-rental levels
	– A project cannot be realised as planned, e.g. because of problems with financing, approvals or historical protection	– Extensive analyses and project planning, timely communications with banks and public authorities, thorough due diligence
	– Construction defects lead to delays and higher costs	– Continuous monitoring of construction progress and quality
	– Problems arise with general contractors or subcontractors	– Selection of experienced business partners and continuous control of all contractors
	– A project cannot be realised as planned due to higher costs or delays	– Detailed project organisation, regular cost, quality and schedule controls, variance analyses, selection of experienced partners, transfer of risks
Property valuation risks	– High dependence on macroeconomic environment, calculation method and underlying assumptions: decline in valuation due to negative market developments or as a result of lower "return" on the property	– Market studies, analyses and forecasts, portfolio optimisation, continuous maintenance and modernisation
Transaction risks	– High dependence on transaction market liquidity: a transaction is not realised as planned, e.g. because the seller drops out or the desired price is not achievable	– Market analyses, legal, economic and technical due diligence, checklists for the transaction process, analysis of effects on the portfolio

Major business and other risks

Description of risk	Effects	Measures
Strategic business risks	– Increase in similar risks in the portfolio	– Diversification by sector and region
	– Capital market movements make it difficult to raise equity or debt	– Balanced structure of equity and debt
	– Loans for projects and transactions are not available	– Medium-term planning, capital and liquidity management; investment grade rating provides access to new capital market segment
Financial risks	– See note 7.2 to the consolidated financial statements	
Legal and tax risks	– Legal disputes with tenants, business partners, investors or public authorities	– Continuous monitoring of legal developments, creation of provisions
	– Changes in national tax schemes result in subsequent tax liabilities	– Continuous monitoring of legal developments, compliance with disclosure requirements
Organisational risks	– IT risks materialise, e.g. failure of technical systems, unauthorised data access or manipulation	– Group-wide IT governance and compliance, continuous updating of security standards, penetration tests, connections to geographically separate back-up data processing facility, strengthen awareness among employees through specialised IT training
	– Environmental risks, e.g. extreme weather conditions, natural disasters or man-made damages like ground contamination, can result in damages to properties	– Insurance to cover environmental damages
	– HR risks like staff turnover lead to the loss of top performers or capacity bottlenecks	– Personnel development and appropriate remuneration and bonus systems
	– Compliance risks materialise, which can result in penalties and damage to the company's reputation	– Strict compliance with legal regulations and regular training for employees
	– Procurement risks, e.g. dependence on suppliers and subcontractor bankruptcies, can lead to supply shortages	– Optimisation of supplier base, development of sourcing strategies, ongoing and comprehensive evaluation of suppliers
	– Implementation of digitalisation strategy	– Sufficient resources for individual projects, professional project management throughout the Group, proactive management of digitalisation process
Investment risks	– Fluctuations in the value of the S IMMO investment	– Continuous monitoring and evaluation

Monitoring and control of the risk management system

The risk management system is monitored and controlled through two corporate channels. On the one hand, internal audit evaluates the effectiveness of risk management and contributes to its improvement. On the other hand, the auditor reviews the effectiveness of risk management in accordance with C-Rule 83 of the Austrian Corporate Governance Code (in the version released in January 2020) and reports to the Executive Board on the results of this analysis.

Evaluation of the functionality of the risk management system

Deloitte Audit Wirtschaftsprüfungs GmbH, Vienna, evaluated the effectiveness of IMMOFINANZ's risk management system during the period from December 2019 to February 2020. This analysis covered the design and implementation of the measures and organisational procedures instituted by the company, but not their application in the sense of operating effectiveness. Based on the knowledge gained by Deloitte during the related activities, no circumstances were identified that would lead to the assumption that the risk management system instituted by IMMOFINANZ as of 31 December 2019 – based on the comprehensive framework for corporate risk management according to COSO – is not functional.

Risks in the 2019 financial year

Market and property-specific risks

The risks arising from the composition of the portfolio, rentals and project development as well as the purchase and sale of properties remained basically unchanged, in total, compared with the 2018 financial year.

The overall occupancy rate for IMMOFINANZ's portfolio equalled 96.8% as of 31 December 2019, which represents an increase of 1.0 percentage points since 31 December 2018. The occupancy rate rose to 95.3% (31 December 2018: 93.7%) in the office properties and remained stable at 98.3% (31 December 2018: 98.2%) in the retail properties.

The development projects currently under realisation by IMMOFINANZ (property under construction) have a combined carrying amount of EUR 177.5 million (31 December 2018: EUR 277.5 million), and the outstanding construction costs for these development projects totalled EUR 111.9 million as of 31 December 2019 (31 December 2018: EUR 95.7 million). The pipeline projects, including real estate inventories, had a carrying amount of EUR 173.2 million as of 31 December 2019 (31 December 2018: EUR 221.4 million).

Business and other risks

IMMOFINANZ is also exposed to other risks in connection with its business activities. These legal, compliance, environmental, tax and human resources risks remained generally unchanged in comparison with the 2018 financial year.

Information security risks

The progressive digitalisation of corporate processes is connected with an increase in the number of information security risks. Data protection therefore represents a key focal point for the IT projects currently in progress. The protection of data outside the company and the sensitive handling of data inside the company have top priority for IMMOFINANZ. In addition to current projects, activities include the creation of greater awareness among employees for data protection and IT security. This goal was reflected in training for all employees on the issue of cybersecurity in 2019. Corporate processes were also evaluated with regard to data security and data protection as part of process management in order to meet the highest security standards. The related efforts were further strengthened with the introduction of the Austrian Data Protection Regulation ("Datenschutzgrundverordnung", DSGVO) in May 2018, and the probability that a risk will occur in this area is therefore seen as low. Another aspect to improve IT security is Business Continuity Management (BCM). Based on the previously established processes, the risk to critical corporate processes can be considered minimal.

Other legal proceedings

In certain East European countries, legal uncertainty could arise in connection with land ownership. This applies, above all, to the VIVO! Cluj shopping center.

Sustainability risks

Sustainability risks can have negative effects on corporate interests. Real estate companies like IMMOFINANZ are, for example, increasingly exposed to climate risks as a result of climate change. Sustainability risks are assigned to the respective risk categories as part of risk management and managed within this framework. Detailed information related to the environment, customers/tenants and employees as well as responsible business practices can be found in the non-financial statement (beginning on page 92).

Investments

IMMOFINANZ AG acquired 19,499,437 bearer shares in S IMMO AG through share purchase contracts dated 18 April 2018. The transaction closed on 21 September 2018. The S IMMO share is listed in the Prime Segment of the Vienna Stock Exchange and is therefore exposed to market price risks. The equity method is used to account for this investment: as of 31 December 2019, the carrying amount of the S IMMO investment equalled EUR 474.7 million, which represents 7.4% of IMMOFINANZ's total assets. The purchase of these shares was not financed externally.

Features of the internal control system

IMMOFINANZ's internal control system (ICS) comprises a wide range of measures and processes to protect assets and to ensure the accuracy and reliability of accounting. The goal of the ICS is to prevent or identify errors and therefore allow for early correction. The ICS also supports compliance with the major legal directives and the business policies defined by the Executive Board.

The ICS is integrated in individual process flows. The key features of the ICS in accounting processes are the appropriate segregation of duties, the application of the four-eyes principle in all order and invoice release procedures, compliance with internal guidelines (e.g. IMMOFINANZ's IFRS accounting manual), the review of accounting data by Group controlling for correctness, plausibility and completeness, the integration of preventive and detective controls in processes as well as automatic key controls through specific software settings.

Monitoring by internal audit
Internal audit is responsible for the independent review of the effectiveness of the ICS and, in this way, contributes to its quality control. This department also evaluates the effectiveness of risk management and supports its continuous improvement. Based on an annual audit plan approved by the Supervisory Board, the internal audit department independently and regularly reviews operating processes and business transactions. The priorities for this schedule are defined in accordance with risk criteria and organisational goals.

The results of the audits are reported to the IMMOFINANZ Executive Board on a regular basis and to the Supervisory Board twice each year. As part of an annual report, the internal audit department gives an account of its performance and presents a summary of the major audit areas and results.

Risks related to the Covid-19 pandemic

In March 2020, the Covid-19 pandemic reached the countries in which IMMOFINANZ owns real estate. The immediate effects involved property-specific risks, e.g. rental income lost due to the government-ordered closing of businesses, special legal regulations for rent cutbacks, and the reduction in rents caused by the declining commercial viability of retail properties (including turnover-based rents). IMMOFINANZ's project development activities have been affected by the limitations placed on construction which, in turn, are connected with a risk of project delays. Indirect risks can also be expected to materialise in the coming months since the Covid-19 pandemic has led to a significant decline in global economic activity. Included here are the market risks which will be triggered by the general economic slowdown and the related recessionary effects. The yields in individual market segments could also shift over the long term due to changed risk profiles and altered investor expectations for these assets. The property-specific risks resulting from rising vacancies caused by tenant bankruptcies and subsequent risks related to the rental of this vacant space could, in combination with weaker economic activity, make business more difficult. General business risks can also have a negative effect on the company through higher risk premiums on financing caused by the rise in bankruptcies as well as possible distortions on the capital market as the result of an increase in receivables defaults.

IMMOFINANZ is actively working to anticipate all these developments and thereby minimise the impact on the company. Specific measures include extensive, solution-oriented cooperation with tenants to prevent bankruptcies and ensure the rapid resumption of economic activity as well as the protection of the company's long-term liquidity in order to be equipped for potential distortions on the capital market.