PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

DEUTSCHE
PFANDBRIEFBANK

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1. Introduction

Good morning, Ladies and Gentlemen.

It is my pleasure to welcome you to Deutsche Pfandbriefbank AG's Ordinary Annual General Meeting 2016.

For Deutsche Pfandbriefbank, or pbb, the year 2015 – which we will be reporting on today – was a **key strategic milestone:** *[Chart: pbb implemented its agenda]*. With the flotation on 16 July, we concluded the transformation to become a public company. This has turned pbb into one of Germany's few listed banks.

pbb was also **successful** in its **operative business** last year: 2015 marked the best year for the Bank since our restart in 2009. We reached a new record in new business volume, achieved another slight increase in net interest income – our most important driver of income – and remained below our ambitious cost targets. Pre-tax profit (in accordance with IFRS) rose to €195 million – thanks to a positive effect from deferred taxes, profit after taxes even increased to €230 million.

Dear shareholders, we want you to participate in pbb's successful 2015 financial year. The Management and Supervisory Boards therefore propose to distribute a dividend of €0.43 per no-par value share entitled to dividend payments. This equates to a total payout of close to €58 million.

We will **continue to pursue** our chosen path and **improve further** throughout 2016. We plan to expand our core business whilst continuing to work on optimising our processes. The macro-economic environment is likely to improve moderately in 2016, thus supporting our business. However, we expect competitive pressures to persist, whilst the interest rate environment will not change materially – plus, we will have to deal with significant uncertainty emanating from changes to regulatory requirements.

Dear shareholders,

In 2015, your Bank once again proved its conservative approach to risk. pbb has demonstrated its European focus, as a market leader in commercial real estate finance and public investment finance. Our ambition is to maintain and expand this position.

2. Review of 2015

2.1 Development of the operating business

I would now like to give you an **overview of our operating business**.

a. New business

For the third year running we increased **new business** by roughly €2 billion – without compromising our stringent risk standards, bringing the total to **€12 billion** for 2015, including extensions for more than one year. At a robust 20%, the share of extensions has remained relatively constant. We have no preference in terms of true new business or extensions, because in both cases we have to compete with our peers.

Real Estate Finance

In the Real Estate Finance segment, which accounted for slightly more than 85% of our new business, we achieved an **increase of 16%, to €10.4 billion** for the year. *[Chart: New business significantly up in both business segments]* We concluded **180 transactions** in total. This demonstrates a characteristic aspect of our business: Every deal is individually structured and subjected to a detailed analysis of risk, and economic viability.

The **average maturity** of new loans rose slightly, to 5.7 years (2014: 5.1 years). At 63%, the average loan-to-value ratio remained on a consistently low level (2014: 64%). The loan-to-value ratio relates the loan amount to the value of the property; it is thus a key indicator for the risk we are taking as a bank.

The average **gross margin** declined in 2015 to roughly 170 basis points (BP), compared to more than 200 BP in 2014. However, margins were stable throughout the year, which we view as a good achievement. We attribute this largely to the fact that clients value our tremendous expertise in finding tailor-made solutions and structures.

In this context, however, it is also worth noting that most early repayments occurred on higher-margin exposures, and that even the strong new business could not fully neutralise the margin pressure on existing business.

Public Investment Finance

In Public Investment Finance, new business increased by an encouraging **33%, to €1.6 billion**.

This volume is distributed across **48 transactions**, with an average loan size of roughly €33 million, slightly up from the previous year. The average **maturity** of the loans increased to 8.4 years in 2015 (2014: 6.7 years)

Public Investment Finance **complements** Real Estate Finance.

- The market shows a lot of momentum, and we are well-positioned.
- Our two business divisions open up economies of scale and scope for us. Allow me to use an example to explain this: we worked with a French bank to supply financing for a large office building in Paris. The tenants are two French ministerial departments. The French government committed to a twenty-year lease agreement, with a fully amortising loan. Whilst we are in fact carrying French sovereign risk on our books, we are generating a more attractive return than we would through traditional public-sector budget financing.
- Last but not least, Public Investment Finance is a more constant source of revenue for pbb because the market is less cyclical than in Real Estate Finance.

b. Portfolio

Let me now turn to our portfolio. I'll put the portfolio for the Consolidation & Adjustments segment to the side for the moment, which basically comprises asset items for the purpose of asset and liability management.

Our **total financing volume** *[Chart: Strategic portfolio up +10% despite high early repayments]* fell by €1.1 billion to €50 billion in 2015.

- This decrease resulted largely from the run-off of the non-strategic **Value Portfolio.** We also sold a €0.8 billion sub-portfolio – from the Value Portfolio – to accelerate the reduction in this non-core book, and to free up committed capital early.

- Both **strategic portfolios** grew by approximately 10% respectively. The Real Estate Finance portfolio stood at €24 billion at the end of 2015, whilst the Public Investment Finance portfolio was €7.3 billion. These portfolios now account for more than 60% of the overall portfolio.

  Growth has been less prominent for the strategic portfolios than new business volume might suggest. We saw extensive prepayments of loans, many of which were originally granted in 2010 to 2012 at higher margins. Such outflows were a common market phenomenon. A major share of new business thus went towards absorbing regular and early outflows in the portfolio.

The **quality of the portfolio** remained very high.

- The share of the portfolio which is rated investment grade according to pbb's definitions, remained unchanged at 96% at the end of 2015.

- The share of **problem loans** fell from €1.14 billion to €0.78 billion – a low level compared to our €50 billion portfolio.

  Only a fraction of this portfolio – just €3 million as at year-end – are **workout loans** or defaulted loans.

  The vast majority of the problem loans are actually exposures where we are in the process of negotiating the necessary **restructuring** with the borrower. This may be, and often is, a case when covenants have been breached. But we're not talking about loan defaults in the traditional sense. This is an expression of our policy of getting involved early on when an unplanned event occurs, for example in the leasing of a property, to prevent default before it happens.

c. Funding

We fund ourselves largely on a matched-maturity basis with a focus on the German **Pfandbrief**, supplemented by unsecured funding where necessary.

Due to the portfolio development on the assets side, funding requirements were lower on the whole in 2015 than in 2014. pbb raised **€4.5 billion in long-term funds** on the capital markets during 2015, compared to €6 billion in 2014. *[Chart: Long-term funding activities reduced]*

- We issued **€1.9 billion in Pfandbriefe** compared to €3.9 billion the previous year.

  In particular, there was a notable decline in **Mortgage Pfandbriefe**, with an annual volume of €1.1 billion (2014: €3.6 billion). The impact of the assets side (from loan prepayments) can be seen here.

  We increased the volume of **Public-sector Pfandbriefe** from €0.3 billion to €0.8 billion, in line with new business growth.

- We also expanded **unsecured funding** from €2.1 billion in 2014 to €2.6 billion. In addition, we significantly increased the volume of our ‘pbb direkt’ retail deposit offering, from €1.5 billion to €2.6 billion.

- **Private placements** accounted for roughly 55% of mortgage bonds and unsecured funding. Private placements, which we tailor to investors' individual requirements, are attractive because they present lower refinancing costs than so-called benchmark issues with broad market placements, which require minimum volumes of €500 million.

2015 was therefore also a very successful year for our funding activities, especially in light of the very volatile capital markets environment, and particularly in the second half of the year. In the fourth quarter of 2015, **after privatisation**, we successfully placed our **first benchmark issues** – both unsecured and Pfandbriefe. It was a milestone for us.

2.2 Consolidated results of Deutsche Pfandbriefbank

This brings me to our consolidated financial statements for 2015. I will not comment on all components of the IFRS income statement at this point; instead, I will limit my remarks to key issues. In line with common practice in the capital markets, which focus primarily on consolidated financial statements in accordance with IFRS, I will not cover the single-entity financial statements under German GAAP. You will find detailed information on both sets of financial statements in our annual reports.

I'd like to begin by asking you to note two things:

- We **compare** the 2015 results to the **adjusted results for 2014**. You will recall that during the period from the end of the reporting period until preparation of the financial statements, we made a €120 million value adjustment to claims against Heta Asset Resolution; as a result, pre-tax profit fell to €54 million. We view this valuation adjustment as a non-recurring item. As such, we made a decision to report adjusted results of €174 million and so refer to these adjusted, and therefore higher, figures in our year-on-year comparisons.

- pbb Group's earnings in the amount of €195 million again reflected **significant extraordinary items** for the 2015 financial year, including a further value adjustment made on claims against Heta to around 50% of the nominal volume. The positive results achieved in 2015 reflect the operational strengths and resilience that pbb has achieved.

In 2015 we were able to build on the previous year's good performance. All relevant performance parameters once again are pointing in the right direction, and we have made further **qualitative structural improvements to our earnings.**

- We grew **pre-tax profit** *[Chart: Pre-tax profit up 12% – net interest income slightly up]* by 12% over the previous year, to €195 million, which was far above the level anticipated in early 2015.

- **Net interest income** showed a slight increase, from €421 million to €426 million.

- In 2015 we reduced **costs** by 18% and, at €207 million, even managed to undercut our €220 million target figure for general and administrative expenses.*]*

  This is where we see the effects of our cost discipline. We benefited from the fact that our IT costs decreased after the servicing for DEPFA ended, which enabled us, for example, to enter into a lower-priced agreement with our IT services provider. Consultancy service expenses were also lower, because we had fewer regulatory projects.

- In the 2015 financial year, we reversed €1 million in **loan loss provisions** (net). In the fourth quarter, €7 million of net additions were attributable to just a handful of individual exposures.

  - The low level of loan loss provisioning was partly due to the **real estate market environment**, which remained robust on the whole.

    Another reason for the low level of loan loss provisions is our **risk policy**. Our loan portfolio is conservative in terms of both, property types and regional distribution, and we have strict lending standards. The basis for our analysis is always the business case for the property or property portfolio. We do not see the property first and foremost as collateral; instead, we look at the property's cash flow. Only when the business case makes sense do we finance our clients' transactions.

  - No loan loss provisions were recognised in Public Investment Finance.

- Due to the unusual situation in 2015, may I turn briefly to the topic of taxes – especially **profit after taxes**. *[Chart: Positive effect from deferred taxes results in tax gain of €35 million – net income above pre-tax profit]*

    - Profit after taxes was **€230 million**, and thus €35 million above pre-tax profits.

      This higher figure is also the basis for the dividend distribution ratio of 50%: this is calculated on an annualised basis – that is, taking the period since privatisation as a basis for calculation.

    - In July 2015, pbb **repaid the silent participation** that had been provided by the German Financial Markets Stabilisation Fund (FMS). In the fiscal sense, this redemption is an expense and therefore corporate tax deductible, which is why pbb had no corporate tax liability in Germany in 2015.

    - The Bank paid €21 million in prepaid **trade tax** and **foreign taxes**, and recognised €27 million in **tax provisions** for past periods.

    - This compares with a positive effect from non-cash **deferred taxes** of €83 million.

      Profit after taxes (in accordance with IFRS) increased by the **delta of €35 million** vis-à-vis pre-tax profits, bringing profit after taxes to **€230 million** as mentioned. We do not anticipate that this largely technical effect will be repeated in 2016.

2.3 Regulatory indicators

Banks must back risk in their lending business with equity capital. To this end, regulatory authorities define corresponding requirements, deducting capital ratios which banks must comply with. New, higher ratios – the so-called Basel III ratios – will apply from 2019 onwards, with transitional provisions applicable at present. Most banks, including pbb, already manage their business in line with these final ratios: the full application of Basel III rules is commonly referred to as 'fully phased-in'.

However, these ratios simulate the application of Basel III rules as they stand now. I would like to also draw your attention to the fact that pbb was exempted from determining capital ratios under the waiver option pursuant to the German Banking Act (until 31 December 2013) and Article 7 of the EU Capital Requirements Regulation ("CRR" – from 1 January 2014). We chose to voluntarily publish ratios in 2014, as pro-forma ratios. Please also note that the calculation of 2014's ratios was not based on that year's adjusted net income, but on actual results, including the valuation adjustments on Heta securities. Net profit is included in each case; for 2015, less the proposed dividend.

Deutsche Pfandbriefbank is well-capitalised. *[Chart: Capital ratios provide buffer for future growth and regulatory uncertainty]*

- The common equity tier 1 ratio – the **CET 1 ratio** which is calculated after appropriation of profits, rose to 18.2% (Dec 2014: 13.8%) at the end of 2015. The increase was mainly due to a marked reduction in risk-weighted assets, from €15.2 billion to €13.4 billion, which was largely attributable to maturities in, and the reduction of, the Value Portfolio, and to improved ratings.

- The Tier 1 and Own funds ratios reflected the full redemption of FMS's €1 billion silent participation in July 2015.

  The **Tier 1 ratio** declined to 18.2% (year-end 2014 20.3%).

  The **Own funds ratio** at the end of 2015 was 19.9% (year-end 2014: 22.5%).

Some market observers might deem pbb to be very highly capitalised, given its CET 1 ratio. At first glance that may well seem to be the case. However, two key things need to be borne in mind.

- We are planning **further growth for the strategic portfolio**, which means higher risk-weighted assets.

- We also foresee stricter **regulatory requirements** being rolled out by supervisory authorities, which may lead to a sustained increase in RWAs.

With all of that in mind, we have decided to maintain a capital buffer for the time being, to ensure we are sufficiently capitalised to face whatever new requirements might arise. With its current capital base, pbb has a sound buffer over and above the "SREP" ratio, which the ECB defined as 10.75% for pbb in the regulatory test undertaken as part of the so-called Supervisory Review and Evaluation Process (SREP).

2.4 Dividend proposal

Against this background, I would like to briefly discuss our dividend proposal.

Our dividend policy is geared towards a pay out ratio in the region of 40-50 per cent of profit after taxes in accordance with IFRS. Relative to this result, which amounted to €230 million for the 2015 financial year, the dividend proposal of €0.43 per share entitled to dividends, as put forward by the Management Board and the Supervisory Board, is at the upper end of this range, on an annualised basis.

As you know, any dividend resolution is limited to net retained profit (*Bilanzgewinn*) of Deutsche Pfandbriefbank AG, in accordance with German GAAP. According to the single-entity financial statements, net retained profit was €57.82 million. The proposed resolution takes into account the fact that the Company does not hold any treasury shares, and that all of the Company's shares are entitled to dividends.

3. Outlook

At this point, I'd like to give you an outlook on what we see coming up in 2016. In this context, I will look at our initiatives in the lending business, and in our funding activities; I will also discuss operating trends as well as our targets for key financial indicators. I will also briefly discuss the results for the first quarter, which we published yesterday.

3.1 Initiatives

The initiatives which we have planned for 2016 are geared towards the **continuous development** of our business. [*Chart: Key initiatives for 2016]* pbb is one of the largest finance providers for commercial real estate and public-sector investments in the European market. That is why it is so important that we anticipate market trends and changes. Doing so is the only way to ensure that we maintain our position as a market leader in our sector.

- Leveraging our strong franchise, we want to **maintain margins on new business** at the previous year's levels – to the extent possible. In our core markets, we offer clients a strong local presence and expertise covering all functions of the financing process chain. Thanks to our expertise in the structuring of loans, our international approach, and cooperation with other financing partners, we are able to undertake complex financings as well as cross-border transactions. In 2016 – and for the future generally – we are planning to expand these skills and continue to devote ourselves passionately to tailor-made solutions.

- We will **expand** our **regional financing activities** in line with our current conservative standards.

  For instance, we are considering getting involved in the **US market**, which, should we decide to move forward, we will approach very cautiously, and at the most opportune time. At present, we have no plans to open an office there.

- **Syndication** – the placement of portions of loans initially taken onto our books across multiple lenders is an original component of our business model and can be used to manage concentration risks, for example. In future we would like to strengthen this business, to generate additional revenue and enhance the profitability of individual deals.

  We see potential demand in the market for loans – structured with our expertise and meeting our strict risk criteria. Possible partners include – in particular – institutional investors interested in commercial real estate and public infrastructure asset classes, but who are lacking in means or market access.

  Even when we are placing loans, we want to retain a significant portion on our books. By placing tranches we earn commissions without burdening our balance sheet.

- So much for our lending business. We would also like to become more broadly diversified with respect to our funding.

  We want to broaden our international **investor base** for both benchmark issues and private placements. We want to continue intensifying our current debt investor relations work. Our clients and banking partners on the liabilities side are just as important as our credit clients.

  At the same time we want to expand our existing **deposit-taking business** with retail customers, to optimise our funding mix.

3.2 Operating trends for 2016

This brings me to the **operating trends** which we anticipate for 2016.

- We anticipate competitive pressures to persist in a generally intact market environment. Accordingly, we have incorporated a slight drop in **margins** in our plans, but we will, as in the past, seek to counter margin pressures whilst adhering to our risk strategy.

- In view of this environment and in light of the high level of new business originated in 2015, we are planning for roughly stable **new business volumes** in 2016. Performance during the first quarter has affirmed this assumption. Having said that, we anticipate further increasing competitive pressures and very demanding credit markets. For example, considering the risk profiles of potential transactions we have been offered over recent weeks, we were rather cautious in our new business.

- Assuming similar new business volumes as in 2015, we expect continued growth in our **strategic portfolio**. We believe that loan repayments will be lower this year than they were last year.

  The non-strategic Value Portfolio will continue to run off. Where practicable and reasonable, we would like to accelerate this process by actively managing reductions.

3.3 Targets for 2016

Against this background and with the strong financial year 2015 in mind, we have set ourselves the following **targets** for 2016:

- We expect **pre-tax profit** to be slightly below the strong previous year's level of €195 million. *[Chart: Financial outlook – income statement]*

- For 2016's pre-tax profit, we anticipate normalised **loan loss provisions** – in 2015, by comparison, no net addition to loan loss provisions was necessary. That does not mean that we foresee any specific reason for higher loan loss provisions. But as cautious business people, we cannot assume that we will have no loan loss provisions at all, or that we might even be able to reverse provisions.

- We expect a slight year-on-year decline in **net interest income** but want to keep commission income stable.

- By maintaining cost discipline, we will aim to ensure that **general and administrative expenses** increase only slightly, despite higher project costs. In any event, as in 2015, we want to remain below our medium term costs target of €220 million.

- We want to keep **return on equity before taxes** stable; in 2015 it was 6.2%, based on average equity outstanding. *[Chart: Financial outlook – key financial indicators]*

- In 2016, the **CET1 ratio** is expected to be significantly above the minimum 5.125% requirement under the CRR, as well as above the 12.5% CET 1 ratio targeted – subject to potential additional regulatory requirements. Based on its capital ratios as at the end of 2015, with a CET1 ratio of 18.2% (fully phased-in, and including 2015's profit distribution) pbb Group has a comfortable buffer for any higher risk weightings which might be imposed.

3.4 Results for the first quarter of 2016

We posted results for the first quarter of 2016 – as published yesterday – which were in line with these expectations.

- Consolidated profit before taxes (in accordance with IFRS) was €45 million.

  Results were shaped by net interest income, which was slightly lower, given the high level of loan prepayments during 2015, balanced loan loss provisioning, further cost reductions, and expenses incurred for the bank levy.

- Against the background of margins and loan-to-value ratios which were stable compared to the full year 2015, new business of €2.9 billion was on a par with the high levels of the previous year (Q1 2015: €2.8 billion).
- Moreover, with two Pfandbrief issues and one unsecured bond – all placed in benchmark format – the Bank has made a strong entry into the year 2016.

We had a solid start, but we anticipate persistently high competitive pressure.

4. Summary

Dear shareholders,
Ladies and Gentlemen,

pbb can look back on a very successful financial year 2015, with the best annual results since its re-start in 2009. Today, your pbb enjoys a better position than ever before: pbb is a leading bank for financing commercial real estate and public-sector investments in Europe. We have reached another milestone with the successful flotation.

The Bank's Management Board and staff cannot – and will not – rest on their laurels, since the transformation process in the banking sector is far from complete – in fact, it seems to be gaining momentum. In 2016 we find ourselves facing manifold challenges, on the markets as well as from regulation. In this context, we have once again set ourselves an ambitious target of pre-tax profit slightly below the good figures of the previous year. We want to create sustainable value for you, our shareholders, with benefits for all stakeholders. On behalf of all members of staff, I would like to thank you – our shareholders – for your interest and the trust you place upon us.

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Thank you very much for your attention.