

Alternative
Performance Measures
As of 31 December 2016

Deutsche Pfandbriefbank

PUBLIC SECTOR FINANCE
REAL ESTATE FINANCE

pbb

DEUTSCHE
PFANDBRIEFBANK

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DEUTSCHE PFANDBRIEFBANK GROUP

The consolidated financial statements as at 31 December 2016 are based on the International Financial Reporting Standards (IFRSs) as adopted in European law by the European Commission as part of its endorsement process. Please refer to the Notes to the consolidated financial statements for further information on the accounting and measurement principles.

Definitions and Usefulness

RETURN ON EQUITY

Definition

Within Deutsche Pfandbriefbank Group (pbb Group), return on equity before tax (after tax) is the ratio of profit or loss before tax (net income/loss) (annualised during the course of the year) and average equity excluding revaluation reserve.

$$\text{Return on equity}_{\text{before tax}} = \frac{\text{profit or loss before tax (during the course of the year: annualised)}}{\text{average equity excluding revaluation reserve}}$$

$$\text{Return on equity}_{\text{after tax}} = \frac{\text{net income/loss (during the course of the year: annualised)}}{\text{average equity excluding revaluation reserve}}$$

During the course of the year, the annualised profit or loss before tax (net income/loss) is based on the current figure (before/after tax) as disclosed according to IFRS, divided by the number of months elapsed and multiplied by the factor 12.

Average equity excluding revaluation reserve is the arithmetic mean based on the equity value according to IFRS excluding revaluation reserve at the beginning of the year and the equity values according to IFRS excluding revaluation reserve as disclosed at the quarterly reporting dates of the current financial year. Equity excluding revaluation reserve comprises the following items: subscribed capital, additional paid-in capital, retained earnings, profit/loss on pension commitments, foreign currency reserve, and consolidated profit.

Usefulness

pbb Group uses return on equity before (after) tax as most important key performance indicator (KPI) to measure profitability. Return on equity after tax is another KPI used in the internal management system.

However, the informative value of the respective KPI is limited by the fact that they represent rates (quota). Therefore, they do not provide information (and cannot be used to draw conclusions) on the absolute amount of profit or loss before tax (or net income/loss) or average equity excluding revaluation reserve. In addition, annualised projections of profit or loss before tax (or net income/loss) provided during the course of the year may be inaccurate due to the linear extrapolation method. Moreover, non-recurring effects may have an influence on return on equity before and after tax without any long-term repercussions on pbb Group's profitability.

COST-INCOME RATIO

Definition

Cost-income ratio is the ratio of general and administrative expenses to operating income.

$$\text{Cost-income ratio} = \frac{\text{general and administrative expenses}}{\text{operating income}}$$

Usefulness

Cost-income ratio is used within pbb Group as most important key indicator to monitor cost discipline and efficiency, and is defined as KPI in the internal management system.

However, the informative value of the cost-income ratio is limited by the fact that it represents a rate (quota). Therefore, it does not provide information (and cannot be used to draw conclusions) on the absolute amount of general and administrative expenses or operating income. Non-recurring effects may have an influence on the cost-income ratio through income and expenses without any long-term repercussions on pbb Group's efficiency.

COVERAGE RATIO

Definition

Coverage ratio is defined as the ratio of specific allowances on loans and advances to the gross carrying amounts for which specific allowances have been recognised.

$$\text{Coverage ratio} = \frac{\text{specific allowances on loans and advances}}{\text{gross carrying amount of impaired loans and advances}}$$

Usefulness

pbb Group uses the coverage ratio as a key indicator to measure coverage of loans and advances for which specific allowances have been recognised.

However, the informative value of the coverage ratio is limited by the fact that it represents a rate (quota). Therefore, it does not provide information (and cannot be used to draw conclusions) on the absolute amount of specific allowances or the gross carrying amounts of loans and advance for which specific allowances have been recognised. Received collateral is not taken into consideration in this calculation. Furthermore, the coverage ratio cannot be used to draw conclusions regarding the coverage of items for which no specific allowances have been recognised. Moreover, the coverage ratio cannot be used to draw conclusions regarding impairment losses pbb Group might be required to recognise in future.

FINANCING VOLUMES

Definition

Financing volume is the notional amount of the drawn parts of granted loans and the securities portfolio (customer business). The financing volume includes loans and advances to other banks, loans and advances to customers as well as financial investments.

The average financing volume is the arithmetic mean based on the value at the beginning of the year and the values at the quarterly reporting dates of the current financial year.

Usefulness

The financing volumes of the strategic segments Real Estate Finance and Public Investment Finance are defined as financial KPIs in the internal management system. pbb Group does not generate new business in the non-strategic Value Portfolio segment, and the financing volume of this segment declines continuously. The financing volume is a significant factor influencing the future earning power of pbb Group, since it represents the interest-bearing part of active customer business.

New business volume, as well as repayments, are the main drivers for the financing volume. However, new business volume provides only a limited basis from which to draw conclusions regarding financing volume amounts, since pbb Group's influence on repayments is limited. In addition, financing volumes are subject to foreign exchange rate movements beyond pbb Group's sphere of influence.

Reconciliation Statements

RETURN ON EQUITY BEFORE TAX AND AFTER TAX

Return on equity reconciliation 1 January to 31 December 2016

in € million	1.1.2016	31.3.2016	30.6.2016	30.9.2016	31.12.2016
Equity	2,746	2,754	2,687	2,799	2,799
Less revaluation reserve	-83	-66	-39	-39	-8
Equity excluding revaluation reserve	2,663	2,688	2,648	2,760	2,791
Calculation					1.1.- 31.12.2016
Profit or loss before tax					301
Net income/loss					197
Average equity excluding revaluation reserve					2,710
Return on equity before tax (in %)					11.1
Return on equity after tax (in %)					7.3

Return on equity reconciliation 1 January to 31 December 2015

in € million	1.1.2015	31.3.2015	30.6.2015	30.9.2015	31.12.2015
Equity ¹⁾	3,512	3,588	3,566	2,638	2,746
Less revaluation reserve	-89	-149	-53	-72	-83
Equity excluding revaluation reserve	3,423	3,439	3,513	2,566	2,663
Calculation					1.1.- 31.12.2015
Profit or loss before tax					195
Net income/loss					230
Average equity excluding revaluation reserve					3,121
Return on equity before tax (in %)					6.2
Return on equity after tax (in %)					7.4

¹⁾ Repayment of silent partnership contribution of €1.0 billion on 6 July 2015.

COST-INCOME RATIO

Cost-income ratio calculation

in € million	1.1.-31.12.2016	1.1.-31.12.2015
General and administrative expenses	198	207
Operating income	508	400
Cost-income ratio (in %)	39.0	51.8

Excluding Heta effects of €123 million disclosed in net income from financial investments, operating income was €385 million, and the cost-income ratio stood at 51.4% in the financial year 2016.

COVERAGE RATIO

Coverage ratio calculation

in € million	31.12.2016	31.12.2015
Specific allowances	86	117
Gross carrying amount of impaired loans and advances	336	534
Coverage ratio (in %)	26	22

AVERAGE FINANCING VOLUMES

Average financing volumes reconciliation

in € billion	1.1.2016	31.3.2016	30.6.2016	30.9.2016	31.12.2016	Annual average 2016
Financing volumes						
Real Estate Finance (REF)	24.0	24.1	24.0	24.0	24.1	24.0
Financing volumes Public Investment Finance (PIF)	7.3	7.3	7.3	7.2	7.4	7.3
Strategic financing volumes (REF and PIF)	31.3	31.4	31.3	31.2	31.5	31.3
Financing volumes Value Portfolio (VP)	18.7	17.9	17.4	16.6	15.8	17.3
Financing volumes total	50.0	49.3	48.7	47.8	47.3	48.6

in € billion	1.1.2015	31.3.2015	30.6.2015	30.9.2015	31.12.2015	Annual average 2015
Financing volumes						
Real Estate Finance (REF)	21.8	23.5	23.5	23.4	24.0	23.2
Financing volumes Public Investment Finance (PIF)	6.6	6.8	7.3	7.1	7.3	7.0
Strategic financing volumes (REF and PIF)	28.4	30.3	30.8	30.5	31.3	30.2
Financing volumes Value Portfolio (VP)	22.7	22.2	20.5	19.7	18.7	20.8
Financing volumes total	51.1	52.5	51.3	50.2	50.0	51.0

DEUTSCHE PFANDBRIEFBANK AG

The financial statements as at 31 December 2016 were prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – “HGB”). Please refer to the notes to the financial statements for further information on the accounting and measurement principles.

Definitions and Usefulness

DEVELOPMENT IN EARNINGS

Definition

By way of derogation from the structure provided for income statements in form 1 of the German Ordinance on the Accounting of Credit Institutions and Financial Services Institutions (Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute – “RechKredV”), Deutsche Pfandbriefbank AG (pbb) discloses aggregated income and expense items in the Development in Earnings section of the management report.

Usefulness

With the aggregation of income and expense items in the income statement, pbb intends to convey background information to the readers of the management report in a more transparent and comprehensible way, compared to the standardised approach provided in form 1 of the RechKredV. In addition, the disclosure of income statement is based on the consolidated financial statements prepared in accordance with IFRS.

Although the disclosure of development in earnings according to HGB (pbb) and IFRS (pbb Group) may look very similar for many items, any comparisons or conclusions between the single-entity financial statements and the consolidated financial statements should be made with utmost care, and may not be appropriate since they are based on entirely different accounting standards. For instance, line items disclosed in the development in earnings section of both the single-entity as well as the consolidated financial statements may differ substantially.

Reconciliation Statements

RECONCILIATION FROM INCOME STATEMENT (RechKredV) TO DEVELOPMENT IN EARNINGS IN THE MANAGEMENT REPORT

Reconciliation from income statement (RechKredV) to development in earnings in the Management Report

in € million

	2016	2015
Net interest income	373	929
Interest income from	3,849	4,284
a) lending and money market business	3,381	3,698
b) fixed-income and government-inscribed debt	468	586
Interest expenses	-3,476	-3,490
Current income from	-	135
a) equity shares and other variable-yield securities	-	-
b) participating interests	-	-
c) investments in associated companies	-	135
Net fee and commission income	8	34
Commission income	10	37
Commission expenses	-2	-3
Net other operating income	5	10
Other operating income	55	35
Other operating expenses	-50	-25
Net operating income	386	973
General and administrative expenses	-207	-221
Staff expenses	-108	-126
a) wages and salaries	-86	-90
b) social security contributions and expenses for pensions and other employee benefits	-22	-36
Non-staff expenses	-99	-95
a) other administrative expenses	-95	-89
b) amortisation/depreciation and write-downs of intangible and tangible assets	-4	-6
Operating results (before loan loss provisions)	179	752
Risk provisioning	53	70
Write-downs of claims and certain securities as well as additions to provisions in the lending business	-	-
Income from write-ups of claims and certain securities as well as reversals of provisions in the lending business	53	70
Net income from financial investments	86	1
Write-downs and impairments to participating interests, investments in associated companies and securities treated as fixed assets	-	-
Income from write-ups of participating interests, investments in associated companies and securities treated as fixed assets	93	2
Income from profit pooling, profit transfer or partial profit transfer agreements	-	-
Expenses from assumption of losses	-7	-1
Additions to the fund for general banking risks	-	-
Operating results	318	823
Extraordinary result	-6	-2
Extraordinary income	2	4
Extraordinary expenses	-8	-6
Profit or loss before tax (carryover)	312	821

Reconciliation from income statement (RechKredV) to development in earnings in the Management Report

Profit or loss before tax (carryover)	312	821
Taxes	-60	-40
Income taxes	-59	-40
Other tax unless reported under "other operating expenses"	-1	-
Net income/loss	252	781
Profit/loss carried forward from the previous year	-	-1,382
Withdrawals from additional paid-in capital	-	1,628
Withdrawals from participatory capital	-	-
Replenishment from silent partnership	-	-908
Allocation to retained earnings	-97	-
Replenishment of participatory capital	-14	-61
Unappropriate retained earnings/loss	141	58

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