Hypo Real Estate
BANK INTERNATIONAL

Structured for finance

A member of Hypo Real Estate Group

Annual Report 2004
(Incorporating Non Statutory Consolidated Financial Statements)

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Directors and Other Information

Directors	Mr. K. F. Viermetz* (German) - Chairman Mr. J. Donnelly* - Deputy Chairman Mr. G. Funke (German) - Chief Executive Officer Dr. J. Bourke* Mr. S. Bub (American) Mr. E. Dettinger-Klemm (German) Dr. M. Fell (German) Mr. J. Fenk (German) Mr. S. Musgrave* (British) Mr. T. Quinn* (American) * *Non Executive*
Secretary	Mr. W. Ramm
Registered office	International House 3 Harbourmaster Place International Financial Services Centre Dublin 1
Auditors	KPMG Chartered Accountants 1 Harbourmaster Place International Financial Services Centre Dublin 1
Principal bankers	JP Morgan Chase 1 Chaseside Bournemouth Dorset BH7 7DA England
Solicitors	Arthur Cox Earlsfort Centre Earlsfort Terrace Dublin 2

Financial Highlights

FINANCIAL HIGHLIGHTS - for the period from January 1, 2004 to December 31, 2004

		2004	2003
Operating performance			
Profit before taxes	€ m	195	47
Profit after tax	€ m	149	32
Key ratios			
Return on equity after taxes	%	10.2	3.1
Cost-income ratio (based on operating revenues)	%	37.6	33.1
Balance sheet figures			
Total assets	€ bn	24.0	15.9
Equity (excluding revaluation reserve)	€ bn	1.6	1.3
Key capital ratios compliant with BIS rules			
Core capital	€ bn	1.6	1.3
Equity funds	€ bn	2.4	2.1
Risk assets	€ bn	17.3	14.5
Core capital ratio	%	9.2	8.9
Equity funds ratio	%	12.6	14.6
Personnel			
Employees		504	344
Portfolio figures			
Volume of international real estate financing	€ bn	17.8	17.8

RATINGS

15 February 2005	Moody´s	S & P	Fitch
Long-term/Short-term/Outlook	A3/P-2/Positive	A-/A-2/Stable	–

Mission Statement

Hypo Real Estate Bank International We are a leading international real estate financing company with European roots, combining commercial real estate financing with modern investment banking. Our competence in executing high volume transactions rests on having a lean organisation within a clearly structured group, creating short decision paths, and a deep knowledge of real estate. We take on risks and manage them in a highly professional way.

An attractive risk-return profile We will be judged by our success. Our foremost aim is to provide a long-term, attractive return on our shareholders' capital. Our internationally diversified portfolio and solid capital structure makes us an investment with a good risk-return profile.

Professional customer relationships We aim to be a reliable partner for our customers, providing them with professional transaction orientated banking of the highest quality. We are committed to customers and markets which meet our standards in terms of risk and return.

Highly motivated employees We expect our employees to be highly committed to our company. At all levels, each of them brings excellent qualifications to their respective tasks. Our concept of leadership allies clarity, with freedom for individuals to take responsible actions, and the willingness to learn from past mistakes. We are committed to fostering performance. Accordingly, above-average effort will be adequately rewarded. Open communication, an international mindset, transparency, reliability, teamwork and respect for colleagues and subordinates are all central elements of our corporate culture.

About Us

Hypo Real Estate Bank International is a wholly owned banking subsidiary of Hypo Real Estate Holding AG ('Hypo Real Estate Group'), a company listed on the German Stock Exchange.

On the basis of the values and principles set out in our Mission Statement, the business model of the Hypo Real Estate Bank International Group combines the most important factors for sustainable success in the real estate financing business;

- A focus on profitable areas of business.
- A highly developed risk management system.
- An organisation which can respond rapidly to changes in customer needs.

With its tried-and-tested business model, the Hypo Real Estate Bank International Group targets the most profitable segment of real estate financing, carrying out mid-size and large transactions for particularly efficient and internationally operating investors, groups and developers, usually involving amounts upwards of tens of millions of euros.

On the basis of the customers' needs, Hypo Real Estate Bank International Group places particular emphasis on sound real estate expertise, speed and reliability in loan decisions as well as the ability to develop a customised solution for each individual transaction.

Despite a clear commitment to transaction banking, it is established practice at Hypo Real Estate Bank International Group, for long-standing and excellent relations with customers to be emphasised and carefully maintained. A fundamental principle of Hypo Real Estate Bank International Group is not only to manage the risks of each individual transaction but also to continually assess the risks of the individual borrowers and to constantly manage the loan portfolio in line with the various market cycles according to region and portfolio structure.

Contents

Directors Report

1. Review of Business Activities and Future Developments in the Business

The company is an Irish domiciled bank licensed by the Irish Financial Services Regulatory Authority, and incorporated in Ireland. The company is engaged in the business of banking and the provision of financial services principally in relation to the real estate sector.

Spin Off from HVB

The spin-off approved by the General Meeting of Bayerische Hypo- und Vereinsbank on May 14, 2003 was enacted on September 29, 2003 when it was recorded in the commercial register in Germany. Thus Hypo Real Estate Holding AG, Hypo Real Estate Bank International's parent, came into being as a new company. The spin-off took place retroactively as from January 1, 2003.

The holding company was the sole shareholder of DIA Vermoegensverwaltungs-GmbH, under which the operating units of the new Group had been pooled as subsidiaries in the run up to the spin-off – including Hypo Real Estate Bank International. The DIA company functioned as a vehicle for the spin-off, so that it was possible, to prepare most of the structure of the future Group, in advance, during 2003. As a logical consequence of this procedure, DIA was then merged with the holding company, so that the latter now holds the shares of the bank directly.

Achieving this lean and highly transparent corporate structure as fast as possible necessitated a number of corporate restructuring measures and portfolio changes in the months preceding spin-off. In relation to Hypo Real Estate Bank International (formerly HVB Bank Ireland) the following changes took place. Hypo Real Estate Bank International acquired the HVB Group's holdings in Hypo Real Estate Capital Limited, London (99.99%), Hypo Real Estate Capital France S.A., Paris (99.99%), and Hypo Real Estate Capital Italia S.p.A., Milan (100%). It purchased all the shares in Hypo Real Estate Capital Iberia S.L., Madrid, from HVB AG and a second shareholder. In addition, Hypo Real Estate Capital Corporation, New York, was founded on 2nd May 2003 and its shares are held by Hypo Real Estate Bank International. As part of the spin-off, Hypo Pfandbrief Bank International (HPBI) was also transferred to Hypo Real Estate Bank International and specialises in refinancing services for Hypo Real Estate Bank International.

In addition, with the exception of the US portfolio, Hypo Real Estate Bank International acquired, on a contractual basis (i.e. not as part of the spin-off), all the foreign real estate finance portfolios of HVB AG, amounting to approximately € 8.1 billion (as at June 30, 2003). A small portion of the portfolios was physically transferred through the assumption of the loans and a change of the creditor, but the majority was transferred synthetically – in other words the loans have remained on the books of HVB AG but with the assumption by Hypo Real Estate Bank International, of both the loan risks and the day to day processing of these loans under a loan transfer agreement. In a second step implemented under an agreement dated November 27, 2003, Hypo Real Estate Bank International also acquired HVB AG's US commercial real estate financing portfolio, of around € 4.9 billion (US$ 5.8 billion).

Hypo Real Estate Bank International was created from its predecessor, HVB Bank Ireland. HVB Bank Ireland has been officially trading under the name of Hypo Real Estate Bank International since September 15,

2003. All the Group's international activities have been pooled within this Bank, including all the activities of the international branch offices and of Hypo Pfandbrief Bank International S.A., Luxembourg.

Of the original portfolio of HVB Bank Ireland commercial loans, an amount of approximately € 3.0 billion was transferred to HVB Banque Luxembourg S.A.

2004

2004 was the first full business year of the Hypo Real Estate Bank International Group (hereafter referred to as 'the Group'). It was a year in which the Group has succeeded in surpassing its expectations. The Group has made major progress with all its important strategic tasks, and strengthened its profile as one of the leading providers of commercial real estate financing in Europe. Substantial progress was made in further expanding the Group's position in the other main international real estate markets

A considerably improved earnings performance in line with a demanding budget was achieved. This excellent outcome impacted significantly on the results of Hypo Real Estate Group and was reflected in the very positive stock market performance of its share price.

For 2004 many targets had been set. The main objectives were as follows:

- To expand the quality and quantity of international business of the Group;
- To adapt refinancing arrangements to bring them into line with expanding new business;
- To strengthen the confidence placed in the Group by the Capital Markets and to communicate the prospects of the Group to new investors,
- To seek to optimise the combined strengths of the holding company and the other operating entities, in the Hypo Real Estate Group through co-operation and a shared corporate culture.

Which of these projects became reality last year?

In 2004 the Group was able to focus its full attention and resources on its markets and customers. This is reflected in the increase in new real estate financing business from € 3.7 billion to € 9.8 billion, which means that the Group has more than met the original budget. The strong growth was attributable to the contributions made by the US real estate financing business acquired at the end of 2003 as well as by stronger sales performance in other key markets, e.g. France. In addition, a subsidiary in Tokyo has been opened, thus commencing the development of the significant Japanese market. Likewise, with the new branch in Hong Kong the Group wants to participate conservatively and with discretion in the opportunities present in the developing Chinese market.

The Group has made significant progress in 2004 towards meeting the aim of achieving a balanced regional diversification of risk in its credit portfolio.

On the refinancing side, the Group established a medium-term notes programme (MTN programme) of € 10 billion, thus setting a framework which permits international placing of bonds.

The Group issued a total of 48 tranches with a bond volume totalling € 3.9 billion in 2004. Refinancing

activities have accordingly matched the pace of expansion of the international business. The response of the capital markets to the issues as part of the MTN programme was very positive; in certain cases, the Group was unable to satisfy the strong demand which exceeded our requirements. This is considered to be a demonstration of the confidence of the market, which has accepted the Group as a relevant partner on the international bond markets.

The confidence placed in the Group, is also reflected in improved outlooks provided by the leading rating agencies. The Group intends to continue its prompt and open communication with its investors, based on what is feasible and not on that which may be desirable.

In 2004, the Group dealt with the problems posed by a wide range of tasks. This process demanded flexibility, rapid decision making and professional commitment from its staff - characteristics which will continue to be essential for its success in the future.

The rapid changes which have been taking place within the Group have encouraged the formation of shared values and maxims, and thus the creation of a uniform corporate culture. This culture of an open and innovative real estate financier, which can be relied upon by all stakeholders, is becoming more and more evident in the Group. This process is creating a new progressive culture which is markedly different from those that pre-existed in the various institutions that are combined in the Hypo Real Estate Group.

The set up phase has finally come to an end. In the course of the next few years, the aim will be to further expand the international business, which still enjoys significant potential yet to be realised; to develop rapidly, the necessary sales strength in order to generate relevant volumes, with due consideration being given to strict risk and yield requirements; to strengthen further the Group's profile as a provider of innovative capital market products in the field of refinancing, syndication, securitisation and risk trading and thus to constantly expand the value-added chain.

Hard work, and attention to detail, will be necessary to achieve these objectives. These measures are not expected to result in short-term effects; instead, they are expected to assure and increase the Group's success on a sustainable basis. In this way, the Group will continue to be a reliable partner for its customers.

Speed and the ability to adapt in a flexible manner to the needs of the market, will continue to be essential. The Group's profile as a solution-based provider of real estate transaction banking will continue unchanged. The processes and structures used are not, however, written in stone. The aim is to adapt as required by the markets. For this reason, the organisational structure was changed at the beginning of 2005. The global real estate financing business with its local entities will in future be grouped into three regions: Europe, America and Asia. The management of underlying entities will be combined in a single business platform. By concentrating forces in such a manner, particularly in London, the Group is taking account of the increasing significance of cross-border financing arrangements, it is closer to its customers, and is distinguishing itself from the intensifying competition in the sector.

The future of the Group requires management to face different, but by no means less demanding, challenges than were faced during the set up phase of the business. Management will approach these challenges

with the same degree of commitment which has been evident in its achievements to date and with the full knowledge of the strengths of the Group.

2. Results for the Year

The Group has fully met its targets in 2004. The Income Statement comparative figures for 2003, exclude the adjustment of earnings paid to the Hypo Real Estate Group by Bayerische Hypo -und Vereinsbank AG (HVB AG) as part of the spin off agreement in 2003. The comparative figures therefore differ from the segmental reporting analysis included in the Annual Report of Hypo Real Estate Group. This adjustment represented part of the earnings of the real estate division for 2003, as originally booked in the various branches of HVB AG. It has been excluded from the 2003 comparative figures reported in these financial statements since the amount was not paid to Hypo Real Estate Bank International puc, but transferred to Hypo Real Estate Holding A.G. and, is therefore, not reflected in the Income Statement. There is no impact in 2004 for this item.

Taking into account this 'Earnings Adjustment' net income before taxes in the Group increased from € 87 million to € 195 million, and the consolidated return on equity after taxes, increased as predicted from 4.3% to 10.2%.

The Audit Committee has reviewed the current financial statements. Following thorough discussions, the statements were approved and an appropriate report was given to the Board. This arrangement permits effective control of financial reporting.

In 2004, the work of the Audit Committee focused primarily on the interpretation and application of International Financial Reporting Standards, regulations and on the expansion of the internal risk control systems. The audit method and key aspects of both internal and external auditing were also defined. During the course of the financial year, the work relating to advice on the risk structure, and in particular advice concerning the need for allowances for losses on loans and advances continued.

The Audit Committee has considered the financial statements, the management report and the proposed appropriation of cumulative profit. The Audit Committee has notified the Board of the results of its own review and proposed that the financial statements, management reports and risk report be adopted. The Board has accordingly adopted the financial statements which have been prepared.

The above-average achievements and success in all areas of the Group would not have been possible without the professionalism, flexibility and tremendous dedication of the Group's staff. The Board, would like to express its thanks to all members of staff for their commitment.

3. Share Capital

Changes in the Authorised and Issued Share Capital of Hypo Real Estate Bank International are disclosed as part of note 57 to the financial statements.

4. Accounting Policies

All material accounting policies are set out in Notes 2 to 20, to the financial statements.

5. Accounting Records

The directors ensure compliance with the Group's obligation to keep proper books of account, by the use of appropriate systems and procedures and the employment of competent persons. The books of account of the Hypo Real Estate Bank International puc are maintained at International House, 3 Harbourmaster Place, International Financial Services Centre, Dublin 1.

The books of account of the branches and subsidiaries of Hypo Real Estate Bank International are maintained at each of the various locations noted on pages 90 and 91.

6. Health and Safety

The well being of the company's employees is safeguarded through the strict adherence to health and safety standards. The Safety, Health and Welfare at Work Act, 1989 imposes certain requirements on employers and the company has taken the necessary action to ensure compliance with the Act, including the adoption of a safety statement.

7. Subsidiary Companies

Details of the principal subsidiary undertakings are disclosed in Note 4 to the financial statements.

8. Directors and their Interests

The directors who held office at 31 December 2004 had no interests, other than those shown below, in the shares, debentures and loan stock of the company/group companies:

Name of director	Description of instrument	Interest at end of year	Interest at beginning of year or date of appointment (if later)
Dr. J. Bourke	Common shares of Hypo Real Estate Holding AG	-	-
Mr. S. Bub	Common shares of Hypo Real Estate Holding AG	-	-
Mr. E. Dettinger-Klemm	Common shares of Hypo Real Estate Holding AG	545	45
Mr. J. Donnelly	Common shares of Hypo Real Estate Holding AG	-	-
Dr. M. Fell	Common shares of Hypo Real Estate Holding AG	188	188
Mr. J. Fenk	Common shares of Hypo Real Estate Holding AG	20	20
Mr. G. Funke	Common shares of Hypo Real Estate Holding AG	30,876	30,876
Mr. S. Musgrave	Common shares of Hypo Real Estate Holding AG	-	-
Mr. T. Quinn	Common shares of Hypo Real Estate Holding AG	-	-
Mr. K. Viermetz	Common shares of Hypo Real Estate Holding AG	50,000	50,000

There were the following changes in Board of Hypo Real Estate Bank International in 2004:

- Mr. Stephan Bub was appointed to the Board on 1st January 2004,
- Mr. Dieter Heusel retired on 31st March 2004,
- Dr. Markus Fell assumed the functions of Chief Financial Officer and Chief Operating Officer on 1st April 2004
- Mr. Stephen Musgrave was appointed to the Board on 9th March 2004,
- Mr. Thomas Quinn was appointed to the Board on 9th March 2004,
- On 31 December 2004, Mr. Frank Lamby resigned from the Board of Hypo Real Estate Bank International.

9. Dividend Policy

The objective of generating an attractive return for the capital, which has been placed in our hands, is the overriding aim of all our actions. However, due to the capital intensive nature of the business and the Group's projected growth, the directors do not intend to recommend the payment of any dividend for the foreseeable future.

10. Political Contributions

The Electoral Act, 1997 requires companies to make disclosures of all political donations in excess of € 5,079, in aggregate, made during the financial year. The Directors, on enquiry, have satisfied themselves there were no such political donations made by the Company during the financial year.

11. Post Balance Sheet Events

On 19th January 2005 200,000,000 Ordinary Shares of €1 each were allotted to Hypo Real Estate Holding AG at par On the same date Subordinated Debt (Supplementary Equity) of €50 million was repaid to Hypo Real Estate Holding AG.

At the beginning of January 2005, Hypo Real Estate Bank International puc successfully issued its third benchmark bond under the MTN programme. As was the case with the second bond, which had been issued in September 2004, this issue also generated a lot of interest on the capital markets: With a volume of €1.25 billion, it beat expectations. There were no other significant post balance sheet events.

12. Auditors

In accordance with Section 160(2) of the Companies Act, 1963, the auditors, KPMG, Chartered Accountants, will continue in office.

On behalf of the Board

G. Funke | **Director**

J. Bourke | **Director**

J. Donnelly | **Director**

W. Ramm | **Secretary**

8th April 2005

Statement of Directors' Responsibilities

The directors acknowledge their responsibilities for the preparation of these non-statutory financial statements which give a true and fair view of the state of affairs of Group and of the profit or loss of the Group for the financial year. In preparing those financial statements, the directors recognise the requirements to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- prepare the financial statements on the going concern basis unless it is inappropriate to do so.

The directors acknowledge their responsibility for keeping proper books of account which disclose with reasonable accuracy, at any time, the financial position of the Group and which enable them to ensure that the financial statements which are separately prepared, comply with the Companies' Acts, 1963 to 2003 and all Regulations to be construed as one with those Acts including the European Communities (Credit Institutions: Accounts) Regulations, 1992. The directors recognise their responsibility for safeguarding the assets of the Group and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

On behalf of the Board

- G. Funke | **Director**
- J. Bourke | **Director**
- J. Donnelly | **Director**
- W. Ramm | **Secretary**

8th April 2005

Map of Locations

Business Development

Business Development

Strategy and Products

Two events were of particular significance in the year under review. The Group was able to devote itself entirely to new business again and exceed its ambitious target for 2004 with a real estate financing new business volume of € 9.8 billion. Following the year of the spin-off, the bank succeeded in refocussing its entire sales strength in all established markets and in new markets such as Asia. After the completion of the purchase of the US real estate portfolio from HVB AG at the end of 2003, the entity in New York in particular was very successful in generating new business. In Asia, the branches or subsidiaries in Hong Kong and Tokyo were opened, and attractive transactions have already been completed, particularly in Japan. New branches were opened in Europe, namely, in Amsterdam and Lisbon.

The second major event which took place in the course of the year is the successful establishment of Hypo Real Estate Bank International as an independent and autonomous player on the capital markets. The provision of the necessary refinancing volume on the basis of competitive terms was perceived to be a critical factor for the success of the young international bank. Accordingly it is particularly satisfying that the new Medium Term Notes programmes as well as the Euro Commercial Paper programme have both made successful starts in a very short time. In addition, Capital Markets has been established as a new segment and integrated into Hypo Real Estate Bank International. Capital Markets complements the bank's core activities, evolving new products, like structuring and converting credit risks into securities capable of being traded on the capital markets. In this way, an integrated sales, credit and capital market platform has been created. At the end of 2004, the real estate financing business was reorganised in certain areas and three regional sales platforms were established for Europe, the USA and Asia. This move has improved productivity, customer support and cost structures. The sales platform for Europe, with headquarters in London, combines the European activities. The rating agencies, S&P and Moody's, recognised the progress which has been achieved in 2004. After the bank had satisfied all requirements of the rating analysts, both agencies responded by revising the outlook for the corresponding ratings. On 31 August 2004, S&P changed its outlook for Hypo Real Estate Bank International A- /A- 2 from negative to stable. On 5 October 2004, Moody’s changed its outlook for A3/ P-2 from stable to positive.

Real Estate Markets

Great Britian

Economic growth slowed down in Great Britain towards the end of 2004, and this had an impact on the property sector, where prices in November 2004 declined at the highest rate seen since 1992. Despite minor improvements on the rental market, there was evidence of rent increases only in certain areas, for instance the West End of London. As a result of strong competition and the limited supply of suitable investment products, property yields continued to decline slightly. This meant that British investors increasingly started to look for suitable investments outside the British market, e.g. in Germany. On the other hand, there are signs that institutional investors are returning from abroad to Great Britain.

Office market:

Compared with the prior year, the office market is more stable and there were signs of a slight improvement. For instance, in Central London, sales were approximately 75% higher than in 2003. Vacancy rates of office premises continued to decline, although they still remained at a relatively high level in absolute terms. Towards mid 2004, the decline in rents in Central London and also price increases on the capital market slowed down. Prices rose towards the end of the year, which meant that London reported strong increases in rents in 2004. The supply of top-quality office accommodation is still limited. The existing strong demand on the investment market put pressure on yields. Rents are expected to increase slightly in 2005, and the investment market will continue to be competitive.

Retail market:

Retail sales slowed down in 2004. Rent increases were lower when compared with last year. Demand for top-quality accommodation is still strong, as such accommodation is in short supply. This strong investor demand depressed yields. Shopping centres continued to be desirable investment objects. This meant that yields of such investment properties were depressed in 2004. The annual forecast for the retail market is positive.

Industrial, warehousing and logistics market:

The market for industrial, warehousing and logistics property was strong in 2004. Supply and demand were stable over the year. Good results were achieved primarily in London and the M25 corridor. Because investor demand was still strong, yields declined, and there was hardly any evidence of rent increases in the top segment. A similar development is expected in 2005.

Residential market:

There were clear signs of deterioration in the market climate towards mid-2004. Expected rate hikes have had a negative impact on the housing market. The market for more exclusive properties in 2004 again achieved slight growth compared with the average market.

France

The French property market weakened slightly in 2004 in the European context. France is exhibiting increasing competition between French banks in the real estate financing market.

Office market:

Because of the centralised nature of the country, the French office market focuses primarily on the Paris (Ile-de-France) region. Because of the comparatively small amounts of new building land released within the city of Paris, most projects involve redevelopment. This is the main reason why the vacancy rate in Ile-de-France in 2004 was only between 6% and 7%, despite a lower rental performance in 2004 compared with the previous year. Office rents nevertheless also came under pressure in 2004, and rents are not expected to stabilise before mid-2005. The investment market in 2004 was characterised by a stronger investment volume than was the case in the previous year. The investors came from France (around 37%), Germany (around 27%) and the USA (around 20%). Because of the shortage of top-quality accommodation in the centre of Paris, the peripheral office market has been developing into an attractive alternative to inner-city accommodation, partly as a result of the lower rents involved.

Retail market:

Despite moderate economic growth in France, the retail market improved slightly compared with the previous year, with a positive outlook for 2005. The investment market is still very active, and in particular, the market for shopping centres. Top-quality accommodation is still in very short supply, which meant that yields remained stable in the face of relatively constant high demand.

Industrial, warehousing and logistics market:

The market for industrial, warehousing and logistics properties reported a weak year. Demand was generally sluggish, supply and the vacancy rate were very high in certain sub-markets. Rents in general were stable.

Residential market:

In 2004, rents and prices, particularly in the region of Ile-de-France, again increased. Sales of existing

properties increased compared with the previous year. On the other hand, sales of new property declined.

USA

The capital market again demonstrated its strength last year. Supply increased, as did investor demand compared with the previous year. There is strong competition on the financing market, particularly for high-quality properties which have been let on good terms. Corporate investments are expected to be the driver of the American economy next year with company-driven expansions. Demand for good investment opportunities will continue.

Office market:

Prospects improved considerably last year. There were signs of a gradual recovery on the rental market. The decline in the supply of sub-let premises was identified as the major factor behind declining vacancy rates and a stable rental level. Although many sub-markets are still reporting high vacancy rates and although the overall level of rents has fallen, many analysts are more confident for the prospects for the office market in the USA than has been the case in previous years.

Retail market:

In 2004, the retail market again achieved the best results of all real estate classes. Continuing strong consumer spending resulted in better sales figures, and expansion efforts were boosted. This had a positive effect on the vacancy rates and drove rents upwards. The rental volume last year continued the advance which commenced in the year 2000. It is expected that investor interest will focus on shopping centres and attractive retail locations.

Industrial, warehousing and logistics market:

The market for industrial property experienced a positive turnaround last year, this is a cause for cautious optimism. The market is characterised by very strong supply. Towards the end of the year, demand increased in most conurbations, resulting in stronger overall sales. Vacancy rates fell below 10%. For 2005, the Group assumes that demand will focus on large cities. If the economy is healthy, the industrial market will probably achieve a positive performance.

Residential market:

The prospects for the residential market improved in 2004. This development was driven by the unemployment figures which declined for the first

time in two and half years, as well as rising interest rates. During last year, rents were stable and vacancy rates declined.

Other strategically important markets

Central and Eastern Europe

The Eastern enlargement of the EU which took place last year, had a stabilising effect on the real estate markets in Central and Eastern Europe. 2004 was characterised by sharply lower yields, a slow-down in the rate at which rents declined and also a slight decline in the vacancy rate for office premises. Particularly in the office market, the main focus is still on the property markets in the three capital cities of Prague (Czech Republic), Warsaw (Poland) and Budapest (Hungary). Investments have also been made in the retail sector outside the three cities mentioned above. For 2005, yields are expected to decline slightly, and rents are expected to stabilise in all areas.

Sweden

The Swedish economy has not expanded as originally planned. In the conurbations of Stockholm and Malmö, the office market saw top rents flatten. Demand for top office premises increased. The retail sector experienced stronger demand for premises on the back of increased consumer spending. The supply shortage should ensure that the positive development will continue in 2005. The Swedish industrial market in 2004, remained roughly at the same level as last year. This market segment is expected to consolidate in 2005.

Italy

In Italy, real estate activities focus primarily on the conurbations of Milan and Rome. Both markets have reported a slow-down in declining rents, but with a further slightly negative trend. However, low vacancy rates in the office sector provided an attractive climate for investors and existing owners. The retail market reported an increase in new building and investment activity in 2004, particularly in relation to shopping centres. The logistics market in Italy is still underdeveloped compared with other European countries, and offers growth opportunities for 2005. The residential market was virtually unchanged last year as a result of stable high demand.

Spain

Within the context of the European office property sector, the markets in the two conurbations of Madrid and Barcelona declined in 2004. Office rents declined slightly over the year, and there was little evidence of movement towards the end of 2004. Vacancy rates

also increased slightly in 2004. The retail sector is the healthiest property sector in Spain, due to continuing, high consumer demand. Following several years of rising retail rents, there were initial signs of flattening in rents towards the end of 2004. Retail properties in first-class locations and well-managed shopping centres, where yields declined in 2004, are still desirable investment objects. Investors are increasingly focussing on secondary cities such as Valencia, Murcia, Seville, Malaga and Zaragoza, where attractive risk-return profiles can be achieved. The strong rent and price increases seen in recent years on the Spanish residential market flattened out in 2004. Private investors are still subject to the risk of higher financing costs due to interest rate increases.

The Netherlands

The property market experienced a weak year in 2004. Demand for office premises was sluggish, and office rents were still under pressure. Demand for, and supply of, office accommodation stabilised or slightly improved towards the end of the year. However, there are hardly any speculative development starts at present, due to the difficult conditions. The vacancy rates, particularly in the Amsterdam conurbation, rose to approximately 20% during 2004, but are now declining.

Japan

The office market in Tokyo reported the highest occupancy rate for 28 months in five districts, however the trend of falling rents continued in 2004. The market for financing is still extremely competitive. Yields for top-quality premises are still under downward pressure. Investors are increasingly focussing on secondary markets such as Osaka.

China

China became the third largest trading nation in the course of last year. Economic growth slowed down during the year as a result of tighter legislation. The investment market expanded by more than 25% compared with the prior year. The real estate markets in Beijing, Shanghai, Guangzhou and Shenzhen in particular attracted a large number of new investors. The number of new building projects rose sharply, compared with the previous year.

General Economic Development

Compared with the beginning of the year, the imbalances in the global economy became more pronounced in the course of 2004. Whereas the economy was booming in Asia, primarily in China and India, the recovery process in Europe has not yet taken hold. The economy in the USA has achieved strong growth but, as is the case in Europe, this has not yet had a significant impact on employment. The adjustments have taken place via exchange rates, whereby the main burden has been borne by the Euro, which appreciated dramatically against the US Dollar in 2004. Raw material prices rose sharply as a result of strong demand from Asia and countries such as South Africa, Brazil and Russia have benefited from this upturn in demand. The oil price was additionally boosted by the permanent uncertainty concerning political developments in the Middle East, and this had a retarding effect on the economy in the Western industrialised countries. Financial markets remain unaffected by the uncertainties created by terrorism, and natural catastrophes. The effect of EU enlargement, if any, has yet to be seen. The outcome of the US presidential elections had an impact on interest rates and exchange rates.

On the other hand, there was a significant increase in the current account deficits and budget deficits of the industrialised countries. In the USA, there was a slight increase in capital market rates, which was perceived to be a turning point in the global rate cycle. The significant amount of liquidity available throughout the world, which was invested mainly in safe fixed-interest securities, and the fact that the expected significant economic recovery in Europe failed to materialise, ensured that interest rates in 'Euroland' fell to a new all-time low.

The deflation potential, which was still being discussed in the Western world a year ago, lost its threat in 2004. The strong growth in the USA, more expensive imports and growth in money supply tended to increase the risks of inflation in the USA. The FED has accordingly raised interest rates in five stages from 1.0% to 2.25%. Despite a sharply increasing money supply, the strong Euro and lower growth in the Euro zone enabled the European Central Bank to leave interest rates unchanged at 2%.

Income Statement

Net income before taxes at Hypo Real Estate Bank International amounted to € 195 million, and is considerably higher than originally planned. This was due to various factors, including the effect of the early adoption of IAS 39 (revised 2003) and the associated redefinition of portfolio-based allowances.

Compared with the previous year (and taking into account the 'Earnings Adjustment' described in section 2 of the Directors' Report in the following analysis), net income before taxes increased by € 108 million. Excluding the deferred tax income from capitalised losses carried forward (€ 1 million) due to the higher earnings, taxes on income were € 17 million higher than was the case in 2003 ; however, the overall tax ratio declined considerably. Net income, amounted to € 149 million compared with € 57 million last year.

Return on equity is 10.2% after taxes, which is more than double the corresponding figure seen in 2003 (4.3%).

The development in earnings reflects particularly the good new business and the income from the US real estate financing portfolio which has been included in the income statement since the beginning of the year. In the course of the year, operating revenues gradually increased from € 193 million to € 362 million. Net interest income rose from € 137 million to € 224 million, and net commission income rose from € 55 million to € 126 million. At the beginning of February 2004, Hypo Real Estate Bank International extended its activities to include the "Capital Markets" segment, which offers a wide range of structured capital market solutions. This segment is in particular responsible for net trading income of € 11 million.

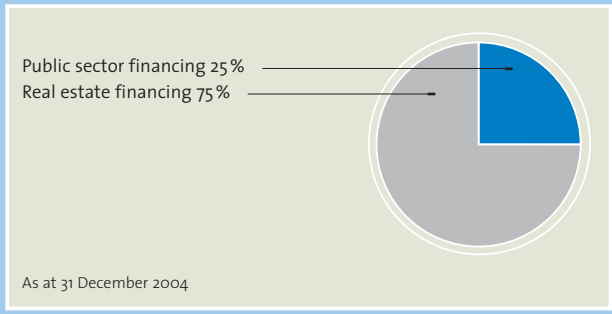
There were no specific provisions made against individual loans and advances during 2004. It is felt prudent that the portfolio based, incurred loss provision be increased by € 33 million.

General administrative expenses increased to € 136 million following the incorporation of US activities, the establishment of "Capital Markets" as well as international expansion (2003: € 64 million). The cost/income ratio is 37.6%.

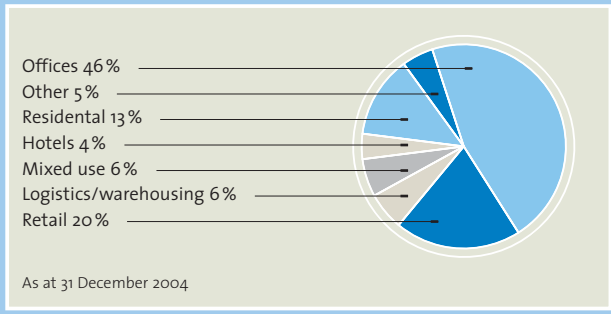
Portfolio Structure

The credit portfolio, (which, in comparison with the lending volume shown in the financial statements, also includes all undrawn commitments), amounted to € 22.8 billion as of 31 December 2004, an increase of € 4.2 billion compared with 31 December 2003 after maturities and repayments. The figure also comprises an amount of € 0.5 billion for US business which is booked with Württembergische Hypothekenbank but is guaranteed by Hypo Real Estate Bank International. In addition, € 1.0 billion relating to business booked in Great Britain has been refinanced through Württembergische Hypothekenbank. Since the loans remain guaranteed by Hypo Real Estate Bank

Total loan portfolio



Real estate financing portfolio by property type



International, they have not been derecognised as Loans and Advances to Customers in the Group's balance sheet, and hence the guarantee is similarly not recognised as an off balance sheet commitment. As a result, real estate financing accounted for around €17.1 billion (75%) and public sector financing, including bonds and debt securities investments which are held by Hypo Pfandbrief Bank International (HPBI), accounted for €5.7 billion (25%) (See also the diagrams above).

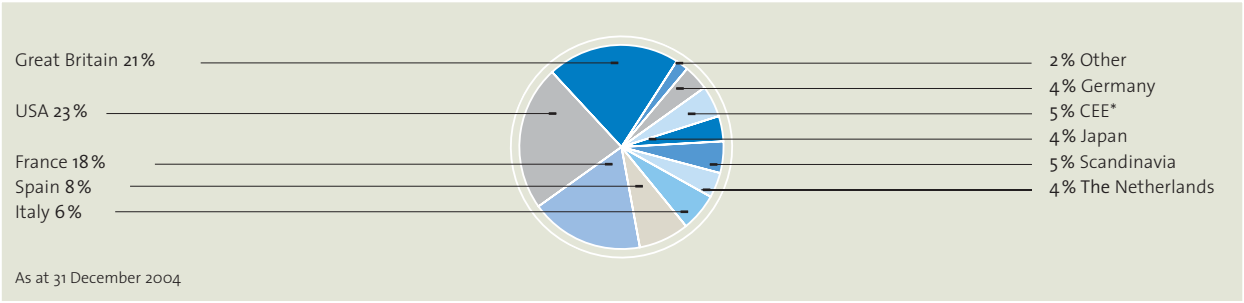
The percentage of real estate financing in the overall portfolio accordingly increased by 5 percentage points compared with 31 December 2003. The total volume of new business of real estate financing with professional investors and developers acquired in 2004 amounted to approximately € 9.8 billion, and was accordingly much higher than the originally budgeted figure. Compared with 31 December 2003, new business more than doubled as a result of the strong sales performance. Contributions in this respect were made by European business (€ 6.8 billion) and American/Asian business (€ 3.0 billion). The Group accordingly succeeded in considerably expanding its real estate financing portfolio despite the reductions attributable to high early repayments, particularly in the fourth quarter. Overall, the volume of real estate financing, after maturities and repayments, increased by € 3.0 billion compared with 31 December 2003.

The transactions feature a healthy risk / return ratio. In the individual regions, the group achieved average interest margins of up to 200 basis points after deducting its own refinancing costs. An average interest margin of more than 140 basis points was achieved across all new real estate financing business.

In the portfolio breakdown based on types of property financed office buildings and retail premises are still predominant, in line with the Group's strategy; these types of properties are also the main components of the "Mixed use" category.

As a result of the expansion of activities into Asia (notably, the opening of units in Japan and Hong Kong), the Group succeeded in introducing an even broader regional diversification into the portfolio. America and Asia account for 28% of the overall real estate financing portfolio. Europe accounts for 72% of the portfolio, mainly split between Great Britain and France. Financing arrangements in Hong Kong, Switzerland, Ireland, etc., are summarised under "Other". None of these countries represent more than 1% of the overall portfolio. In the following analysis, the regions are based on the location of the underlying properties, and compared with 31 December 2003, this shows changes in the relative percentages of most countries.

Real estate financing portfolio by property type



* The CEE mainly comprises Hungary, Poland and the Czech Republic.

Refinancing

MTN programme

As planned, Hypo Real Estate Bank International launched a €10 billion Medium Term Note programme listed on the stock exchanges in Ireland and Luxembourg, at the beginning of February 2004. The purpose of the MTN programme is to improve the transparency of refinancing activities and also to diversify the refinancing base. Shortly after the programme was launched, Hypo Real Estate Bank International issued its inaugural € 400 million three-year FRN tranche. This marked the successful start to the Group's issuance on the international capital markets. Since that time, Hypo Real Estate Bank International has issued the impressive volume of more than 40 private placements by the end of 2004. In addition, the Group issued its first benchmark transaction, a €1.25 billion Senior Floating Rate Note, which represents a milestone in the Group's strategic development. The order book was almost two-times over-subscribed. This issue is due to mature on 23 September 2009 and has considerably increased investor diversification.

The bonds issued also comprise tranches in EUR, USD, GBP and JPY. In addition, the expansion of the investor base of Hypo Real Estate Bank International has also meant that the Group was able to place bonds in Czech and Slovakian Koruna. At present, 80% of refinancing comprises floating rate notes with the remainder in fixed-income issues and structured products. Since January 2005, the maturity profile of the Group's liabilities closely reflects the maturity profile of the underlying asset base. The investor base of Hypo Real Estate Bank International is evenly split between Germany and the rest of Europe, which is a satisfactory regional diversification. In addition to the strong interest of banks in Hypo Real Estate Bank International issues, the broad and diversified group of investors is also made up of money market funds, investment funds, pension funds, financial service providers and insurance companies. A key aspect of the success of the programme has been the clear positioning of the Group and the continuous and extensive market activity with investors.

ECP programme

The wide range of refinancing instruments was extended in September 2004 by the introduction of Hypo Real Estate Bank International's €3 billion Commercial Paper programme. This further expanded refinancing sources of the Group. The Group succeeded in achieving a volume of

€ 512 million by the end of December 2004. In order to further improve refinancing for short-term maturities, Hypo Real Estate Bank International also intends to launch a French CD programme in the near future.

Hypo Pfandbrief Bank International

In order to underline the fact that Pfandbrief Bank International S.A., Luxembourg, is a member of the Hypo Real Estate Bank International Group, its name was changed to Hypo Pfandbrief Bank International S.A. (HPBI) at the beginning of September 2004. HPBI has expanded its position in the European Pfandbrief market with an increase in net income over the corresponding figure for 2003 and with a higher volume of new issues. In addition, HPBI acts as the centre of competence for the Group in assessing the credit of public sector borrowers by analysing total Group exposure with regard to the new Basel II capital requirements. It operates in tandem with the Luxembourg branch of Hypo Real Estate Bank International. As such, Luxembourg has the responsibility for Hypo Real Estate Bank International's senior unsecured and HPBI's lettre de gage issuance programmes, the Luxembourg style covered bond.

Personnel

The total number of employees in Dublin and the international branch network was 504 at the end of December 2004 (2003: 344 employees).

During 2004, existing departments such as Finance and Operations, Treasury, Marketing and IT were expanded in order to keep up with the growth in overall business. Additional personnel were necessary for setting up new special functions such as the appraisers and credit administration. The process of establishing "Capital Markets" started with a team comprising employees in Dublin, London and New York and was gradually expanded in the course of the year. Within the reorganised group, the main task was to develop the skills and knowledge of existing staff for relatively new functions and departments. Ambitious plans for growth and exceptional financial efficiency can only be achieved by the commitment and involvement of all employees. The aim is to encourage entrepreneurial thinking and efficiency in all entities of the Group. Hypo Real Estate Bank International consists of a multi-cultural team of employees, reflecting the markets in which the Group operates. In the financial year, 15 nationalities were represented at the Dublin headquarters. The number of employees will remain

constant in 2005. Following the increase in numbers in 2004, there are plans for only a minor programme of specific investment in recruiting specialists during 2005. The main challenge in future will be to further strengthen quality and professionalism.

Outlook for 2005

In 2005, the Group will continue to face major business challenges with increasing competition particularly in the European and American markets. Hypo Real Estate Bank International will use its market competence to generate new business of around € 10 billion in 2005. The securitisation platform combined with the commercial banking capabilities provides a single source solution for senior, mezzanine, capex and other facilities not commonly available at investment banks.

Hypo Real Estate Bank International will continue to provide clients with a superior service and a full product range of financing options in one platform - "one-stop" shopping, for all their real estate needs. The fact that sales entities have been established in some Asian markets demonstrates that the Group has correctly positioned itself for its internationally focused and expanding customers. This will result in further attractive business opportunities and will further diversify the portfolio.

The reorganisation of the European platform especially, is providing a stronger foundation, which will be used for carrying out cross-border and trans-European business. This will enable the Group to expand its tried-and-tested business model and increase its portfolio with the budgeted new business. The new Capital Markets segment will also make positive contributions in 2005.

Risk Report

Risk Report

Banking is based on taking on risks. Wherever risks are taken on in the Group, they have to be managed. For this purpose, in 2004 Hypo Real Estate Bank International adapted its risk management system to ensure it remained in line with its business model. This has been achieved primarily by establishing a steering principle based strictly on a risk-return approach and also by the preparations made in advance for the revised capital principles under Basel II, which have introduced important improvements and additions.

Risk management

Risk management is an integral component of Group management. The objective of risk management is to ensure that a return is generated commensurate with the risks that have been taken on, and that simultaneously, risk policy tools and guidelines, limit these risks in such a way, that no unexpected problems endanger the sound position of the Group. Risk management within the Group therefore always stands for careful and responsible handling of risk. Management aims to increase the value of the enterprise. In order to generate added value, the return on capital employed must exceed the cost of the capital. However, value is also boosted by every yield improvement in relation to capital costs. The Group measures and regularly monitors the progress towards the desired target yield for the individual units. The main factor determining the capital costs are the risk premiums in relation to the risk-free return, which may differ for every stake in line with the individual risk profile. Risk measurement and the process of calculating the risk premiums or checking the risk structure of the portfolios are accordingly of vital importance.

Several committees have been set up at the Hypo Real Estate Group level for the statutory requirements of standardisation and meaningful coordination of risk management:

- The group asset-liability committee for market and liquidity risks
- The credit committee for all credit risks and
- The operational-risk committee for operational risks.

These committees, which are manned by members of management from all entities within the Hypo Real Estate Group, meet on a regular basis, define conditions for the risk policy in the Hypo Real Estate Group, allocate risk limits, adopt methods for measuring risk and make recommendations with regard to risk positioning.

The fact that members of the Management Board of the holding company serve on the boards of Hypo Real Estate Bank International and our fellow subsidiary banks, also contributes towards ensuring a uniform risk policy in the Hypo Real Estate Group.
For example, in excess of a defined size, all planned credit exposures of the Hypo Real Estate Group are submitted to the relevant loan committees for an initial review; one of the aims of this arrangement is to limit concentrations of risk in the Group. The loan committees are supported by the newly established group credit risk management team at Hypo Real Estate Holding AG.

Operational risk management is the responsibility of the individual units within the Group. It was also improved in 2004 as a result of the introduction of improved methods of risk measurement in order to comply with the future requirements of Basel II.

The Group distinguishes between credit risk, market risk, liquidity risk, operational risk, strategic risk and other risks.

The procedures, responsibilities and reporting lines for handling these risks are defined in the risk manual of Hypo Real Estate Holding AG and also in our own risk manual, and are binding for every employee. The measurements of the individual risk types are aggregated at the Hypo Real Estate Group level as well as at the Hypo Real Estate Bank International level, as part of an annual risk capacity analysis and are compared with defined risk cover funds on a conservative basis using a "going-concern" approach. As it additionally takes account of risks for planned transactions as well as risks from stress scenarios, the risk capacity analysis is of key importance for the overall bank management of the Group. The analyses have shown that, with surplus cover of approximately 40%, the Group has more than adequate risk cover assets, in order to back its overall risk position. Quantitative risk recording has been complemented by the annual risk inventory, which focused to a greater extent on strategic and operational risks.

Credit risks

Credit risks can be broken down into loan default risk, counterparty risk, issuer risk and country risk, and define the potential loss of value which may occur as a result of the default or rating downgradings of customers in lending business, issuers of promissory notes and debt securities as well as counterparties in money market, securities and derivative transactions.

In the real estate financing business, the credit risk comprises not only the pure rating risk but also the collateral risk. The latter is attributable to potential losses of value of collateral due to factors related to the financed properties and/or the market environment.

The credit risk attributable to real estate financing transactions is the main risk type for the Group. In order to ensure that this risk is managed in a professional manner, lending policy throughout the entire Group is based on the following core principles:

- Thorough and careful credit analyses of each individual transaction
- Determining the extent to which forecast cash flows are able to cover capital servicing (specifically under extreme market conditions such as sharply rising interest rates) as well as the current and sustainable value of collateral
- Use of rating methods for determining the default probability of the borrower and use of early warning systems
- Use of Loss-Given-Default (LGD) measurement procedures for estimating future proceeds of any foreclosures which may become necessary if borrowers default
- Ongoing active observation of the real estate market and adjustment of the lending policy where necessary
- Avoiding concentration risks and enforcing systematic diversification of the loan portfolio by way of active credit portfolio management
- Ensuring that the loans can be resold or syndicated.

The quality of the valuation methods which are used is constantly monitored by risk controlling; they meet Basel II requirements throughout the Group. In addition, credit risk management regularly monitors the information provided when loans are extended. The Group uses best-practice approaches to organisational structure and functional segregation of credit processes right through from the Front Office through Middle and Back Office to Board level. In addition to traditional lending business, the Group is also actively involved in purchasing, structuring and onward placing of mortgage backed securities as a method for optimisation of return and risk. Even in the field of public sector financing business, which is no longer part of the target business of the Group, we use internal rating procedures which comply with the Basel II requirements for assessing ratings.

Counterparty risks are defined as possible losses of value affecting interest rate and foreign currency derivatives and forward transactions. Most of these transactions are carried out as hedge positions as part of asset-liability management. A value-at-risk approach based on a marked-to-market method is used for measuring the counterparty risk throughout the Group.

Counterparty risks with derivative, security and money market transactions exist with financial institutions, central banks and supranational institutions whose credit standing is above-average on the basis of the assessment of external rating agencies and also on the basis of internally used rating procedures. The term country risk is used to describe the risk of possible transfer and conversion problems encountered with contract partners domiciled abroad. The location of the property collateral provided is also very important in this respect. Credit risk management is responsible for constantly monitoring and controlling the country limits.

Credit portfolio management is particularly important within the framework of credit risk management.

The aim is to reduce the extent and volatility of credit risk costs in line with the overall business strategy of the Group and the Group's ability to bear risk by way of suitable portfolio measures, and to achieve greater diversification in the Group measured against risk and earnings parameters. The process of achieving this aim is supported by the following instruments, some of which are in the process of being set up:

- Continuous portfolio and real estate market analysis
- Systematically increasing or decreasing sub-portfolios in line with the risk strategy by way of taking on appropriate new business or adjustments of conditions with risk-adequate margins
- Risk transfer by way of partial portfolio sales, securitisation measures and syndications
- Use of a credit portfolio model for establishing the probabilities of potentially unexpected losses and
- Limiting sub-portfolios in relation to types of property types, regions, customer groups, rating classes or maturities.

The credit portfolio committee regularly defines a target portfolio structure in order to achieve further gradual improvement of diversification in the context of changing real estate markets. The success in meeting this target portfolio structure is monitored regularly.

There were no additions to the specific loan loss provisions, and adequate provisions for future losses were set aside for the credit portfolio of the Group by recognising portfolio-based allowances in accordance with the incurred loss principle under IAS.

Derivative Transactions

In order to minimise both the economic and the regulatory credit risk arising from these instruments master agreements (bilateral netting agreements) have been concluded. By means of such netting agreements, the positive and negative fair values of the derivatives contracts included under a master agreement can be offset against one another and the future regulatory risk add-ons for these products can be reduced. Through this netting process, the credit risk is limited to a single net claim on the party to the contract (close-out netting).

For both regulatory reports and the internal measurement and monitoring of the credit commitments, such risk-reducing techniques are used only if they are considered to be enforceable under the relevant legal system, should the business associate become insolvent. In order to check enforceability, legal opinions are obtained.

Similar to the master agreements, the Group concludes collateral agreements with its business associates to secure the net claim or liability remaining after netting (receiving or furnishing of security). As a rule, this collateral management reduces credit risk by means of prompt measurement and adjustment of the exposure to customers.

Market risks

Market risk is defined as the potential loss which may be incurred as a result of changes in prices on the financial markets. All lending business, all own issues, all securities held as investments and liquidity instruments as well as all derivative transactions are taken into consideration for this purpose. This is also applicable for the positions held in the trading book. Scheduling assumptions for equity funds, allowances for potential losses and the effects of non-scheduled redemptions are also taken into consideration. The resultant market risks are mainly interest rate risks. Currency risks are, to a large extent, hedged at all banks in the Group, and are accordingly present only to a limited extent. Equity, commodity and other price risks are only permitted to a strictly limited extent via alternative investments as part of the investment of own funds.

The Group uses a uniform value-at-risk approach for daily quantification of the market risk. This approach determines a potential loss on the assumption that a position is held for ten days and also on the assumption of a confidence level of 99%. The value-at-risk is established daily by the risk control function; it is aggregated by Hypo Real Estate Holding to form a total market risk at the Hypo Real Estate Group level, and is then reported to management.

With this system, the Group is able, at all times, to control the consequences of major market fluctuations, e.g. significant increases in interest rates, in a timely and profitable manner.

Market risk management is handled by a committee on the basis of the market risk position established daily by risk control; this committee meets regularly and intensively considers the future development of the financial markets and market parameters. In addition, the Group asset-liability committee uses the market analyses as the basis for making a trend statement for further positionings within the Group.

In 2004, a trading book was implemented in the Group following approval by regulatory authorities. This means that the Group is now also in a position to benefit to a greater extent from short-term market fluctuations. Resultant market risks are also subject to

the strict risk management process detailed above, including daily risk measurement, setting of limits and reporting to management.

Liquidity risks

The foremost goal of the process of managing liquidity risks is to ensure that the Group is solvent at all times.

For this purpose, probable payment inflows and outflows and possible liquidity-procuring measures, the so-called liquidity position, must be at least balanced at all times during the following five days. This position is determined daily, with due consideration being given to precautionary discounts, ("haircuts"); it is monitored by the independent risk control function and reported to the Board.

A liquidity preview covering 90 days is prepared in order to identify any additional short-term refinancing needs, at an early stage. This preview is used as the basis of active liquidity management. For controlling structural long-term liquidity, the Group uses a capital schedule which is also broken down on the basis of individual product groups and thus also permits fine tuning on the basis of market segments.

An annual funding plan is then prepared, with due consideration for planned new business; this funding plan is adopted and implementation thereof is monitored. When this plan was introduced, the Group closely followed the Basel recommendations for liquidity management. For short-term funding, the Group has adequate access to the money market. In addition, the Group has extensive liquidity reserves which can be used as part of the monetary operations of the European Central Bank system, or which can be provided in the repo market. In Ireland, the Irish Financial Services Regulatory Authority ensures that the banks are solvent at all times by way of regulations specifying that one quarter of equity has to be invested in very liquid funds.

For medium- and long-term refinancing, the main refinancing instruments of the Group are unsecured capital market issues as well as jumbo bonds with their special credit ratings and liquidity.

The medium-term note programme has ensured that the Group is able to respond to the market even more quickly and in a more flexible manner.

In order to quantify the liquidity risks, the potential impact of any downgrading of the rating on the refinancing costs of the Group is determined. As a result of the improved outlook confirmed in 2004 by the rating agencies, the risk of higher refinancing costs for the Group has declined further.

Operational risks

Operational risks are defined as risks attributable to unexpected losses caused by defective internal processes, human errors, technology failure or external events. The definition used by the Group is consistent with the Basel II formula.

The risk control function is responsible for identifying and handling bank and sector-specific operational risks. An operational risk committee meets regularly at Hypo Real Estate Holding level in order to ensure uniform recognition and management of these risks throughout the Hypo Real Estate Group; this committee defines further standards and guidelines, and coordinates activities between the banks.

A group-wide database for identifying losses of operational risks was developed and introduced in 2004 (and also for implementing the Basel II requirements). In 2005, specific key indicators for the whole of the Group will be developed as the basis of an early warning system for potential operational risks.

In addition to these indicators which can be evaluated quantitatively, a quality-oriented risk self-assessment will be designed; this can also be used for identifying measures which limit and avoid risk.

No significant operational risks occurred during the year under review, such as IT failures or major losses due to process errors. Wherever necessary, changes in legislation and legal rulings will be implemented promptly.

Strategic risks

Strategic risks are defined as the risk that fundamental decisions of business policy might endanger the long-term success of the Group. The strategic direction of the Group is regularly reviewed at Board level on the basis of extensive market observations. This enables risks to be limited and countermeasures to be taken at an early stage in the event of problems. The Group uses regular performance against budget comparisons to monitor the success of operational implementation of the business strategy.

Summary

Credit risks are the predominant form of risk in the Group. In addition, one of the overriding aims is still to ensure that the Group will always be able to obtain adequate liquidity and refinancing funds at acceptable prices. This means that liquidity and market risks are very important. As far as the operational risks are concerned, the focus is on supporting the growth planned by the Group with appropriate know how, systems and processes.

The Group already uses a modern risk management system with which the risks which are taken on can be efficiently managed even if overall market conditions deteriorate. The risk management system for comprehensive, prompt and active identification, measurement, monitoring and steering of all major risks is based on best-practice approaches and market standards. The Group aims to adopt the advanced approach based on internal rating procedures within the framework of the new Basel II agreement. The necessary preparatory work is already far advanced and is on schedule. The Group is confident that these efforts in particular will enable it to further improve its competitiveness, and generate sustainable value for its shareholders.

Non Statutory Consolidated Financial Statements

Consolidated Income Statement

for the period from January 1, 2004 to December 31, 2004

in € millions	*Notes*	**2004**	**2003**
Interest income	*27*	1,339	826
Interest expense	*27*	(1,115)	(749)
Net interest income		**224**	**77**
Provisions for losses on loans and advances	*28*	(33)	(37)
Net interest income after provisions for losses on loans and advances		**191**	**40**
Fees and commission income		145	60
Fees and commission expense		(19)	(5)
Net fees and commission income	*29*	**126**	**55**
Net trading income	*30*	**11**	**0**
General administrative expenses	*31*	(136)	(44)
Other operating income and expenses	*32*	1	1
Operating result		**193**	**52**
Net income from investments	*34*	3	(5)
Other income and expenses	*35*	(1)	0
Profit before taxes		**195**	**47**
Income tax expense	*36*	(46)	(15)
Profit after tax		**149**	**32**

On behalf of the Board

| G. Funke | **Director**

| J. Bourke | **Director**

| J. Donnelly | **Director**

| W. Ramm | **Secretary**

8th April 2005

Consolidated Balance Sheet
as at December 31, 2004

ASSETS
in € millions

	Notes	2004	2003
Cash and balances with Central Banks	37	44	42
Assets held for trading purposes	38	1,513	0
Placements with, loans and advances to other banks	39	1,608	1,683
Loans and advances to customers	40	11,214	7,237
Allowances for losses on loans and advances	42	(72)	(37)
Investments	44	8,666	6,699
Intangible assets	45	13	1
Property, plant and equipment	46	8	6
Other assets	47	787	242
Tax assets	48	212	44
Total assets		**23,993**	**15,917**

EQUITY AND LIABILITIES
in € millions

	Notes	2004	2003
Deposits from other banks	49	9,457	7,709
Amounts owed to other depositors	50	281	242
Promissory notes and other liabilities evidenced by securities	51	9,422	4,978
Liabilities held for trading purposes	52	927	0
Provisions	53	2	1
Other liabilities	54	1,335	740
Tax liabilities	55	230	56
Subordinated capital	56	752	840
Liabilities		**22,406**	**14,566**
Shareholders equity			
Subscribed capital	57	1,410	1,260
Retained earnings		42	53
Changes in valuation of financial instruments		(14)	6
Consolidated net income		149	32
Equity		**1,587**	**1,351**
Total Equity and Liabilities		**23,993**	**15,917**

On behalf of the Board

| G. Funke | **Director**

| J. Bourke | **Director**

| J. Donnelly | **Director**

| W. Ramm | **Secretary**

8th April 2005

Consolidated Statement of Changes in Shareholder's Equity

in € millions

	Subscribed capital	Retained earnings	Change in valuation of financial instruments		Consolidated net income	Share-holder's equity
			AfS reserve	Cash flow hedge reserve		
Shareholders' equity at 1.1.2003	**511**	**32**	**29**	**(9)**	**0**	**563**
Issue of Share Capital	749	0	0	0	0	**749**
Change in value of financial instruments not affecting income	0	26	(23)	9	0	**12**
Net Income	0	0	0	0	32	**32**
Reserves arising from currency and other changes	0	(5)	0	0	0	**(5)**
Shareholders' equity at 31.12.2003/ 1.1.2004	**1,260**	**53**	**6**	**0**	**32**	**1,351**
Correction to Prior year reserves	0	(39)	(21)	0	0	**(60)**
Adjusted Shareholders' equity	**1,260**	**14**	**(15)**	**0**	**32**	**1,291**
Issue of Share Capital	150	0	0	0	0	**150**
Change in value of financial instruments not affecting income	0	0	1	0	0	**1**
Net Income	0	0	0	0	149	**149**
Reserves arising from currency and other changes	0	28	0	0	(32)	**(4)**
Shareholders' equity at 31.12.2004	**1,410**	**42**	**(14)**	**0**	**149**	**1,587**

Consolidated Cash Flow Statement

in € millions

	2004	2003
Net income	149	32
Write-downs, provisions for losses on, and write-ups of, loans and advances	35	37
Write-downs and depreciation less write-ups of long term assets	4	4
Result from the sale of investments, property, plant and equipment	0	0
Other adjustments	(9)	78
Subtotal	**179**	**151**
Change in assets and liabilities from operating activities after correction for non-cash components:		
Increase in assets/decrease in liabilities (-)		
Decrease in assets/increase in liabilities (+)		
Placements with, and loans and advances to other banks	75	(1,683)
Assets held for trading purposes	(1,513)	0
Loans and advances to customers	(3,977)	(7,237)
Other assets from operating activities	(545)	(242)
Deposits from other banks	1,748	7,709
Amounts owed to other depositors	39	242
Promissory notes and other liabilities evidenced by securities	4,444	4,978
Other liabilities from operating activities	596	741
Taxes on income paid	(31)	(15)
Cash flow from operating activities	**1,015**	**4,644**
Proceeds from the sale of property, plant and equipment	1	0
Payments for the acquisition of property, plant and equipment & intangibles	(19)	(11)
Purchases of securities	(1,984)	(6,693)
Proceeds from the sale of investments	0	0
Cash flow from investing activities	**(2,002)**	**(6,704)**
Proceeds from capital increases	150	1,260
Subordinated capital, net	(88)	840
Other financing activities, net	927	0
Cash flow from financing activities	**989**	**2,100**
Cash and cash equivalents at the end of the previous period	42	2
+/- Net cash provided/ used by operating activities	1,015	4,644
+/- Net cash provided/ used by investing activities	(2,002)	(6,704)
+/- Net cash provided/ used by financing activities	989	2,100
+/- Effects of exchange rate changes on cash and cash equivalents	0	0
Cash and cash equivalents at the end of the period	**44**	**42**

Notes to the Non Statutory Consolidated Financial Statements

Notes to the Non Statutory Consolidated Financial Statements

1. General information

Hypo Real Estate Bank International is a member of the Hypo Real Estate Group, an international provider of commercial real estate finance.

The holding company of Hypo Real Estate Bank International is Hypo Real Estate Holding Aktiengesellschaft, which is incorporated in Germany and whose registered office is as follows:

Hypo Real Estate Holding Aktiengesellschaft
Unsöldstraße 2
80538 München

The shares of Hypo Real Estate Holding AG are traded on the stock exchange in Frankfurt am Main (Prime Standard) and Vienna (Standard Market Continuous).

ACCOUNTING AND VALUATION
2. Principles

These financial statements are not the statutory financial statements of the company which company law requires to be prepared, and laid before the members at an Annual General Meeting. These non statutory financial statements have been prepared separately as consolidated financial statements and present information about the group comprising of this company and its subsidiaries and associated undertakings.

These consolidated financial statements have been prepared by the Hypo Real Estate Bank International Group in accordance with International Financial Reporting Standards (IFRS). They are presented in Euro (€) and in round millions.

IFRS are standards and interpretations adopted by the International Accounting Standards Board (IASB). They comprise the International Financial Reporting Standards (IFRS), the International Accounting Standards (IAS) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Early adoption of International Financial Reporting Standards (IFRS)

In the consolidated financial statements as of 31 December 2004 the Hypo Real Estate Bank International Group had adopted the following IFRS:

- IAS 1 (revised 2003)
  Presentation of Financial Statements
- IAS 8 (revised 2003)
  Accounting Policies, Changes in Accounting Estimates and Errors
- IAS 10 (revised 2003)
  Events after the Balance Sheet Date
- IAS 16 (revised 2003)
  Property, Plant and Equipment
- IAS 17 (revised 2003)
  Leases
- IAS 21 (revised 2003)
  The Effects of Changes in Foreign Exchange Rates
- IAS 24 (revised 2003)
  Related Party Disclosures
- IAS 27 (revised 2003)
  Consolidated and Separate Financial Statements
- IAS 28 (revised 2003)
  Investments in Associates
- IAS 32 (revised 2003)
  Financial Instruments: Disclosure and Presentation
- IAS 33 (revised 2003)
  Earnings per share
- IAS 36 (revised 2004)
  Impairment of Assets
- IAS 38 (revised 2004)
  Intangible Assets
- IAS 39 (revised 2003)
  Financial Instruments: Recognition and Measurement
- IFRS 3 (issued 2004)
  Business Combinations

The early adoption of the IAS (revised 2003) resulted in the following material changes to accounting policies, and disclosures:

IAS 1 (revised 2003) Notes have been extended to include key assumptions relating to future conditions and other uses of estimates in relation to sources of uncertainty at the reference date, that have a significant risk of causing a material adjustment to

the carrying amounts of assets and liabilities within the next financial year (see note 20).

- IAS 8 (revised 2003) Changes in accounting policies and material prior-period errors are adjusted retrospectively, and not through the Income statement for the current year. In 2004 such adjustments amounted to a reduction of €39 million in Retained Earnings and a reduction of €21 million in Revaluation reserves, as at 1st January 2004 (see below).

As part of the procedure for reviewing the accounting and valuation methods used within the Group's business model (which is regularly updated), the Group guidelines applicable to recognising income for commissions received in the course of the lending business were changed in 2004. The new group guideline results in delayed recognition of the commission fees and is considered by the Directors to be more appropriate for the Group.

The implementation of a new trading system at Hypo Pfandbrief Bank International, has improved the measurement approach which has been applied. The new measurement approach results in better information concerning the assets, financial and earnings situation.

The early adoption of IAS 10, 16, 17, 21, 24, 27, 28 and 33 (all revised 2003) has not had a material impact on the Group.

- IAS 39 (revised 2003) in conjunction with IAS 32 (revised 2003) According to the revised standard, financial instruments (see note 5) have been amended to include a category for financial assets or liabilities designated at fair value through profit or loss.

Originated loans and receivables are included with the category of "Loans and Receivables". This category can now be used for all non-derivative assets with fixed or determinable payments, which are not listed on an active market.

Loans, with no objective evidence of individual loan impairment, are pooled into risk-inherent portfolios in accordance with IAS 39.64 (revised 2003). Portfolio-based allowances are set aside to cover this risk (see note 10).

Due to the 2003 spin-off, and the resulting impracticality of amending the comparative amounts, all above changes in accounting policies were recognised by correction of the retained earnings shown in the opening balance sheet as at 1 January 2004.

3. Uniform consolidated accounting

The individual financial statements of the domestic and foreign entities are incorporated into the consolidated financial statements of Hypo Real Estate Bank International using uniform accounting and valuation principles.

4. Consolidation

The Hypo Real Estate Bank International Group ("the Group") comprises Hypo Real Estate Bank International puc and the following companies:

- HI Asset Management Inc., New York
- HI Capital Markets Inc., New York
- Hypo Pfandbrief Bank International S.A., Luxembourg
- Hypo Real Estate Capital Corp., New York (sub-group with a total of 6 companies)
- Hypo Real Estate Capital France S.A., Paris (sub-group with a total of 2 companies)
- Hypo Real Estate Capital Iberia S.L., Madrid
- Hypo Real Estate Capital Italia S.p.A., Milan
- Hypo Real Estate Capital Japan Corp., Tokyo
- Hypo Real Estate Capital Ltd., London (sub-group with a total of 8 companies)

All these companies are fully consolidated, and all have prepared their financial statements for the period ending 31 December 2004.

Only one wholly owned subsidiary, Hypo Dublin Properties Limited, has been excluded from the consolidated financial statements. This is due to its extremely minor significance to the Group. (The 2003 accounts showed: Total assets of €216 thousand, Equity of €(170) thousand, and a Net Loss of €170 thousand.)

Pfandbrief Bank International S.A., Luxembourg, was renamed Hypo Pfandbrief Bank International S.A. on 1 September 2004.

The following companies were incorporated during the year and are fully consolidated in 2004:

- HI Asset Management Inc., New York
- HI Capital Markets Inc., New York
- Hypo Real Estate Capital Japan Corp., Tokyo

During 2004 the Group sponsored a US registered Special Purpose Entity (SPE) named 'Pallas Capital Corporation'. The common shares of Pallas are owned by a third party, which is not affiliated with the Group. The owners of the common shares have the right to unilaterally dissolve Pallas, the power to change the bylaws or to veto a proposed change of the charter or bylaws.

Pallas was formed for the purpose of issuing guaranteed investment contracts (GIC) to municipalities and to hold certain investments in accordance with the Corporation's credit and investment policy.

In the context of the requirements of IAS 27 and SIC 12 the Board has decided that it would be more appropriate to exclude the entity from consolidation for 2004, but will review the status of Pallas regularly. A summary of the effects on the Group results if Pallas were to be consolidated, is shown below:-

Effects of Consolidation at 31st December 2004

	+/-	in € millions
Investments	+	171
Amounts owed to other depositors	+	171
Consolidated Net Income	-	0.5

For the purposes of consolidation, the costs of purchasing an affiliated company are netted with the group's stake in the shareholders' equity as at the date of the acquisition. This shareholders' equity is calculated as the difference between the assets and liabilities of the acquired company, using their fair values. The excess of acquisition cost over the recalculated shareholders' equity is stated as goodwill in the balance sheet under intangible assets. After initial recognition, goodwill is carried at cost less any accumulated impairment losses.

Business transactions between consolidated companies are eliminated. Unrealised profits attributable to inter-company transactions are eliminated.

5. Financial instruments

According to IAS, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. According to IAS all financial instruments have to be classified according to this standard, to be recognised in the balance sheet and to be measured according to its classification.

Held-for-trading: A financial asset or financial liability is classified as held-for-trading if it is:

i) acquired or incurred principally for the purpose of selling or repurchasing it in the near term;

ii) part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or

iii) a derivative (except for a derivative that is a designated and effective hedging instrument).

These instruments are measured at fair value. (See note 63). Any changes in fair value are recognised in the Income statement.

Designated at fair value through profit or loss (dFVTPL):

Upon initial recognition any financial asset or financial liability within the scope of IAS39 may be designated, when initially recognised, as a financial asset or financial liability at fair value through profit or loss, except for investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured.

As part of the EU endorsement procedure, the designation of financial liabilities is initially precluded; this has been recognised in the Group accounting policies.

dFVTPL financial instruments are measured at fair value. Changes in fair value are recognised in the Income statement.

Held-to-Maturity (HtM)

Held-to-Maturity investments are non-derivative financial assets with fixed or determinable payments and a fixed maturity, that an entity has the positive intention, and ability, to hold to maturity.

HtM financial investments are shown at amortised cost and disclosed as part of the following balance sheet positions; 'Investments', 'Placements with, loans and advances to, other banks' and 'Loans and advances to customers'.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Loans and receivables are disclosed as part of the following balance sheet positions; 'Placements with, loans and advances to, other banks' and 'Loans and advances to customers' and are shown at amortised cost.

Available-for-Sale (AfS)

Available-for-Sale financial assets are those non-derivative financial assets that are designated as available for sale.

AfS financial assets are shown at fair value. Changes in fair value are recognised in a separate equity reserve (AfS reserve) and are not recognised in the Income statement until the asset is sold, withdrawn or otherwise disposed of, or if an impairment is established for the financial asset in accordance with IAS 39.58 so that the cumulative profit or loss previously recorded under equity is now taken to the income statement. If the fair value of an AfS debt instrument increases in a subsequent reporting period, an original impairment has to be reversed to the income statement. On the other hand, impairments for an AfS equity instrument which have been recognised in the income statement are not permitted to be reversed and taken to the income statement.

AfS financial assets are usually disclosed as part of the following balance sheet positions; 'Investments', 'Placements with, loans and advances to, other banks' and 'Loans and advances to customers'.

In principle, the purchase or sale of financial instruments is recognised at the trade date. Premiums and discounts on such assets are part of the amortised costs and appear in net interest income over the relevant period. (See also note 63)

Impairments in value under IAS 39.63 are taken into consideration. Where subsequent measurement of financial assets is based on fair value, impairment is implicit in the fair value.

Hedge accounting

Hedging relationships between financial instruments have been classified as either fair-value hedges or cash flow hedges in accordance with IAS 39. (See also note 63) Derivatives are initially stated at cost and subsequently measured at fair value.

Fair-value hedge

This is a hedge of the exposure to changes in the fair-value of a recognised asset or liability or an un-recognised, firm commitment, (or an identified portion of such an asset, liability or commitment) which is attributable to a specific risk, and could have an effect on the reported net profit or loss for the period.

If such a hedge satisfies the criteria of IAS 39.88, throughout the accounting period, the hedge is disclosed in the balance sheet as follows:

a the profit or loss arising when the hedging instrument is revalued to its fair value (for a derivative hedging instrument) or the currency component of its book value re-calculated in accordance with IAS 21 (for non-derivative hedging instruments), is recognised in the Income statement for the period; and

b the book value of the underlying transaction is adjusted by the profit or loss arising from the underlying transaction and attributable to the hedged risks, and is recognised in the Income statement for the period. This is applicable if the underlying transaction would otherwise be stated at purchase cost. The profit or loss attributable to the hedged risk is recognised in the net profit / loss for the period if the underlying transaction is an available-for-sale (AfS) financial asset.

Cash flow hedge

According to IAS 39, a cash flow hedge hedges the risk inherent with fluctuating payment streams which is attributable to a certain risk associated with the stated asset or the stated liability (for instance some or all future interest payments of a variable-interest debt) or the risk associated with a future transaction which is expected to occur with a high degree of probability and which could have an effect on profit or loss for the period.

Cash flow hedge accounting recognises derivatives which are used for hedging the interest rate risk as part of asset / liability management. For instance, future variable interest payments for variable-interest receivables and liabilities are swapped for fixed payments primarily by means of interest rate swaps. Under cash flow hedge accounting, hedging instruments are stated at their fair value. The valuation result has to be broken down into an effective and an ineffective part. The portion of the gain or loss relating to the effective part of the hedging instrument is recognised in a separate item of equity without any impact on earnings (cash flow hedge reserve). Depending on the classification of the hedged financial instrument, the ineffective part of the hedging instrument is recognised either in the income statement or in equity.

A hedging relationship is deemed to be effective if, among other requirements, at the beginning and throughout the entire duration of the transactions, changes in the payment streams of the underlying transactions are balanced out almost completely by changes in the payment streams of the hedging transactions. For the purpose of establishing whether a specific part of the hedging instrument is effective, the future variable interest payments from the receivables and liabilities to be hedged are compared on every reference date for the financial statements, with the variable interest payments from the interest derivatives, in detailed maturity bands.

In those periods in which the payment streams of the hedged underlying transactions have an impact on the net profit / loss for the period, the cash flow hedge reserve is recognised in the Income Statement in the same period during which the hedged forecast transaction affects the Income Statement.

For the purpose of calculating return on equity, the AfS reserve and the cash flow hedge reserve are not taken into consideration.

6. Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

7. Sale and repurchase agreements and lending of securities

Securities sold subject to linked repurchase agreements ('repos') are retained in the financial statements as dFVTPL or AfS securities and the counterparty liability representing amounts received is included in amounts due to other banks, deposits from banks, other deposits, or deposits due to customers, as appropriate. Securities purchased under agreements to resell ('reverse repos') are not recognised. The amounts paid are recorded as loans and advances to other banks or customers as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective yield method. Securities lent to counterparties are also retained in the financial statements.

Securities borrowed are not recognised in the financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss included in trading income. The obligation to return them is recorded at fair value as a trading liability.

8. Assets held for trading purposes

Assets held for trading purposes comprise held-for-trading securities as well as positive market values of trading derivatives and derivatives for hedging foreign exchange risks attributable to financial instruments which are not AfS securities.

Borrower's note loans and registered bonds as well as public sector bonds, to the extent that they are used for trading purposes, are disclosed as 'Other trading assets'.

Trading assets are stated at their fair value. In the case of derivative financial transactions which are not listed on a stock exchange, internal price models based on cash value considerations and option price models are used as the basis of calculating the balance sheet value. Valuation and realised profits and losses attributable to trading assets are stated under 'Net Trading Income' in the Income statement.

9. Placements, loans and advances

Placements with, and loans and advances to, other banks and loans and advances to customers are recognised under IAS 39 at their amortised cost of

purchase unless they are dFVTPL receivables, AfS receivables or an underlying transaction of a fair-value hedge.

10. Allowances for losses on loans and advances

The provision for incurred losses inherent in the lending portfolio has been calculated by reference to estimates of losses which have been incurred. These are generated by the structure and quality of the loan portfolio as well as macro-economic factors.

For all recognisable lending counterparty risks, individual allowances or provisions equivalent to the level extent of incurred losses from future defaults are set aside and are written back when the default risk is no longer applicable, or are utilised when the receivable has been classified as irrecoverable, and eliminated.

Under IAS 39.64, loans for which there is no objective indication of the need for an allowance or provision, are grouped together to form risk-inherent portfolios. Portfolio-based allowances are set aside for these portfolios; which are based on historical default rates and losses given such defaults. Allowance is made for any information regarding specific events or significant changes to the market, the technological, legal or economic environment.

11. Investments

In addition to dFVTPL, HtM and AfS financial instruments noted above, direct investments in property are stated as Investments.

dFVTPL financial assets are stated at their fair value. Changes in the fair value are taken to the income statement. (See also note 63)

HtM financial assets are stated at the amortised cost of purchase. Discounts and premiums are recognised on a pro-rata basis. Write-downs are taken to the income statement if the value of such assets is affected by changes in the underlying credit risk position. If the reasons for such write-downs are no longer applicable, an appropriate amount is written back to the income statement (to a maximum of the amortised costs of purchase).

AfS financial assets which are hedged effectively against market price risks are recognised within the framework of fair-value hedge accounting.

Under IAS 40, land and buildings which are held as investments to generate rental income and / or capital gains, are stated at their fair value as determined by a Directors valuation. Although there has been no valuation by an independent valuer, the determination of fair value was supported by market evidence. Changes in this fair value are reflected in the Income Statement.

12. Intangible assets

In addition to Goodwill mentioned in note 4, this category includes software, and this is stated at the amortised cost of purchase, and is written down over an expected useful life of three to five years.

13. Property, plant and equipment

Property, plant and equipment is stated at cost less (in the case of assets subject to wear and tear) scheduled straight-line depreciation. The charge for depreciation is calculated to write down the cost of tangible fixed assets to their estimated residual values by equal annual instalments over their expected useful lives which are as follows:

Computer equipment	**Between 2 and 5 years**
Leasehold improvements	**Term of each lease**
Motor vehicles	**5 years**
Office equipment	**Between 3 and 10 years**

The useful life of an asset is determined by taking into account the physical life, technical obsolescence and other factors. Fixed assets are regularly reviewed for impairment.

Subsequent costs of development or acquisition are capitalised where they add economic benefit. Maintenance costs for property, plant and equipment are recognised in the income statement in the period in which they arise.

If the value of property, plant and equipment has been reduced beyond the depreciated amount, non-scheduled depreciation is charged to the income statement. If the reasons for the non-scheduled

depreciation cease to apply, an amount will be written back to the income statement, not exceeding the limit of the scheduled depreciated cost.

14. Liabilities

Liabilities other than underlying transactions of an effective fair-value hedge are stated at amortised cost. Discounts and premiums are recognised on a pro-rata basis. Interest-free liabilities are stated at their cash value, where they are repayable on demand.

15. Liabilities held for trading purposes

This item comprises trading derivatives and derivatives used for hedging foreign currency risks attributable to financial instruments other than dFVTPL or AfS holdings. In addition, this item also includes warrants and certificates issued for trading purposes.

Within liabilities held for trading purposes, short positions in registered bonds as well as public sector bonds, to the extent that they are used for trading purposes, are stated under other liabilities held for trading purposes. Trading liabilities are stated at their fair value. In the case of derivative financial transactions which are not listed on a stock exchange, internal price models based on cash value considerations and option price models are used as the basis of calculating the balance sheet value. Valuation and realised profits and losses attributable to trading liabilities are stated under 'Net Trading Income' in the Income statement.

16. Provisions

Under IAS, the best possible estimate is used for establishing provisions for uncertain liabilities and losses attributable to current transactions. Long-term provisions are discounted to present values.

The company operates a defined benefit pension scheme in respect of the employees in the German branch (there are two active members). The defined benefit scheme is not funded. However, the defined benefits payable by the company for the benefit of the employees, is carried as a liability, on the balance sheet of the German branch and increases in the liability are charged to the Income Statement. Certain obligations in respect of the scheme amounting to €153,000 were assumed by the company in accordance with the "Group Transfer Guideline" of HVB AG in respect of each employee. This was as a result of the set up of the German branch on 25th September 2003.

Provisions for pensions and similar obligations are calculated on the basis of actuarial reports in accordance with IAS 19. They are calculated using the "projected unit credit" method, and this method takes account of the cash value of the earned pension entitlements as well as the actuarial profits and losses which have not yet been redeemed. These are attributable to various factors, including irregularities in the risk curve (for instance a higher or lower number of invalidity or mortality cases than expected on the basis of the calculation principles used) or changes in the calculation parameters.

17. Other liabilities

Accrued liabilities in accordance with IAS 37, are included as other liabilities. These include expenditure, which is uncertain in terms of actual extent or timing, but which is less uncertain than is the case with provisions. Generally, these are liabilities for products or services which have been received or supplied and which have not been paid for, or invoiced by the supplier or formally agreed. This also includes short-term liabilities due to employees, for instance flexi-time credits and holiday entitlements.

18. Currency translation

Currency translation is carried out in accordance with the requirements of IAS 21. On the balance sheet date, monetary items in a foreign currency are translated into Euro using the rate applicable on that day. Non-monetary items which were stated in a foreign currency using historical costs of purchase were translated at the exchange rate applicable at the date of purchase. Gains and losses on currency translation are recognised in the income statement of each Group Company. In the consolidated financial statements, the financial statements of subsidiaries denominated in currencies other than Euro are translated at period end market rates for balance sheet items and average rates for income and expenditure, with resulting foreign exchange differences being recognised directly in equity.

19. Taxes on income

Taxes on income are stated and valued in accordance with IAS 12. Apart from the exceptions defined in the

standard, deferred taxes are set aside for all temporary differences between the figures stated under IFRS and the values used for tax purposes, and also for any differences arising from applying uniform group valuations or from consolidation. Deferred tax assets arising as a result of unused tax losses carried forward to future years are recognised where it is probable that they will be applied against future taxable profits.

Deferred tax is calculated using the national tax rates which are expected to apply at the date on which the differences are likely to reverse. Due consideration has been given to any changes in tax rates which have been announced by the accounting reference date.

20. Future-related assumptions and estimation uncertainty

In preparing the financial statements, the Group has made assumptions about, and estimations of, the future. Revisions of these assumptions and estimates during the next financial year may result in a significant risk of a material change to the stated values of assets or liabilities.

Standards which have not been adopted early

New standards which have been issued, or existing standards which have been revised and which have not yet been adopted may result in changes in the accounting treatment, valuation, and presentation of assets and liabilities when they are first applied. IAS 19 (revised 2004) was published on 16 December 2004 and has not yet been adopted by the Group. The new option allowed in the revised standard for enabling actuarial profits or losses to be recognised without any immediate impact on earnings in the year they arise, will probably not be exercised by the Group. All other changes refer primarily to disclosure requirements.

Allowances for losses on loans and advances

The loan portfolio of the Group is reviewed frequently each year, to identify any required provisions for losses on loans and advances. In order to check whether a provision should be charged to the income statement, it is necessary to assess whether there are any indications that the estimated future payment streams of a loan portfolio have diminished. In order to make such an assessment, it is necessary to make estimates which are based on historical default rates and including information relating to specific events or significant changes to the market, the technological, legal or economic environment.

The methods and assumptions concerning the assessment of the extent and timing of the payment streams are regularly checked in order to reduce any differences between estimated and actual defaults.

Fair values of financial instruments

The fair value of unlisted financial instruments is calculated using valuation models. In those cases in which valuation models are used, a check is performed regularly to assess whether the valuation models provide a comparable standard for current market prices. For practical considerations, the valuation models can only take account of quantifiable factors which also require estimates. Changes in assumptions relating to these factors might have an impact on the fair values of the financial instruments.

Investments

If financial instruments are classified as HtM investments, it is necessary to assess the intention and ability to keep these investments until maturity. If these investments are not held until maturity (with the exception of special circumstances), all similar HtM investments have to be reclassified as "Available-for-Sale". The investments accordingly have to be restated with their fair value, and not at amortised cost.

Taxes on income

The Group is subject to a wide range of national tax regulations with regard to the calculation of taxes on income. In order to assess the actual tax burden, it is necessary to make estimates and assumptions in relation to certain matters, in respect of which, further information may become known before the tax return for the year is due to be filed. In some countries, the actual tax charges attributable to the current financial year can only be established following a corresponding tax audit. These variances with regard to the estimated tax burden may have a positive or negative influence on the tax burden in future financial years.
The capitalisation of losses carried forward and other tax credits, the extent as well as the actual availability of such items, are subject to estimates. The deferred tax assets which have been recognised, are in line

with a Group planning period of three years, planned profits after this period, are deemed by IAS 12.34 to be insufficiently probable.

Securitisation and special purpose entities

Special purpose entities are established by the Group mainly for the purpose of securitising financial instruments. Whether a special purpose entity should be consolidated under SIC 12 is determined by the level of control of the company, in accordance with IAS 27. The standard provides no specific details as to whether the qualitative criteria specified in IAS 27.6 or objective criteria specified in IAS 27.12 are relevant for identifying a control relationship; this means that any assumption relating to the control relationship has an impact on the group of consolidated companies. The decision to consolidate companies in line with IAS 27 and SIC 12 was made on the accounting reference date. If the underlying assumptions change, it is possible that a review in future years will lead to a different decision.

SEGMENT REPORTING

21. Notes to segment reporting by geographical segment (primary segmenting)

The Group's business is divided into two geographic platforms, which are referred to as primary segments:

Europe

This segment pools income from Hypo Real Estate Bank International puc in Dublin and from the following locations where the Company has unincorporated operating units:

- Amsterdam
- Lisbon
- London
- Luxembourg
- Madrid
- Milan
- Munich
- Paris
- Stockholm

This segment also includes the earnings contributions of the following fully consolidated companies:

- Hypo Pfandbrief Bank International S.A., Luxembourg
- Hypo Real Estate Capital France S.A., Paris (sub-group)
  - Hypo Real Estate Transactions S.A.S., Paris
- Hypo Real Estate Capital Iberia S.L., Madrid
- Hypo Real Estate Capital Italia S.p.A., Milan
- Hypo Real Estate Capital Ltd., London (sub-group)
  - Hypo Property Investment (1992) Ltd., London
  - Hypo Property Investment Ltd., London
  - The Greater Manchester Property Enterprise Fund Ltd., London
  - Hypo Property Participation Ltd., London
  - Hypo Property Services Ltd., London
  - Hypo Real Estate Investment Banking Ltd., London
  - Zamara Investments Ltd., Gibraltar

North America & Asia:

This segment pools the earnings contributions of the following fully consolidated companies:

- HI Asset Management Inc., New York
- HI Capital Markets Inc., New York
- Hypo Real Estate Capital Corp., New York (sub-group)
  - Isar East 60th Street LLC, New York
  - Isar Gotham West 38th Street LLC, New York
  - Isar RP Member LLC, New York
  - Isar Two Columbus LLC, New York
  - Liffey 451 LLC, New York
- Hypo Real Estate Capital Japan Corp., Tokyo, together with the Hong Kong branch of Hypo Real Estate Bank International puc.

22. INCOME STATEMENT – analysed by geographical segment

in € millions

	Europe	North America & Asia	Total
Net interest income			
2004	188	36	224
2003	77	0	77
Provisions for losses on loans and advances			
2004	33	0	33
2003	37	0	37
Net interest income after provision for losses on loans and advances			
2004	**155**	**36**	**191**
2003	40	0	40
Net fees and commission income			
2004	97	29	126
2003	55	0	55
Net trading income			
2004	11	0	11
2003	0	0	0
General administrative expenses			
2004	93	43	136
2003	44	0	44
Other operating income/expenses			
2004	(10)	11	1
2003	1	0	1
Operating result			
2004	**160**	**33**	**193**
2003	52	0	52
Net income from investments			
2004	3	0	3
2003	(5)	0	(5)
Other income/expenses			
2004	(1)	0	(1)
2003	0	0	0
Profit before taxes			
2004	**162**	**33**	**195**
2003	47	0	47
Income tax expense			
2004	33	13	46
2003	15	0	15
Profit after tax			
2004	**129**	**20**	**149**
2003	32	0	32

23. KEY RATIOS – analysed by geographical segment

in %

	Europe	North America & Asia	Total
Cost-income ratio (based on operating revenues)			
2004	32.5	56.6	37.6
2003	33.1	0.0	33.1
Return on equity before tax [1)]			
2004	12.6	21.2	13.3
2003	4.6	0.0	4.6
Return on equity after tax [1)]			
2004	10.0	12.8	10.2
2003	3.1	0.0	3.1

1) Based on Group Equity used by the segment.

In respect of the ratios for 2003 shown above, these have been revised from those presented in the segmental reporting analysis included in the 2003 Annual Report of Hypo Real Estate Group, to remove the effect of the Earnings Adjustment.

24. BALANCE SHEET FIGURES – analysed by geographical segment

in € millions

	Europe	North America & Asia	Total
Placements with, loans and advances to other banks			
2004	1,075	533	1,608
2003	1,683	0	1,683
thereof:			
Real estate financing			
2004	*26*	*0*	*26*
2003	*0*	*0*	*0*
Municipal loans			
2004	*668*	*0*	*668*
2003	*560*	*0*	*560*
Loans and advances to customers			
2004	8,872	2,342	11,214
2003	5,729	1,508	7,237
thereof:			
Real estate financing			
2004	*8,217*	*2,342*	*10,559*
2003	*1,732*	*1,508*	*3,240*
Municipal loans			
2004	*621*	*0*	*621*
2003	*620*	*0*	*620*
Deposits from other banks			
2004	6,808	2,649	9,457
2003	6,201	1,508	7,709
Amounts owed to other depositors			
2004	262	19	281
2003	242	0	242
Promissory notes and other liabilities evidenced by securities			
2004	9,422	0	9,422
2003	4,978	0	4,978
thereof:			
Public-sector bonds			
2004	*4,917*	*0*	*4,917*
2003	*4,838*	*0*	*4,838*

CONTINGENT LIABILITIES AND OTHER COMMITMENTS

in € millions

	Europe	North America & Asia	Total
Contingent liabilities			
2004	5,034	27	5,061
2003	8,858	0	8,858
Other Commitments			
2004	1,417	1,108	2,525
2003	1,033	0	1,033

24. BALANCE SHEET FIGURES – analysed by geographical segment *(contd.)*

in € millions

TOTAL VOLUME OF LENDING
in € millions

		Europe	North America & Asia	Total
Placements with, loans and advances to other banks				
	2004	1,003	533	**1,536**
	2003	1,683	0	**1,683**
Loans and advances to customers				
	2004	8,872	2,342	**11,214**
	2003	5,729	1,508	**7,237**
Contingent liabilities				
	2004	5,034	27	**5,061**
	2003	8,858	0	**8,858**
Total				
	2004	**14,909**	**2,902**	**17,811**
	2003	**16,270**	**1,508**	**17,778**

25. EMPLOYEES – analysed by geographic segment

	Europe	North America & Asia	Total
As at 31 December 2004	370	134	504
As at 31 December 2003	290	54	344

26. SEGMENT REPORTING BY ACTIVITY (secondary segmenting)

Different types of business activity are referred to as secondary segments. The Group's business has been almost exclusively concentrated on Real Estate lending. During 2004 however, the Capital Markets business together with other mainly Treasury related activities, have been expanded and hence are segregated below.

OPERATING PERFORMANCE
in € millions

	Lending	Other	Total
Operating revenues			
2004	310	52	362
2003	95	38	133
Provisions for losses on loans and advances			
2004	32	1	33
2003	37	0	37
General administrative expenses			
2004	106	30	136
2003	33	11	44
Operating result			
2004	172	21	193
2003	25	27	52
Profit before taxes			
2004	153	42	195
2003	28	19	47

COST – INCOME RATIO

	Lending	Other	Total
2004	34.2%	57.7%	37.6%
2003	34.7%	28.9%	33.1%

TOTAL VOLUME OF LENDING

	Lending	Other	Total
2004	87%	13%	100%
2003	87%	13%	100%

EMPLOYEES

	Lending	Other	Total
2004	409	95	504
2003	307	37	344

NOTES TO THE INCOME STATEMENT

27. NET INTEREST INCOME

in € millions

	2004	2003
Interest income		
Lending and money-market business	953	495
Fixed-income securities	386	331
	1,339	**826**
Of Which:		
From Hypo Real Estate Holding Group Companies	5	0
Interest expense		
Interest on Deposit	873	586
Promissory notes and other liabilities evidenced by securities	240	160
Subordinated capital	2	3
	1,115	**749**
Of Which:		
To Hypo Real Estate Holding Group Companies	29	4
Net Interest Income	**224**	**77**

INTEREST MARGIN
in %

	2004	2003
based on average risk assets	1.46%	0.95%
based on average volume of business	1.27%	0.87%

28. PROVISIONS FOR LOSSES ON LOANS AND ADVANCES

in € millions

	Notes	2004	2003
Additions		**33**	**37**
Allowance for losses on loans and advances		33	37
Releases		**0**	**0**
Total	*42*	**33**	**37**

29. NET FEES AND COMMISSION INCOME

in € millions

	2004	2003
Lending operations	122	52
Other service operations	4	3
Total	**126**	**55**

30. NET TRADING INCOME

in € millions

	2004	2003
Equity Contracts	1	0
Interest rate and currency contracts	10	0
Total	**11**	**0**

31. GENERAL ADMINISTRATIVE EXPENSES

in € millions

	2004	2003
Personnel expenses		
Wages and salaries	82	25
Social security costs	6	3
Pension expenses and related employee benefits costs	3	1
	91	**29**
Other general administrative expenses	**41**	**14**
Depreciation and amortisation	**4**	**1**
on property, plant and equipment	2	1
on software and other intangible assets excluding goodwill	2	0
Total	**136**	**44**

Employee Share Participation Scheme

Whilst there are no Share Option plans for Board members or employees, the company operates an Irish Revenue approved employee share participation scheme. The costs of the scheme, are met by the company and charged to the Income Statement in the period to which they relate. Shares of Hypo Real Estate Holding AG are purchased by the Trustees of the scheme, on behalf of employees who participate out of employee profit shares and salary foregone at market price. All eligible employees of Hypo Real Estate Bank International may participate subject to signature of a contract agreeing to be bound by the terms of the scheme. The directors approve the list of employees entitled to participate.

32. OTHER OPERATING INCOME AND EXPENSES

in € millions

	2004	2003
Other operating income	12	1
Other operating expenses	(11)	0
Other operating income and expenses	**1**	**1**

Other operating income includes €3 million (2003: €nil) in respect of rental income from investment properties. There are no other individual amounts of major significance.

33. OPERATING REVENUES

in € millions

	2004	2003
Net interest income	224	77
Net fees and commission income	126	55
Trading income	11	0
Other operating income and expenses	1	1
Total	**362**	**133**

34. NET INCOME FROM INVESTMENTS

in € millions

	2004	2003
Income from Investments	4	3
Expenses From Investments	(1)	(8)
Total	**3**	**(5)**

Net income from investments relates to income from the sale of dFVTPL and AfS financial instruments and also changes in the value of such instruments that are to be recognised in profit or loss. The result from AfS investments amounted to €2.3 million and €0.5 million relates to revaluation of loans originated by the Group which have associated fair value hedges.

35. OTHER INCOME AND EXPENSES

in € millions

	2004	2003
Other income	0	0
Other expenses	(1)	0
thereof:		
Other non income related taxes	(1)	0
Other income and expenses	**(1)**	**0**

36. INCOME TAX EXPENSES

in € millions

	2004	2003
Current taxes	55	13
Deferred taxes	(9)	2
Of which:		
Deferred taxes on capitalised losses carried forward	1	0
Total	**46**	**15**

36. INCOME TAX EXPENSES *(contd.)*

The differences between the computed taxes on income and the taxes on income actually shown are outlined in the following reconciliation:

RECONCILIATION
in € millions

	2004	2003
Profit before taxes	195	47
Applicable (legal) tax rate	12.5%	12.5%
Expected (computed) tax expense	24	6
Tax effects		
arising from foreign income	24	10
arising from tax rate differences	5	0
arising from losses	(4)	0
arising from the benefit of the 10% tax rate applicable to the IFSC Certificate	(2)	0
arising from tax-free income	0	(1)
arising from non-deductible expenses	1	3
arising from valuation adjustments and the non-application of deferred taxes	0	0
arising from the write-up of deferred taxes	(2)	(4)
arising from prior years and other periodical effects	0	1
Accounted taxes on income	**46**	**15**
Group tax ratio	**23.59%**	**31.91%**

The Irish tax rate applicable for the year under review is 12.5%. Hypo Real Estate Bank International puc in Dublin, has an IFSC certificate which entitles it to avail of the 10% tax rate in Ireland until 31 December 2005. The tax benefit of this 10% tax rate is €2 million in 2004.

The effects attributable to foreign income comprise tax rate differences attributable to foreign tax authorities. They have resulted because foreign income has been taxed with different tax rates.

The effects from tax rate differences include the differences due to different trade tax rates. The trade tax burden (current and deferred) is calculated in accordance with IFRS.

The item effects from losses include the effects of netting from losses carried forward.

The effects arising from tax-free income relate to income from participating interests, dividends and capital gains and losses.

The effects attributable to tax additions and deductions relate primarily to non-allowable business expenses, which do not generate deferred taxes as they are permanent differences between the accounting treatment and the tax treatment.

The effect from the write-up of deferred taxes is primarily attributable to the statement of deferred tax claims on deferred fee income.

The item "Effects from prior years and other periodical effects" comprise both actual previous year taxes which have been incurred as a result of tax audits or a reassessment of the tax liability, as well as effects attributable to other periods and deferred taxes from previous years.

The consolidated tax ratio is the quotient of the stated taxes on income (actual and deferred taxes) and profit before taxes. In general it has been influenced by the capitalisation of losses carried forward and the related income effect from the deferred tax assets.

The deferred tax liabilities or deferred tax assets relate to the following items:

36. INCOME TAX EXPENSES *(contd.)*

DEFERRED TAX LIABILITIES/ DEFERRED TAX ASSETS
in € millions

	Notes	**2004**	**2003**
Deferred tax liabilities			
Loans and advances to other banks/customers including provisions for losses on loans and advances		18	0
Investments		98	0
Property, plant and equipment / intangible assets		1	0
Other assets/ liabilities		81	45
Recognised deferred tax liabilities	*55*	**198**	**45**
Deferred tax assets			
Investments		1	0
Property, plant and equipment / intangible assets		0	0
Provisions		0	0
Other assets/ liabilities		177	39
Placements with, loans and advances to other banks / customers including provisions for losses on loans and advances		10	5
Losses carried forward		1	0
Other		23	0
Recognised deferred tax assets	*48*	**212**	**44**

On the reference date for the financial statements, there are losses carried forward totalling € 6.9 million, which have not yet been utilised. Deferred tax assets have been recognised of €1.3 million having met the criteria of IAS 12.34 et seq . The losses carried forward can be utilised for an unlimited period of time.

Adjustments to equity reserves, regarding equity securities which are available for sale, include associated deferred tax of €7 million (2003 €(2) million).

NOTES TO THE BALANCE SHEET - ASSETS

37. CASH AND BALANCES AT CENTRAL BANK

in € millions

	2004	2003
Cash on hand and central bank balances	44	42
Total	**44**	**42**

38. ASSETS HELD FOR TRADING PURPOSES

in € millions

	2004	2003
Debt securities amd other fixed-income securities	**1,356**	**0**
Bonds and notes	**1,356**	**0**
issued by public sector borrowers	323	0
issued by other borrowers	1,033	0
Equity Securities and other variable yield securities	157	0
Total Trading Assets	**1,513**	**0**

Of which:
in € millions

	Debt securities and other fixed-income securities	Shares and other variable-yield securities	Total
Marketable securities			
Listed securities			
2004	587	0	587
2003	0	0	0

39. PLACEMENTS WITH, LOANS AND ADVANCES TO OTHER BANKS

in € millions

ANALYSIS BY BUSINESS TYPE

	2004	2003
Placements, loans and advances	**1,536**	**1,683**
Public sector loans	668	560
Real estate loans	26	0
Other placements, loans and advances	842	1,123
Investments	**72**	**0**
Total	**1,608**	**1,683**

ANALYSIS BY MATURITIES

	2004	2003
Repayable on demand	**74**	**20**
With agreed maturities	**1,534**	**1,663**
up to 3 months	809	6
from 3 months to 1 year	123	3
from 1 year to 5 years	376	167
from 5 years and over	226	1,487
Total	**1,608**	**1,683**

40. LOANS AND ADVANCES TO CUSTOMERS
in € millions

ANALYSIS BY BUSINESS TYPE

	2004	2003
Loans and advances	**11,214**	**7,237**
Public sector loans	621	620
Real estate loans	10,559	3,240
Other loans and advances	34	3,377
Total	**11,214**	**7,237**
Of Which:		
Due from Hypo Real Estate Holding Group Companies	0	119

ANALYSIS BY MATURITIES
in € millions

	2004	2003
Unspecified terms	**95**	**27**
With agreed maturities	**11,119**	**7,210**
up to 3 months	512	34
from 3 months to 1 year	552	99
from 1 year to 5 years	6,833	1,486
from 5 years and over	3,222	5,591
Total	**11,214**	**7,237**

41. VOLUME OF LENDING
in € millions

	2004	2003
Placements with, loans and advances to other banks	1,536	1,683
Loans and advances to customers	11,214	7,237
Contingent liabilities	5,061	8,858
Total	**17,811**	**17,778**

42. ALLOWANCES FOR LOSSES ON LOANS AND ADVANCES

in € millions

	Notes	**Portfolio Based Allowances**
Balance at 31.12.2003		**37**
Changes affecting income		
+ Gross additions	*28*	33
– Releases	*28*	0
Changes not affecting income		
– Use of existing loan-loss allowances		0
+/– Effects of currency translations and other changes not affecting income		2
Balance at 31.12.2004		**72**

Changes not affecting income include the effects from the initial recognition of the portfolio-based allowance according to IAS 39.64 in conjunction with IAS 39.104 (revised 2003).

43. ANALYSIS OF LOAN DEFAULT RISK

RATIO OF ALLOWANCES TO TOTAL LENDING
in € millions

	2004	**2003**
Total provisions for losses on loans and advances	72	37
Volume of lending	17,811	17,778
Provision rate in %	**0.40**	**0.21**

NET ADDITION RATE
in € million

	2004	**2003**
Provision for losses on loans and advances	33	37
Volume of lending	17,811	17,778
Net addition rate in %	**0.19**	**0.21**

LOAN LOSS RATIO
in € millions

	2004	**2003**
Loan losses	0	0
Volume of lending	17,811	17,778
Loan loss ratio in %	**0.00**	**0.00**

44. INVESTMENTS
in € millions

	2004	2003
Available-for-sale investments		
Shares in non-consolidated subsidiaries	0	61
Equity securities and other variable yield securities	2	0
Debt securities and other fixed-income securities	8,638	6,638
Investment properties	26	0
Total	**8,666**	**6,699**

OF WHICH:
in € millions

	Debt securities and other fixed-income securities	Shares and other variable-yield securities	Total
Marketable securities			
Listed securities			
2004	8,444	2	8,446
2003	5,509	0	5,509

44. INVESTMENTS *(contd.)*

in € millions

MOVEMENTS IN INVESTMENTS
in € millions

	AfS - Investments				Total
	Non - consolidated affiliated companies	Debt securities and other fixed-income securities	Equity securities & other variable yield securities	Investment properties	
Acquisition costs					
Balance at 1.1.2004	61	6,638	0	0	6,699
Changes arising from foreign currency	0	(60)	0	0	(60)
Additions	0	3,154	0	26	3,180
Reclassifications	(61)	(255)	2	0	(314)
Disposals	0	(980)	0	0	(980)
Balance at 31.12.2004	**0**	**8,497**	**2**	**26**	**8,525**
Changes in valuation not affecting income					
Additions	0	6	0	0	6
Balance at 31.12.2004	**0**	**6**	**0**	**0**	**6**
Write-downs and write-ups affecting income					
Disposals	0	90	0	0	90
Write Ups	0	45	0	0	45
Balance at 31.12.2004	**0**	**135**	**0**	**0**	**135**
Carrying amounts					
Balance at 31.12.2004	**0**	**8,638**	**2**	**26**	**8,666**
Balance at 31.12.2003	**61**	**6,638**	**0**	**0**	**6,699**

Write ups affecting income, noted above, relate to AfS debt securities held in Hypo Pfandbrief Bank International. These qualify for hedge accounting treatment and are stated at fair value, with changes in fair value being recognised in the Income Statement.

DEBT SECURITIES, OTHER FIXED-INCOME SECURITIES
in € millions

	2004	2003
Debt securities and other fixed-income securities	**8,638**	**6,638**
Bonds and debt securities	**8,638**	**6,398**
by public issuers	3,457	2,824
by other issuers	5,181	3,574
Debt securities issued by group companies	0	240

45. INTANGIBLE ASSETS
in € millions

	Goodwill	Negative goodwill on initial consolidation	Purchased Software	Total
Acquisition/production costs				
Balance at 31.12.2003	0	0	1	1
Additions	11	(8)	13	16
Disposals	0	0	0	0
Balance at 31.12.2004	**11**	**(8)**	**14**	**17**
Amortisation/depreciation and write-ups				
Balance at 31.12.2003	0	0	0	0
Scheduled depreciation/ amortisation	0	0	(2)	(2)
Reclassifications	0	0	(2)	(2)
Balance at 31.12.2004	**0**	**0**	**(4)**	**(4)**
Net Book Amount				
Balance at 31.12.2004	**11**	**(8)**	**10**	**13**
Balance at 31.12.2003	**0**	**0**	**1**	**1**

Amortisation/depreciation of software and other intangible assets is shown under amortisation /depreciation of intangible assets within general administrative expenses.

46. PROPERTY, PLANT AND EQUIPMENT
in € millions

	Land and buildings used for operational purposes	Plant and operating equipment	Total
Acquisition/production costs			
Balance at 31.12.2003	1	9	10
Additions	0	5	5
Disposals	0	(4)	(4)
Balance at 31.12.2004	**1**	**10**	**11**
Amortisation/depreciation and write-ups			
Balance at 31.12.2003	(1)	(3)	(4)
Scheduled depreciation/ amortisation	0	(2)	(2)
Disposals	0	3	3
Balance at 31.12.2004	**(1)**	**(2)**	**(3)**
Net Book Amount			
Balance at 31.12.2004	**0**	**8**	**8**
Balance at 31.12.2003	**0**	**6**	**6**

47. OTHER ASSETS

in € millions

	2004	2003
Positive fair values from derivative financial instruments	547	114
Other assets	214	24
Deferred charges and prepaid expenses	26	104
Total	**787**	**242**
Of Which:		
Due from Hypo Real Estate Holding Group Companies	323	0

48. TAX ASSETS

in € millions

	2004	2003
Current tax assets	0	0
Deferred tax assets	212	44
Total	**212**	**44**

Tax assets include a significant amount of deferred tax assets. These are mostly attributable to tax effects relating to valuations according to IAS 39 (revised 2003). Deferred tax assets on losses carried forward were only recognised if the criteria according to IAS 12 were met (see also note 19).

NOTES TO THE BALANCE SHEET - EQUITY AND LIABILITIES

49. DEPOSITS FROM OTHER BANKS

in € millions

	2004	2003
Repayable on demand	4	0
With agreed maturities	**9,453**	**7,709**
up to 3 months	4,057	3,585
from 3 months to 1 year	1,390	655
from 1 year to 5 years	3,620	3,327
from 5 years and over	386	142
Total	**9,457**	**7,709**
Of Which:		
Due to Hypo Real Estate Holding Group Companies	1,005	1,123

50. AMOUNTS OWED TO OTHER DEPOSITORS

in € millions

	2004	2003
Repayable on demand	1	0
With agreed maturities	**280**	**242**
up to 3 months	243	242
from 3 months to 1 year	6	0
from 1 year to 5 years	19	0
from 5 years and over	12	0
Total	**281**	**242**
Of Which:		
Due to Hypo Real Estate Holding Group Companies	0	133

51. PROMISSORY NOTES AND OTHER LIABILITIES EVIDENCED BY SECURITIES

ANALYSIS BY BUSINESS TYPE
in € millions

	2004	2003
Debt securities in issue	**9,042**	**4,754**
Public-sector bonds	4,547	4,614
Other debt securities	4,495	140
Registered notes in issue	**380**	**224**
Public-sector bonds	370	224
Other debt securities	10	0
Total	**9,422**	**4,978**

ANALYSIS BY MATURITY
in € millions

	2004	2003
up to 3 months	897	227
from 3 months to 1 year	1,252	1,159
from 1 year to 5 years	6,568	2,982
from 5 years and over	705	610
Total	**9,422**	**4,978**

52. LIABILITIES HELD FOR TRADING PURPOSES
in € millions

	2004	2003
Deposits from other banks	523	0
Amounts owed to other depositors	404	0
Total	**927**	**0**

53. PROVISIONS
in € millions

	2004	2003
Provisions for pensions and similar obligations	1	1
Other provisions	1	0
Total	**2**	**1**

The Group provides retirement arrangements covering the majority of subsidiaries and employees working in Ireland, the United Kingdom, the United States, Spain, Italy, Germany, France, the Netherlands and Asia. The majority of these schemes are Defined Contribution in nature.

The assets of all the Group's defined contribution plans are held in independently administered funds. Contributions are generally determined as a percentage of salary.

As disclosed in note 16, the Group had one unfunded defined benefit obligation for its employees in Germany (Only two current employees are covered). This scheme has been evaluated at the 31st December 2004 using the Projected Unit Credit Actuarial Cost Method. The assumptions used in the valuation are as follows:

Discount Rate:	5 %
Annual Increase in Post-Retirement Pensions:	2%
Annual Increase in Salaries	2.5%

At the 31st December 2004, the Defined Benefit Obligation (DBO) was € 514,319.
The following pension costs have been recognised in the Income Statement during the year in respect of pension costs:

Defined Benefit Current Service Costs:	€55,744
Defined Benefit Interest Costs:	€25,716
Defined Contribution Costs:	€2,584,410
Total Pension Costs:	**€2,665,870**

54. OTHER LIABILITIES
in € millions

	2004	2003
Negative fair values from derivative financial instruments	1,098	507
Other liabilities	200	226
Deferred income	37	7
Total	**1,335**	**740**
Of Which:		
Due to Hypo Real Estate Holding Group Companies	1	0

Other Liabilities include accruals which include trade accounts payable in respect of invoices still outstanding, short-term liabilities to employees and other accruals in respect of commission, interest, operating expenses, etc.

55. TAX LIABILITIES
in € millions

	2004	2003
Current tax liabilities	32	11
Deferred tax liabilities	198	45
Total	**230**	**56**

Tax liabilities include both provisions and other liabilities for current taxes as well as deferred tax liabilities. Deferred tax liabilities can arise when single assets or securities increase in value according to IFRS, but such valuation increases do not become relevant for tax purposes until the asset is sold at some date in the future. A considerable amount of deferred tax liabilities was attributable to tax effects relating to valuations relating to IAS 39 (revised 2003). In this respect, adjustments to equity reserves, regarding equity securities which are available for sale, include associated deferred tax of €7 million (2003 €(2) million).

56. SUBORDINATED CAPITAL
in € millions

	2004	2003
Subordinated liabilities	752	840
Total	**752**	**840**

ANALYSIS BY MATURITIES
in € millions

	2004	2003
With agreed maturities		
up to 3 months	1	0
from 1 year to 5 years	519	600
from 5 years and over	232	240
Total	**752**	**840**
Of Which:		
Due to Hypo Real Estate Holding Group Companies	202	202

With all subordinated liabilities, there can be no early repayment obligation on the part of the issuer. In the event of bankruptcy or liquidation, such liabilities may only be repaid once all non-subordinate creditors have been satisfied.

Holder	Nominal in € millions	Interest %	Maturity
Bayerische Hypo-und Vereinsbank AG	500	EURIBOR + 2.00%	25th September 2008
Hypo Real Estate Holding AG	200	EURIBOR + 2.00%	Perpetual
ABN Amro N.V.	25	6.80%	18th May 2026
Citibank International plc	20	EURIBOR + 1.23%	26th March 2024
	745		

Interest expense of € 2 million (2003: € 3 million) was incurred in respect of subordinated liabilities. There were no subordinated liabilities to non-consolidated subsidiaries and companies with whom a participatory relationship exists. On the 23rd March 2004 the bank bought back €100 million of the subordinated liabilities maturing on the 25th September 2013. In 2004, in accordance with the Recommendation on Equity issued by the Basel Committee on Banking Supervision in July 1988, the Sub-ordinated capital was shown as part of supplementary capital.

57. SHAREHOLDERS EQUITY – Subscribed Capital
in € millions

	2004	2003
Authorised:		
4,000,000,000 Ordinary Shares of €1 each	4,000	4,000
Allotted, called up and fully paid:		
1,410,000,000 Ordinary Shares of €1 each (2003: 1,260,000,000)	1,410	1,260

Share Transactions during the year:
The issued share capital was increased on 31 March 2004, by the issue of 150 million ordinary shares of € 1 each.

58. TREASURY STOCK

No Group Company holds shares in Hypo Real Estate Bank International puc

59. FOREIGN CURRENCY ASSETS AND LIABILITIES

Translated into Euros, the total amount of assets in foreign currencies on the reference date for the financial statements was € 10 billion and the total amount of foreign-currency liabilities was € 7.1 billion. Of these, the most important foreign currencies accounted for the following amounts:

	2004	2003
Foreign currency assets		
of which	**8,035**	**4,142**
USD	5,679	3,476
JPY	927	201
CHF	0	465
SEK	263	0
HKD	2	0
GBP	1,164	0
Foreign currency liabilities		
of which	**5,024**	**2,579**
USD	2,889	1,358
JPY	317	118
CHF	0	1,103
SEK	53	0
HKD	2	0
GBP	1,763	0

There are considerable differences between assets and liabilities in foreign currencies as only balance-sheet items have been taken into account here. The off-balance-sheet volume, which also includes the volume of hedging transactions, is not included.

NOTES TO THE CASH FLOW STATEMENT

60. NOTES TO THE ITEMS IN THE CASH FLOW STATEMENT

The cash flow statement shows the payment flows for the financial year, classified according to "operating activities", "investing activities" and "financing activities". Operating activities are given a wide basis of definition with differentiation based on operating results.

The item shown as 'cash and cash equivalents' corresponds to the balance sheet item "cash and balances with Central Banks" and contains cash in hand and central bank balances.

The item 'other adjustments' contains the changes in the valuation of financial instruments

NOTES REGARDING FINANCIAL INSTRUMENTS

61. DERIVATIVE TRANSACTIONS

The following tables present the respective nominal amounts and fair values of OTC derivatives and derivatives traded on a stock exchange. Please refer to the Risk Report on pages 31 to 37, for narrative on the use of derivatives.

DERIVATIVES VOLUME - 31.12.2004
in € millions

	Nominal amount				Fair value	
	Remaining maturities					
	less than 1 year	1 to 5 years	more than 5 years	Total	positive	negative
Interest-based transactions						
OTC products						
Interest rate swaps	5,971	10,673	7,301	23,945	203	815
Interest rate options						
Call options	108	61	9	178	1	0
Put options	207	187	0	394	0	2
Other interest rate contracts	133	3,042	1,011	4,186	51	50
Total	**6,419**	**13,963**	**8,321**	**28,703**	**255**	**867**
Foreign-currency-based transactions						
OTC products						
Spot and forward currency transactions	959	0	0	959	13	11
Interest rate/currency swaps	725	512	607	1,844	275	215
Total	**1,684**	**512**	**607**	**2,803**	**288**	**226**
Other transactions						
OTC products						
Credit derivatives	292	424	332	1,048	4	5
Total	**292**	**424**	**332**	**1,048**	**4**	**5**
Total derivative volume	**8,395**	**14,899**	**9,260**	**32,554**	**547**	**1,098**

61. DERIVATIVE TRANSACTIONS *(contd.)*

DERIVATIVES VOLUME - 31.12.2003
in € millions

	Nominal amount				Fair value	
	Remaining maturities					
	less than 1 year	1 to 5 years	more than 5 years	Total	positive	negative
Interest-based transactions						
OTC products						
Interest rate swaps	2,617	4,156	3,389	10,162	143	634
Interest rate options						
Call options	0	0	0	0	0	0
Put options	0	0	0	0	0	0
Other interest rate contracts	87	382	787	1,256	9	10
Total	**2,704**	**4,538**	**4,176**	**11,418**	**152**	**644**
Foreign-currency-based transactions						
OTC products						
Spot and forward currency transactions	541	0	0	541	7	4
Interest rate/currency swaps	626	492	301	1,419	87	60
Currency options						
Other foreign-exchange contracts	0	0	0	0	0	0
Total	**1,167**	**492**	**301**	**1,960**	**94**	**64**
Other transactions						
OTC products						
Credit derivatives	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**
Total derivative volume	**3,871**	**5,030**	**4,477**	**13,378**	**246**	**708**

COUNTERPARTIES
in € millions

	Fair value		Fair value	
	2004 positive	2004 negative	2003 positive	2003 negative
OECD central governments (and central banks)	0	1	0	0
OECD banks	484	1087	245	707
OECD financial institutions	54	3	0	0
Non-OECD central governments (and central banks)	0	0	0	0
Non-OECD banks	0	0	0	0
Non-OECD financial institutions	0	0	0	0
Other companies and private individuals	9	7	1	1
Total	**547**	**1,098**	**246**	**708**

Fair values appear as a total of positive and negative amounts per contract, from which no pledged security has been deducted and no netting agreements have been taken into consideration. By definition, no positive fair values exist for put options.

62. ASSETS ASSIGNED OR PLEDGED AS SECURITY FOR OWN LIABILITIES

Assets were pledged as security for the following liabilities:

OWN LIABILITIES
in € millions

	31.12.2004	31.12.2003
Deposits from other banks	3,551	1,770
Total	**3,551**	**1,770**

The following assets were pledged as security for the above-mentioned liabilities:

ANALYSIS OF ASSETS PLEDGED
in € millions

	31.12.2004	31.12.2003
Loans and advances to customers	567	0
Investments	2,984	1,770
Total	**3,551**	**1,770**

63. FAIR VALUES OF FINANCIAL INSTRUMENTS

The recognised fair values of financial instruments according to IAS correspond to the amounts at which, the Group believes an asset could be exchanged on the accounting reference date between willing, independent, and expert business partners, or at which, a liability could be settled between such business partners.

The fair values were determined at the accounting reference date based on the market information available and using the Group's own methods of calculation.

The fair values of certain financial instruments reported at nominal values are almost identical to their carrying amounts. These include, for example, the cash reserve and receivables and liabilities without a specific maturity or interest tie-up. For other receivables and liabilities, the future expected cash flows are discounted to the present value using current interest rates.

Quoted market prices are applied for market securities and derivatives as well as for quoted debt instruments. The fair value of other securities is determined as the present value of future expected cash flows.

The fair values of interest and currency interest swap agreements and also interest rate futures are determined on the basis of discounted future expected cash flows. The market interest rates applicable to the remaining maturity of the financial instruments are used for the purpose of this calculation.

The fair value of forward exchange transactions is determined on the basis of current forward rates. Options are valued using exchange rate quotations or recognised models for determining option prices.

The fair values of irrevocable loan commitments and contingent liabilities correspond to their carrying amounts. For assets and liabilities, the difference between fair values and carrying amounts is €15 million. The development of this parameter over time depends on changes in market prices and the valuation parameters applied in calculating fair values, including in particular changes in interest rates and changes in financial instrument portfolios.

63. FAIR VALUES OF FINANCIAL INSTRUMENTS *(contd.)*

FAIR VALUES OF FINANCIAL INSTRUMENTS
in € million

	2004 Carrying amounts	2004 Fair value	2003 Carrying amounts	2003 Fair value
Assets				
Cash and balances with Central Bank	44	44	42	42
Assets held for trading purposes	1,513	1,513	0	0
Placements with, loans and advances to other banks	1,608	1,610	1,683	1,709
Loans and advances to customers	11,214	11,227	7,237	7,323
Investments	8,666	8,666	6,699	6,541
Other assets	787	787	242	242
Liabilities				
Deposits from other banks	9,457	9,457	7,709	7,786
Amounts owed to other depositors	281	281	242	242
Promissory notes and other liabilities evidenced by securities	9,422	9,422	4,978	4,961
Liabilities held for trading purposes	927	927	0	0
Other liabilities	1,335	1,335	740	740
Subordinated capital	752	752	840	846
Other items				
Contingent liabilities	5,061	5,061	8,858	8,858
Irrevocable loan commitments	2,525	2,525	1,033	1,033

As at 31 December 2004, the revaluation reserve amounted to € (14) million of which the cash flow hedge valuation result amounted to € 0.3 million.

OTHER NOTES

64. SIGNIFICANT CONCENTRATIONS OF ASSETS AND LIABILITIES

The group's assets and liabilities exhibit a balanced structure and do not contain any significant areas of concentration.

SHARE OF LOAN VOLUME
in %

	2004	2003
Municipal loans	7.24	6.64
Mortgage loans	55.53	17.81
Other loans and advances	8.81	25.73
Contingent liabilities	28.42	49.82
Total	**100.00**	**100.00**

Similarly, the balanced maturities structure of the liabilities does not reveal any significant concentrations of risk. Detailed information on the risks associated with the business of the Hypo Real Estate Bank International puc is contained in the risk report (see pages 31 to 37).

65. KEY CAPITAL RATIOS

According to the Recommendation on Equity issued by the Basel Committee for Banking Supervision in July 1988, the core capital ratio (core capital/risk weighted assets) may not fall below 4.0% and the equity capital ratio (equity/risk weighted assets) may not be less than 8.0%. At the same time, the equity funds ratio calculated on the basis of the relationship between equity funds and total risk weighted assets plus 12.5 times the weighting amount for items subject to market price risk (including options transactions) must be at least 8.0%.

Equity funds consist of core capital and supplementary capital (equity) plus tier III capital and are comprised as follows, according to approved annual financial statements as at 31 December 2004:

EQUITY FUNDS
in € millions

	2004	2003
Core capital *	1,584	1,300
Supplementary capital	776	834
Equity capital	**2,360**	**2,134**
Tier III capital	0	0
Total equity funds	**2,360**	**2,134**

** Includes Negative goodwill*

The risk weighted assets and positions subject to market risk were as follows:

RISK WEIGHTED ASSETS
in € billions

	2004	2003
On-balance-sheet assets	12.7	8.4
Off-balance-sheet assets	4.5	6.1
Counterparty Risks in Trading Book	0.1	0
Total risk weighted assets	**17.3**	**14.5**
Positions subject to market risk in € millions		
Interest Rate Risk	57	0
Risks from shares	19	0
Currency risks	34	6
Total position subject to market risk	**110**	**6**

Calculated in accordance with the Basel Recommendation on Equity, the following ratios applied as at 31 December 2004 (based on approved annual financial statements):

KEY CAPITAL RATIOS
in %

	2004	2003
Core capital ratio	9.2	8.9
Equity capital ratio	13.6	14.7
Equity funds ratio	12.6	14.6

66. CONTINGENT LIABILITIES AND OTHER COMMENTS

in € millions

	2004	2003
Contingent liabilities*	**5,061**	**8,858**
From guarantees and indemnity agreements	5,061	8,858
Performance guarantees and indemnities	5,061	8,858
Other commitments	**2,525**	**1,033**
Irrevocable loan commitments	2,525	1,033
Book credits	152	36
Guarantees	199	0
Mortgage and municipal loans	2,174	997
Total	**7,586**	**9,891**

** in principle, the amount of contingent liabilities equates to the amount of contingent claims*

The contingent liabilities from performance guarantees and indemnities include guarantee obligations of Hypo Real Estate Bank International vis-à-vis HVB AG; these were issued as part of the synthetic transfer of the "Western Europe" real estate finance portfolio.

The other contingent liabilities and other liabilities do not contain any individual items of significant importance.

67. INFORMATION ON AUDITORS' FEES

in € thousands

	2004	2003
Audit	811	402
Other services	297	136
Total	**1,108**	**538**

68. INFORMATION ON RELATIONSHIPS WITH RELATED PARTIES

Remuneration paid to the Board of Hypo Real Estate Bank International puc:

		€'000
Fixed Components		2,830
Profit Related Components		2,865
Total Remuneration	**2004**	**5,695**
	2003	**3,219**

Profit related components include remuneration for the year 2004 but which is paid in 2005. Fixed components include benefits in kind. A loan of €1.2 million has been extended to one member of the Board. As at 31 December 2004, there were no other receivables or contingent liabilities in respect of Board members.

69. EMPLOYEES

	2004	2003
Average Number of Employees	468	285

Independent Auditors' Report to the Directors on the Non-Statutory Consolidated Financial Statements of Hypo Real Estate Bank International

We have audited the consolidated balance sheet as at 31 December 2004 and the consolidated income statement for the year ended 31 December 2004 together with the related notes ("the non-statutory consolidated financial statements") on pages 39 to 85 which have been prepared in accordance with the basis of preparation note on page 46. These consolidated financial statements are not the statutory financial statements of the company which in accordance with Irish company law and applicable accounting standards, are required to deal with the group of which this company is the parent.

This report is made solely to the directors, as a body, in accordance with our letter of engagement dated 31 December 2004, and our work has been undertaken solely to enable us to report on the matters set out in that letter. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the directors, as a body, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described on page 14, the directors are responsible for the preparation of the non-statutory consolidated financial statements, directors' report and accompanying information. Under the terms of our engagement, our responsibility is to report on the non-statutory consolidated financial statements as independent auditors. In carrying out those responsibilities we follow auditing standards as established by the Auditing Practices Board and our profession's ethical guidance.

We report to you our opinion as to whether the non-statutory consolidated financial statements give a true and fair view and are properly prepared in accordance with the basis of preparation note on page 46.

We read the other information accompanying the non-statutory consolidated financial statements and consider whether it is consistent with those statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the non-statutory consolidated financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the non-statutory consolidated financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the non-statutory consolidated financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the non-statutory consolidated financial statements.

Opinion

In our opinion, the non-statutory consolidated financial statements have been properly prepared in accordance with the basis of preparation note on page 46 and give a true and fair view of the state of the Group's affairs at 31 December 2004 and of its profit for the year then ended.

KPMG
Chartered Accountants **8th April 2005**

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