



DEUTSCHE
PFANDBRIEFBANK

Press Briefing
Results for 2011

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Manuscript – the spoken word prevails.

1. Introduction (Manuela Better)

Good morning, Ladies and Gentlemen,

I would like to welcome you to our press briefing to present the annual results. I am very pleased that you have been able to attend today.

When we met the last time, the situation was clearly different: pbb Deutsche Pfandbriefbank had just restructured its portfolio by transferring assets to FMS Wertmanagement, and the decision regarding the EU state aid proceedings was still pending. Since then, we have taken several key steps on pbb Deutsche Pfandbriefbank's path towards an efficient specialist lender for Real Estate Finance and Public Investment Finance, and an institution that is ready for re-privatisation (diagram 1).

The macro-economic environment has also changed – it has deteriorated. The euro sovereign debt crisis has escalated, the growth prospects for European economies have slowed, financial markets volatility has increased, and deposits by banks with the ECB have reached record highs.

In this challenging environment, pbb Deutsche Pfandbriefbank performed very well.

- We have placed our focus on the market and on our clients, and **returned** pbb Deutsche Pfandbriefbank **to the credit and capital markets**.
- We **achieved our operating business targets** in 2011. The bank was profitable, posting pre-tax profits of € 188 million according to IFRS. We also increased new business volume to € 8 billion. We are on schedule.
- We want to follow this path. Thanks to our business model, we are well-positioned, distinguishing ourselves through key success factors. In the absence of any further distortions on the public finance markets, we expect to **remain profitable** in 2012, with profit before taxes between € 100 million and € 140 million. Beyond this purely commercial view, pbb Deutsche Pfandbriefbank continues to benefit the economy as a whole, by providing finance to the real estate sector as well as for public-sector infrastructure projects.

My colleague Alexander von Uslar will now present and discuss the results for the 2011 financial year in detail.

2. Results 2011 (Alexander von Uslar)

Good morning, ladies and gentlemen – welcome to our press briefing.

In my comments, I will focus on pbb Deutsche Pfandbriefbank, HRE Group's strategic core bank. I will however also cover the HRE Group as a whole, which I know is important for some of you in your news coverage.

Allow me to make a few introductory statements:

- The Deutsche Pfandbriefbank sub-group, the DEPFA sub-group and the HRE Group were all profitable in 2011.
- The 2011 financial statements are only comparable to a very limited extent with the figures of the previous year. Specifically, this is due to the fact that the transfer of non-strategic assets to FMS Wertmanagement ("FMS WM") took place towards the end of the third quarter of 2010.
- The figures which we will present to you today are preliminary and are accordingly as yet unaudited. Our financial statements will be published on 29 March 2012.

2.1 Consolidated results of Deutsche Pfandbriefbank

The Deutsche Pfandbriefbank Group posted € 188 million in pre-tax profit (in accordance with IFRS) for 2011; the Group also posted a pre-tax profit in each individual quarter. In the the previous year, the result was still negative, at €-135 million. The main drivers of the good results for 2011 were profitability of the portfolio and the corresponding net interest income. Moreover, provisions for losses on loans and advances were at a low level – in fact, we were able to reverse provisions (diagram 2).

Operating revenues amounted to € 526 million (2010: € 652 million). Main contributing factors were net interest income, income from servicing the portfolio of FMS Wertmanagement, and net commission income. In contrast, net trading income was negative, mainly due to changes in the market value of derivatives. These items are broken down as follows:

- **Net interest income** totalled € 371 million (2010: € 600 million). The decline reflected the smaller portfolio, compared with the previous year, on account of the transfer of parts of the portfolio to FMS Wertmanagement, and due to repayments which exceeded new business during 2011. Still, margins on some new transactions were in fact higher than those on existing exposures, which allowed us to compensate to some extent for the lower portfolio.

- At € 32 million, **net commission income** was positive (2010: € -10 million). Positive factors included non-recurring income of € 7 million from a loan repayment.

Expenses for liquidity support in connection with SoFFin guarantees, which had burdened net commission income with € 74 million in 2010, were no longer incurred.

- Net trading income** of € -8 million (2010: € 77 million) was slightly negative. This figure was attributable, in particular, to changes in the market value of derivatives; pbb Deutsche Pfandbriefbank does not however maintain a trading book comprising portfolios designed to generate short-term profits.

In the previous year, net trading income included € 106 million in income from an HRE-internal guarantee which was transferred to FMS Wertmanagement in 2010.

- Net income from **hedge relationships** amounted to € -56 million (2010: € -45 million).

A valuation result of € -37 million (unchanged from 2010) was due to assets designated at fair value through profit or loss ("dFVTPL"). At the reporting date 2011, four items with an aggregate nominal value of € 185 million were classified in this category, resulting in expenses of € 32 million (2010: expenses of € 15 million), mainly attributable to three securities issued by the Republic of Portugal, with an aggregate nominal value of € 105 million. The loss in market value of these bonds, which was the result of a spread widening for this issuer, is recognised in income.

In addition, hedge inefficiencies within the range as permitted by IAS 39 (80%-125%) resulted in expenses of € 19 million (2010: € 8 million).

- The balance of other operating income/expenses** totalled € 184 million (2010: € 47 million). The largest individual items within this figure were income from services for the ongoing operations of FMS Wertmanagement, and from services rendered to DEPFA and HRE Holding; these totalled € 144 million (2010: € 60 million). Services' income compensated for the corresponding administrative expenses.

Our credit risk management, in combination with the positive development on the real estate markets, resulted in a net release of € 12 million in **provisions for losses on loans and advances** in the reporting period (2010: additions of € 443 million).

- The net additions to **individual allowances** amounted to € 20 million (2010: € 443 million), and were limited to a small number of real estate financing transactions.
- Portfolio-based allowances** and loan loss provisions of € 23 million were released in the 2011 financial year (2010: additions of € 110 million).

At € 357 million, **general administrative expenses** were almost in line with the previous year's figure (2010: € 352 million), even though the figure comprises costs incurred, amongst other items, in connection with the servicing for FMS Wertmanagement and for the changeover of the IT environment. These costs will no longer be incurred after 2013. At this point, we endeavour to reach a cost/income ratio below 40% (2011: 67.9%).

2.2 Total assets of Deutsche Pfandbriefbank

Total assets of the Deutsche Pfandbriefbank Group in accordance with IFRS amounted to approx. € 109 billion as at 31 December 2011, and were thus approx. € 78 billion lower than the corresponding figure as at 31 December 2010 (€ 187 billion) (diagram 3).

- The decline was mainly attributable to a further **reduction of the counter effects** which had increased the total assets when positions were transferred to FMS Wertmanagement in October 2010. We continued to reduce these counter effects during 2011, as planned. The effects occurred upon the as a result of refinancing items or the transfer of risks under back-to-back derivatives, for example. The remaining counter effects amount to some € 8 billion.
- Even without the decline in counter effects, the total assets of the Deutsche Pfandbriefbank Group also declined as a result of the planned **reduction of some portfolios**: in particular, this concerned portfolios such as pure budget financings, where the Deutsche Pfandbriefbank Group no longer originates any new business, in accordance with the conditions imposed by the European Commission. In contrast, new business in Real Estate Finance and Public Investment Finance largely offset repayments.
- The decline in total assets, due to the reduction in counter effects and the planned reduction of some portfolios, was compensated to some extent by **market-induced effects** (such as currency fluctuations) which increased total assets.

2.3 Results of the HRE Group and the DEPFA sub-group

As mentioned before, I would only like to make a few very brief comments on the results of the HRE Group. Please refer to our presentation for a more detailed breakdown (diagram 4).

The HRE Group was also profitable in the 2011 financial year, posting a pre-tax profit of € 257 million in accordance with IFRS. In the the previous year, the result was still negative, at € -859 million. The factors contributing to this improvement of results were the same as those described for the Deutsche Pfandbriefbank sub-group. Specifically, the result was driven by the profitability of the portfolio and the low loan loss provisioning. It thus reflects the successful restructuring and realignment of the strategic core bank Deutsche Pfandbriefbank AG in particular; non-recurring effects had an additional favourable effect.

The DEPFA sub-group posted € 124 million in pre-tax profit according to IFRS for 2011 (2010: € -680 million), the result was positively influenced primarily due to non-recurring effects in the first two quarters of 2011.

3. Regulatory capital ratios

Banks' capital ratios have been under scrutiny recently. As a sub-group of the HRE Group, Deutsche Pfandbriefbank is exempted under the German Banking Act from the obligation to determine capital ratios at the level of the institution. I would therefore like to state the pro-forma ratios which we have determined. To facilitate comparisons, these ratios already include the preliminary profit figure for the respective year (diagram 5). Capital ratios were virtually unchanged: the **tier 1 ratio** was 16.2% (31 December 2010: 16.7%) and the core tier 1 ratio 14.2% (31 December 2010: 14.5%). pbb Deutsche Pfandbriefbank thus continues to benefit from a solid capital base that enables the bank to face the challenges ahead.

This concludes my review of results for the full year 2011. Thank you very much for your attention.

4. Review of the year 2011 (Manuela Better)

Ladies and Gentlemen,

Following a restructuring and realignment process spanning several years, we were able to focus completely on our customers and the markets during the 2011 financial year. This new focus – which was contingent upon the conclusion of the EU state aid proceedings – was clearly visible in the higher volume of new business.

I would like to briefly comment on both aspects, starting with the EU state proceedings.

4.1 Positive outcome of the EU state aid proceedings

With its decision in mid-July 2011, the EU Commission **affirmed** pbb Deutsche Pfandbriefbank's **business model**: a specialist bank for real estate finance and public investment finance.

This decision was preceded by a very intensive process which lasted for about two years. Throughout this period, as part of the realignment we implemented numerous changes and anticipated adjustments which we recognised from the discussions with the Commission. For this reason, the remaining adjustments **required were relatively minor**.

- Firstly, we will continue to pursue **Real Estate Finance** as our most important business segment. Our second segment remains **Public Investment Finance**, a sub-segment of the public sector finance where exposures are linked to specific projects. These two business segments provide sufficient potential for pbb to be successful on the credit and capital markets.
- Secondly, we will not continue the **traditional budget finance**, as required by the conditions imposed by the EU. Whilst the existing portfolio in this segment will be run down over time, it will continue to yield interest income for the time being. This portfolio, which totalled approximately € 33 billion at the end of 2011, is almost fully funded through Public-Sector Pfandbriefe, and almost entirely on a matched-maturity basis. The portfolio will be reduced to around € 20 billion by 2015, through normal run-off.

The EU has made its approval conditional upon **further conditions** concerning portfolio servicing for FMS Wertmanagement and re-privatisation.

- Following the transfer of assets by HRE Group to FMS Wertmanagement, pbb Deutsche Pfandbriefbank has only acted in the capacity of servicer for this portfolio. This function was chosen to facilitate a short-term transfer, and to ascertain continuity in portfolio management. The EU Commission has set a time limit for the provision of these services of the end of September 2013.

This condition requires an alternative solution for portfolio servicing. FMS Wertmanagement has meanwhile defined its target structure: it will establish a service company for portfolio management, and will outsource Operations and IT functions to external third parties. FMS Wertmanagement plans to use existing staff members of pbb and DEPFA – something which we consider very important in order to be able to offer perspectives to our staff. We will strongly support FMS Wertmanagement in the process of implementing this target structure.

- The EU has also imposed the condition that pbb Deutsche Pfandbriefbank be re-privatised by the end of 2015. We have always emphasised our conviction that maintaining pbb Deutsche Pfandbriefbank as a going concern, with a subsequent re-privatisation, is the right way to repay as much of the capital support which pbb Deutsche Pfandbriefbank and the entire HRE Group received from the Federal Republic of Germany as possible. We have demonstrated our ability to increase the enterprise value. In this sense, re-privatisation is as much an objective as it is a condition. For us, this project has utmost priority.

4.2 New business

This brings me to our new business. **New business** originated during 2011 (including loan extensions of more than 12 months) **totalled €8 billion**, clearly exceeding the previous year's figure of €4.1 billion and achieving our full-year target (diagram 6).

The following aspects defined our new business in 2011:

- **Distribution**

At €6.3 billion, Commercial Real Estate Finance accounted for the largest part of new business. The majority was in new business in the strict sense of the word, which grew disproportionately to €3.5 billion. The remaining €2.8 billion relates to extensions of existing exposures for more than one year. Whilst this distinction is formally correct, it is worth noting that renewals are by no means 'automatic' but require that we win this business once again. Accordingly, we consider both 'real' new business as well as renewals when looking at new business origination.

New public finance business amounted to €1.7 billion.

- **Real Estate Finance**

We extended the majority of real estate loans in Germany, followed by the United Kingdom. In terms of the existing portfolio, we slightly overweighted the UK because we saw particular opportunities in this sub-market during 2011. Accordingly, we want to continue exploiting opportunities going forward, in line with the outlook and potential offered by each market.

- **Public Investment Finance**

We focused on Germany and France in our Public Investment Finance business. In this business segment, we also adhere to a portfolio approach. This means that we are under no obligation to do business in each and every country in our existing portfolio, each year – instead, we focus on those markets where we perceive opportunities, having accounted for the risks involved.

- **Margins**

We increased our margins in 2011: average gross margins increased by five basis points in each of our two business segments during the period under review, and exceed our budgeted margin levels.

4.3 Portfolio

During the period under review, pbb Deutsche Pfandbriefbank's **overall portfolio** declined by €9 billion, to €79 billion, particularly due to maturities in the run-off portfolio.

There were no major changes to the **portfolio structure** during the year under review. On the one hand, aside from the run-off portfolio of public budget finance assets, the structure of our streamlined portfolio is largely in line with our targets. On the other hand, any changes to a portfolio of this size are bound to be gradual and slow. In line with the Basel II framework, we use the Exposure at Default (EAD) parameter when describing the portfolio.

Our exposure to borrowers in **European countries in the focus** has declined (diagram 7).

- pbb Deutsche Pfandbriefbank does not have any sovereign exposure to Ireland, Greece or Spain. Exposure to Portugal was unchanged, at €300 million; we reduced this by around €25 million during the first quarter of 2012. The €100 million increase in exposure to Italy was due to currency translation effects, as a part of the relevant assets is denominated in US dollars. There will be a planned reduction of this Italian exposure during 2012, to about half the size, as a result of repayments.

Thanks to active credit management, an aggregate €400 million was repaid on loans to local authorities and municipalities in Portugal and Italy.

- For the sake of completeness, I would also like to briefly refer to DEPFA, where exposure to European countries affected by market volatility fell by €1.3 billion compared to the year-end 2010, again, thanks to active management.

4.4 Funding of the lending business

I would now like to turn to our liabilities side.

pbb Deutsche Pfandbriefbank has a **liquidity buffer** resulting from the transfer of assets to FMS Wertmanagement in October 2010.

Thanks to our comfortable liquidity situation, we needed to access capital markets – in an overall tense market environment – to a limited extent only. We carried out private placements of unsecured bonds and Pfandbriefe during 2011 and also placed a public Mortgage Pfandbrief issue. In addition, we sold securities and promissory note loans to investors by way of private placements.

Looking ahead to 2012, we expect the funding market environment to remain difficult and challenging. Having said that, we started out in January with a first benchmark Mortgage Pfandbrief. Other activities included a € 100 million increase to a Mortgage Pfandbrief issued in October 2011.

5. Outlook

After this review I would now like to give you an outlook for 2012.

We distinguish ourselves from our competitors through three **strategic success factors**: coverage, market penetration, and our value-creation chain (diagram 8).

- **Coverage**

pbb Deutsche Pfandbriefbank is active in key European countries and is not restricted to its home market. We take advantage of this structure through a targeted overweighting of specific markets offering particular opportunities. For instance, we are currently also active in selected Central and Eastern European markets. Conversely we have the option of temporarily staying out of specific markets: currently, for example, our Public Investment Finance business is not active in Spain and Italy.

We will continue to expand our coverage: this year we will open a Stockholm office; the real estate markets in the Nordic countries have shown a very stable performance.

- **Market penetration**

pbb Deutsche Pfandbriefbank leverages its presence in the markets that are relevant to the bank, its in-depth knowledge of these markets, and its resources – both locally and at head office. In this way we can handle the most complex transactions.

- **Value-creation chain**

We have the ability to take medium-sized financings on our own books. For tickets in excess of € 100 million, we join forces with partners. We increasingly assume an active role as arranger and/or agent to the syndicate. In this way, we strengthen our value chain, generating additional income.

And finally: pbb Deutsche Pfandbriefbank **benefits the economy** as a whole.

- All market observers expect the falling number of providers and stricter regulatory requirements to lead to reduced volumes and more expensive borrowing terms for small-sized public investment projects. Yet, at the same time, demand for such financings is particularly high, especially on the sub-sovereign level.
- This is where we will provide finance for public-sector infrastructure projects such as public services, public housing, utilities and waste disposal, as well as healthcare and care facilities for the elderly. This means that we create indirect benefits to society, over and above all economic and financial aspects. The number of banks that are able and willing to take on such transactions has declined notably. To give you one example, we are about to conclude a transaction that will finance the construction of about half a dozen public day care centres for children in Northern Germany.

5.2 Outlook for 2012

I would now like to outline our assessment for 2012. The Management Board assesses the situation for pbb Deutsche Pfandbriefbank as follows:

- The **macro-economic environment** during 2012 will be characterised by the still-unresolved European sovereign debt crisis, and the resulting bond market volatility. As in the previous year, national economies are set to diverge in their respective performance.
- Nevertheless, looking at our **business segments** we anticipate fairly stable development in the core real estate markets we cover, and stable demand for small-sized public-sector investment finance. In contrast, supply tends to be shrinking in Europe due to the market withdrawal of competitors – even though the remaining providers are subject to uncertainty resulting from the changing regulatory framework. Overall, against this background, we do not see any limitations concerning pbb Deutsche Pfandbriefbank's market potential.
- The biggest challenge will be the **appetite of debt investors** for Pfandbrief issues and senior unsecured funding. We expect new business volume to depend upon the availability of funding. The key issue will be to find the right balance between new business and extensions on the one hand and preserving liquidity on the other hand. Clearly, our priority is on liquidity.

We believe that we will not be able to **fully disassociate ourselves from a market environment that must be regarded as altogether difficult.**

- Yet we want to maintain our position as a leading specialist lender, and will **continue to provide loans** to our real estate clients and to the public sector. At the same time, we want to maintain the liquidity buffer which the bank currently has. For this reason, when acquiring new business, pbb Deutsche Pfandbriefbank will take into account the presently limited scope available in the funding markets – an issue that concerns the entire sector. We will intensify our business activities in line with any normalisation of the situation.
- Assuming that the funding markets will normalise, we plan a **new business volume** for 2012 (including loan extensions) **up to the volumes originated in the previous year.** Having said that, given the prevailing capital markets environment, we expect a slower start for new business in 2012.

Nonetheless, we envisage **positive results for 2012** of between €100 million and €140 million.

- We do not expect to match the previous year's results, which benefited from non-recurring effects and a low level of risk provisioning. We will need to consider that provisions for losses on loans and advances are unlikely to remain at their current low levels. Also, costs will be incurred as a result of maintaining liquidity.
- In addition, the rebuilding of our IT environment will involve costs: this year will see the fourth (and last) release of our 'New Evolution' programme designed to consolidate the IT systems across the entire HRE Group. We will take the release as an opportunity to redesign many processes; to match them more closely to our clients' needs and to enhance efficiency.

6. Summary

I would like to summarise our statements:

- Following the successful repositioning of the HRE Group, pbb Deutsche Pfandbriefbank – as the Group's strategic core bank – focused on its clients and the market, achieving its **targets for the year 2011**. The sub-group posted a pre-tax profit of €188 million; it significantly increased its new business volume (including extensions) to €8 billion.
- The bank is **well positioned** in the markets for Real Estate Finance and Public Investment Finance. It creates a benefit to the economy as a whole, by providing finance to the real estate sector as well as for public-sector infrastructure projects.
- The Management Board **generally anticipates favourable business prospects** in the bank's two segments of Real Estate Finance and Public Investment Finance. We will not be able to disassociate ourselves from market trends, which will affect us especially through the limited scope available in the funding markets. Whilst we want to maintain our market position, our priority is on holding liquidity. Notwithstanding these limitations, the Management Board anticipates a clearly positive pre-tax result for 2012, between €100 million and €140 million.

Ladies and Gentlemen,

This brings me to the conclusion of my comments. I would like to thank you all for your interest and attention. We now look forward to answering your questions.