DEUTSCHE PFANDBRIEFBANK

# News Release

**pbb generates good results for 2017, plans to distribute dividend of €1.07 per share**

- Consolidated profit before taxes (IFRS) of €204 million, driven by higher net interest and net income, as well as persistently low loan loss provisions
- New business rises to €11.6 billion
- Arndt: The strong operating result for 2017 clearly exceeds the previous year's figure, which benefited from a non-recurring effect

**Munich, 7 March 2018** – As reported on March 1st, Deutsche Pfandbriefbank AG (pbb) grew its new business in 2017, in a challenging market environment, generating sound results. Against this background, pbb plans to distribute a dividend of €1.07 per share, exceeding the previous year's payout.

**Consolidated profit before taxes** (prepared in accordance with IFRS, audited) totalled €204 million, clearly exceeding the results for the previous year, when adjusted for the Heta effect (2016: €169 million; including non-recurring income from Heta: €301 million). The development in 2017 was driven on the one hand by aggregate net interest and commission income of €443 million, which exceeded the previous year's figure of €412 million, and by continued low net additions to loan loss provisions of €6 million on the other hand (2016: net additions of €1 million). Conversely, general and administrative expenses of €216 million were higher year-on-year (2016: €198 million), as expected –due to higher personnel costs (primarily reflecting technical factors), as well as higher regulatory costs and expenses for strategic projects. Profit after taxes amounted to €182 million or €1.35 per share. Return on equity after taxes rose to 6.5%, compared to the adjusted previous year's figure of 3.3%.

pbb significantly expanded its **volume of new business**, to €11.6 billion (2016: €10.5 billion – new business figures include extensions of more than one year). The increase was entirely attributable to Commercial Real Estate Finance, which accounted for €10.7 billion (2016: € 9.5 billion). The volume of new Public Investment Finance business declined to €0.9 billion (due to rounding) during the period under review (2016: €1.0 billion). Once again, the fourth quarter was particularly strong, with €4.2 billion in new business, whilst around €2.5 billion was generated in each of the first three quarters.

The **proposed dividend** for 2017 of €1.07 per share comprises the regular dividend amounting to 50% of consolidated profit after taxes in accordance with IFRS, plus a special dividend of 25% and full distribution of income after taxes exceeding the upper end of the original pre-tax profit guidance of €170 million. The Management and Supervisory Boards resolved to apply the higher payout ratio – comprising the regular dividend of 50% of consolidated profit after taxes, plus a 25% special dividend – for the financial years 2018 and 2019 as well.

**Andreas Arndt**, pbb's CEO and CFO, said: "The strong operating result for 2017 clearly exceeds the previous year's figure, which benefited from a non-recurring income. Against this background, and in view of pbb's good capitalisation, the Management and Supervisory Boards have resolved to markedly increase the payout ratio until 2019 inclusive – and with a payout of 79% for 2017, we will even exceed this."

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pbb's **guidance for the financial year 2018** is in line with 2017, with profit before taxes of between €150 million and €170 million. The forecast is based on slightly lower aggregate of net interest and commission income, as well as on risk costs estimated in the order of 10 to 15 basis points (bp) of the Real Estate Finance portfolio. pbb aims to keep general and administrative expenses below €220 million in 2018 as well. The application of the new IFRS 9 accounting standard means that year-on-year comparability of individual items will be limited.

Considering its conservative approach to risk, as well as the maturity of the present real estate cycle, pbb aims for a lower volume of new business, between €10.0 billion and €11.0 billion (including extensions of more than one year).

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## FACTS AND FIGURES ON THE 2017 FINANCIAL YEAR

### 1. New business

New **Commercial Real Estate Finance** business was up to €10.7 billion (2016: €9.5 billion). At 18%, the share of extensions of more than one year was virtually unchanged. Growth was driven predominantly by the expansion of business activities into new markets (such as the United States) and client groups, as well as by the broadening of pbb's product range – with unchanged conservative risk standards. High net worth private clients also gained in importance; finally, more new business was generated in so-called 'low-leverage lending'.

- As in the past, Germany accounted for the lion's share in new business, which was almost unchanged at 49% (2016: 47%). Office was once again the most important property type: their share was also in line with the previous year (45%, compared to 42% in 2016).

- New business in the United Kingdom was markedly lower in 2017 accounting for 13% (2016: 18%). pbb has adopted a clearly more selective stance in the UK, given the uncertainty brought about by Brexit. Yet the UK remained pbb's second most important market in 2017 – and the Bank envisages the UK to remain one of its core markets.

  New business in the US, which pbb commenced during the second half of 2016, contributed a share of 8% to new business in 2017.

- The average gross margin on new business declined from >175 basis points (bp) to >155 bp in 2017, reflecting fierce competition overall. In addition, the business policy shift to transactions with lower loan to value ratios had an impact. Net margin on new business remained stable, thanks to low funding cost.

- Loan-to-value ratios fell slightly, from 62% to 60%, and the average term of 5.3 years was in line with the previous year's level (2016: 5.1 years).

New **Public Investment Finance** business totalled €0.9 billion during the period under review (2016: €1.0 billion). Gross margins rose from around 85 bp to above 100 bp. France remained the most important market, albeit with a lower share of 57% (2016: 72%).

## 2. Funding

In 2017, pbb realised new long-term funding of €6.1 billion, which was some 11% more than in the previous year (2016: €5.5 billion). At €3.8 billion (2016: €2.9 billion), Pfandbriefe accounted for more than 60%, with an additional €2.3 billion placed in unsecured issues. pbb also issued €0.5 billion in subordinated liabilities.

Issue spreads on pbb's bonds continued to tighten during 2017, averaging 16 bp (2016: 22 bp) over 3-month Euribor for Mortgage Pfandbriefe; for Public Sector Pfandbriefe they were 11 bp (2016: 28 bp). Spreads for unsecured issues tightened from 111 bp to 75 bp. This means that pbb is also very well positioned compared to its competitors.

## 3. Income statement for the 2017 financial year

(consolidated, prepared in accordance with IFRS, audited)

pbb Group generated pre-tax profit of €204 million in the 2017 financial year. This fell short of the previous year's figure of €301 million – which benefited however from a non-recurring effect of €132 million from the reversal of value adjustments for Heta Asset Resolution AG (Heta; €123 million in net income from financial investments, and €9 million in loan loss provisions ). Adjusted for this non-recurring effect, pre-tax profit 2017 considerably exceeded adjusted pre-tax profit reported for 2016 of €169 million. The positive development of net interest income had a particularly positive effect.

**Operating income**

**Net interest income** rose to €435 million (2016: €404 million). Current net interest income increased due to lower interest expense for maturities of higher-yielding liabilities, and also due to the slightly higher average portfolio margin. The average financing volume in pbb's two strategic segments – Real Estate Finance and Public Investment Finance – rose to €31.8 billion (2016: €31.3 billion), whilst average financing volumes in the non-strategic Value Portfolio continued to decline (€14.8 billion; 2016: €17.3 billion), in line with pbb's strategy. Positive non-recurring income from prepayment fees and from the redemption of liabilities amounted to €31 million, and was below the previous year's level (2016: €52 million). Net fee and commission income from non-accruable fees of €8 million was unchanged year-on-year.

**Net trading income** totalled €-5 million (2016: €-6 million). The credit risk measurement of pbb as well as its derivatives counterparties yielded income of €6 million (2016: expenses of €3 million), whilst interest rate and exchange rate fluctuations led to positive measurement effects of derivatives in the amount of €1 million (2016: €13 million). This was offset by €12 million (2016: € 13 million) in expenses from the pull-to-par effect. In the previous year, the inclusion of the funding value adjustment into derivative measurement translated into expenses of €2 million, with an additional €1 million in expenses was due to the adjustment of estimates used to determine the bilateral Credit Value Adjustments for certain derivative counterparties

Negative **net income from financial investments** (€-4 million; 2016: €125 million) was predominantly due to net additions to portfolio-based allowances, following the changed risk assessment for some Southern European regions. Additional expenses from deconsolidation of a subsidiary in Spain (€1 million) were offset by income from the disposal of securities (also €1 million). During the same period of the previous year, pbb Group recognised income of €123 million from non-recurring effects associated with Heta.

The **net income from hedging relationships** of €-1 million (2016: €6 million) was attributable to ineffective portions from fair value micro-hedge relationships within the range permitted under IAS 39 (80% to 125%).

**Net other operating income/expenses** (€-9 million; 2016: €-29 million) was burdened, inter alia, by the bank levy. Taking into account pledged collateral amounting to 15%, pbb recognised expenses of €19 million (2016: €21 million). Various other factors translated into additional income in the amount of €10 million: these included the disposal of assets held in pbb’s non-strategic Value Portfolio, the outcome of an arbitration process and VAT reimbursements, which together exceeded expenses incurred from provisions recognised for legal risks and litigation costs.

**Loan loss provisions**

Loan loss provisions amounted to a net addition of €6 million (2016: net addition of €1 million). Even though provisions for loan losses exceeded the previous year's figure, they remained below expectations, relative to the overall portfolio and standard risk costs. Specific allowances for a minor number of Real Estate Finance exposures increased by €3 million net. Net additions to portfolio-based allowances of €4 million resulted from the changed risk assessment for a Southern European region in particular. This was offset by €1 million in payments received on loans and receivables previously written off. In the same period of the previous year, there were €6 million in net reversals of specific allowances, €12 million in net additions to portfolio-based allowances, €4 million in recovery payments on previously written-off loans and advances recognised through profit or loss, as well as €1 million in income from the reversal of provisions for contingent liabilities and other commitments.

**General and administrative expenses**

General and administrative expenses increased to €216 million (2016: €198 million). During the same period of the previous year, personnel expenses benefited from the utilisation of provisions recognised in previous periods. Personnel expenses have reached a normalised level in the current financial year, whilst the average staffing level declined. Non-personnel expenses for the period under review were in line with the previous year's level; the item included expenses for a Bank-wide project to further optimise the finance and risk IT target architecture. Specifically, this project comprises, inter alia, the implementation of the requirements resulting from IFRS 9 and other regulatory changes, as well as the adjustment of the IT systems and processes used to prepare financial statements. Non-personnel expenses also included start-up costs for the creation of a public finance portal within CAPVERIANT GmbH, and for the planned opening of a representative office in New York City, scheduled to open in 2018.

**Net miscellaneous income/expenses**

Net miscellaneous income/expenses in the amount of €2 million (2016: €-8 million) was due to the reversal of restructuring provisions.

**Income taxes**

Expenses for current taxes of €39 million (2016: €59 million) and income from deferred taxes of €17 million (2016: expenses of €45 million) resulted in total tax expenses of €22 million (2016: €104 million).

## 4. Total assets
(consolidated, prepared in accordance with IFRS, audited)

Consolidated total assets of pbb Group declined to €58.0 billion as at 31 December 2017, after €62.7 billion the year before. This reflected lower loans and advances to customers, financial investments, and other assets. Loans and advances to customers were down year-on-year since the decline in loans to local authorities exceeded the increase in real estate lending. As at the reporting date, the nominal volume of the strategic portfolio of €31.9 billion slightly exceeded the previous year's figure (31 December 2016: €31.5 billion).

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## 5. Regulatory capital ratios and SREP
(prepared in accordance with IFRS, pbb Group, audited)

As part of its prudential activities, ECB is currently in the process of harmonising risk models used by banks to quantify their risks. This is carried out across Europe, on a case-by-case basis for each individual bank. This process resulted in an increase to pbb's risk-weighted assets of approximately €2 billion during the third quarter of 2017. The ECB's Targeted Review of Internal Models (TRIM) is still ongoing; the deadline was recently postponed to 2019. Hence, it is not yet possible to finally quantify the resulting impact upon pbb's RWA levels.

New regulations imposed by the Basel Committee on Banking Supervision at the Bank for International Settlements – also known as **Basel IV** – will also require further adjustments. However, the stricter requirements will not be effective immediately, but will be gradually phased in from 2022 onwards. Moreover, the EBA published new Capital Guidelines in December 2017. pbb also considers higher RWA levels due to **cyclical market fluctuations** (or stress factors), as well as due a **growth**-driven portfolio increase. Taking all these factors into account, pbb's CET1 ratio would be much closer to its medium-term target of at least 12.5% (or a CET1 ratio between 13% and 14%, which increasingly emerges as a standard in the banking sector).

pbb remains well capitalised despite the RWA increase by approximately €2 billion in 2017 (ratios include the results for 2017, including the proposed dividend distribution; figures for 2016 are stated after appropriation of profits, all ratios fully loaded):

- The **CET1 ratio** stood at 17.6% as at 31 December 2017 (December 2016: 19.0% – both fully phased-in). Notwithstanding the marked reduction, which corresponds to the increase in risk-weighted assets, pbb remains clearly above minimum regulatory requirements.

- The **Own Funds Ratio** rose to 22.2% at the 2017 year-end (December 2016: 20.7%), due to the fact that additional subordinated liabilities issued (€0.5 billion) more than offset the increase in risk-weighted assets.

- The **Leverage Ratio** also increased slightly, to 4.5% (December 2016: 4.2%).

The ECB reduced pbb's **SREP requirements** (the Pillar 2 requirement) for 2018, by 0.5 percentage points; this is offset by an increase of 0.625 percentage points applicable to all banks, given the capital conservation buffer being introduced in stages. Taking into account the countercyclical capital buffer, this results in pbb’s SREP requirement for the CET1 ratio of 9.325% for 2018, following 9.2% in 2017. Assuming full implementation of Basel III rules, the ratio is 9.95% for 2018 (2017: 10.45%).

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**Consolidated Income Statement of pbb Group**
(prepared in accordance with IFRS, audited, € million)

| | 2016 | | 2017 | | | | |
|---|---|---|---|---|---|---|---|
| | **Q4** | **FY** | **Q1** | **Q2** | **Q3** | **Q4** | **FY** |
| Operating income | 113 | 508 | **98** | **105** | **106** | 115 | 424 |
| Net interest and similar income | 112 | 404 | 103 | 103 | 109 | 120 | 435 |
| Net fee and commission income | 3 | 8 | 3 | 2 | 1 | 2 | 8 |
| Net trading income | 4 | -6 | -2 | 2 | -4 | -1 | -5 |
| Net income from financial investments | -3 | 125 | 1 | - | -1 | -4 | -4 |
| Net income from hedging relationships | 5 | 6 | 1 | - | -1 | -1 | -1 |
| Balance of other operating income/expenses | -8 | -29 | -8 | -2 | 2 | -1 | -9 |
| Loan loss provisions | -4 | -1 | **-2** | **2** | **-2** | -4 | -6 |
| General and administrative expenses | -51 | -198 | **-50** | **-52** | **-53** | -61 | -216 |
| Net miscellaneous income/expenses | -3 | -8 | **1** | **1** | **-** | - | 2 |
| Pre-tax profit/loss | 55 | 301 | **47** | **56** | **51** | 50 | 204 |
| Income taxes | -45 | -104 | **-9** | **-9** | **-10** | 6 | -22 |
| Profit/loss after taxes | 10 | 197 | **38** | **47** | **41** | 56 | 182 |

**Overview of the pbb Group**

| | **2016** | **2017** |
|---|---|---|
| **Key financial indicators** | | |
| Earnings per share (€) | 1,46 | 1,35 |
| Dividend per share (€) | 1,05 | 1,07[1)] |
| Cost/income ratio (in %) | 39,0 | 50,9 |
| Return on equity before taxes (%) | 11,1 | 7,3 |
| Return on equity after taxes (%) | 7,3 | 6,5 |
| | | |
| **Balance sheet figures (IFRS)** | **31.12.2016** | **31.12.2017** |
| Total assets (€ bn) | 62,7 | 58,0 |
| Financing volume (€ bn) | 31,5 | 31,9 |
| Equity (€ bn) | 2,8 | 2,9 |
| | | |
| **Regulatory indicators** | **31.12.2016[2)]** | **31.12.2017[3)]** |
| CET1 ratio (fully phased-in; %) | 19,0 | 17,6 |
| Own funds ratio (fully phased-in; %) | 20,7 | 22,2 |
| Leverage Ratio (fully phased-in[4)]; %) | 4,2 | 4,5 |

1) Proposed to the Annual General Meeting on 21 June 2018

2) After confirmation of the 2016 financial statements and after result distribution

3) After confirmation of the 2017 financial statements, less the proposed dividend (subject to approval of the AGM).

4) The Leverage Ratio is defined as the ratio between tier 1 capital and the relevant exposure according to the CRR.