DEUTSCHE PFANDBRIEFBANK

Annual press briefing

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1. Introduction

Good morning, Ladies and Gentlemen.

Welcome to the annual press briefing of pbb Deutsche Pfandbriefbank.

High competitive pressure and tight margins, a fundamentally sound commercial real estate market environment, and continuously rising regulatory activities: these were the defining factors for the real estate finance sector in 2017 – and these naturally also apply to pbb as one of the leading real estate finance providers in Europe. Despite this challenging environment, pbb **grew its new business** and, once again, **generated sound results**, clearly exceeding the adjusted 2016 figure as the previous year benefited from non-recurring income (*diagram 2*).

- **New business** amounted to **€11.6 billion** and was thus higher than in the previous year (€10.5 billion).

  Growth was driven predominantly by the **expansion of our business activities** into new markets and client groups, as well as by the broadening of pbb's product range – with unchanged conservative risk standards. The real estate financing market in the US, which pbb re-entered in the second half of 2016, contributed approximately 8% to the new business volume in 2017.

  Gross margins on new business remained under pressure. However, pbb continued to strengthen its position on the funding markets, therefore significantly reducing fund-raising costs in the year 2017 – not least due to a long-term rating of A- which was upgraded by two notches. As a result of the lower funding costs, our competitive edge has further improved; we were able to **keep our net margins on new business more or less stable**.

- Interest expenses decreased markedly, thanks to the more favourable funding terms and the maturity of higher-yielding issues, leading to a significant improvement in **net interest income**. At the same time, **risk costs** for the loan portfolio remained at a very low level, whilst **general and administrative expenses** were higher, inter alia as a result of further increasing regulatory requirements as well as strategic measures and projects.

  On the whole, we achieved sound **profit before taxes of €204 million** (or profit after taxes of €182 million).

- Against the background of this good result and pbb's sound capitalisation, the Management Board and Supervisory Board have resolved to increase the payout ratio for the years 2017 to 2019; the current distribution ratio of between 40% and 50% of consolidated profit after taxes in accordance with IFRS is set to be raised to a regular dividend of 50% plus a special dividend of 25%. In addition, a one-off distribution of profit after taxes exceeding the original guidance of €170 million has been proposed for 2017. Based on this, the Management Board and Supervisory Board will propose to the Annual General Meeting the distribution of a **dividend** of **€1.07 per share**, resulting in a total distribution ratio of 79% for the year 2017.

  In other words: instead of 40% to 50%, it is now 50% plus 25% for three years, plus the distribution of higher income from 2017.

- On the one hand, we implemented initiatives for the successful expansion of our real estate financing business in 2017, on the other hand, we also cautiously, but consistently pursued further steps towards digital initiatives and the **digital transformation** of pbb. Our newly established subsidiary CAPVERIANT GmbH is developing a portal for public-sector financings. Its main function will be to intermediate loan supply and demand. pbb is planning additional digitalisation initiatives in its core Real Estate Finance business.

2018 will be no less challenging than 2017. Taking into consideration the continuous increase in supervisory action, as mentioned before, the competition, and the boom in the commercial real estate sector – and the associated risks –, our approach remains deliberately conservative. Thus, we maintain a decidedly cautious outlook for 2018. Nevertheless – or, more precisely, just because of this – we will continue to work hard for pbb to continue its successful development in the next few years.

2. 2017 results

This concludes my brief overview. Now I will turn to the individual items, beginning with the 2017 financial statements.

Whilst 2016 was affected by the non-recurring 'Heta' income, two basic operating tendencies impacted the 2017 results: a higher net interest income and far lower risk costs. For better comparability, when talking about the 2016 results, I will be referring to the results **adjusted for the Heta effect**. As a reminder: the year 2016 was positively influenced by write-ups on Heta exposures totalling €132 million – specifically, reported in net income from financial investments (€123 million for seven securities) and loan loss provisions (€9 million for two promissory note loans).

The figures for pbb's 2017 consolidated financial statements were prepared by the Management Board, in accordance with IFRS, and audited. They are scheduled to be approved by the Supervisory Board, and the annual report will be published by the end of March.

2.1 Income statement 2017

This brings me to the individual items of the income statement for 2017. I will concentrate on the drivers of our business, i.e. net interest income, loan loss provisions and general and administrative expenses, but you will find more detailed information in today's press release.

- The Bank's **pre-tax profit** amounted to €204 million (*diagram 3)*, clearly exceeding the adjusted results for the previous year (2016: €169 million – including non-recurring income from Heta: €301 million). In the fourth quarter of 2017, we upped our initial guidance to €195-200 million; we slightly exceeded our projections.

- **This development was driven** by higher than expected aggregate of net interest income and net fee and commission income, as well as by a persistently low level of loan loss provisions. Both these aspects are encouraging, as they directly reflect the improvement of our funding and risk-conservative positioning.

- **Net interest income** rose to €435 million (2016: €404 million) as a result of disproportionately lower interest expenses. This was due to various factors:

  - We benefited from considerably lower new issue spreads in 2017, outperforming the market.
  - We therefore not only achieved new business funding at more favourable levels, but also exchanged maturing higher-yielding liabilities with cheaper new issues.
  - Finally, we reduced the structural excess liquidity by raising less new funds.

  The positive net interest income development was supported by a slight **increase in the Bank's strategic positions**, the latter of which however remained below our expectations as per the beginning of the year.

  Prepayment penalties on the other hand played a less important role than in the previous year. In addition, other non-recurring effects did not have such a strong favourable impact on results. In this respect, our **current net interest income** has improved to a higher extent than a comparison of absolute figures would suggest.

- **Net fee and commission income** was stable, at €8 million.

- For years, pbb's **loan loss provisions** have been on a constantly low level. With net additions of €6 million resulting mainly from a changed risk assessment of a Southern European region and from changed default probabilities and default rates, 2017 proved to be no different.

  Even though loan loss provisions exceeded the previous year's figure (2016: net addition of €1 million), they remained well below the standard risk costs we include on our planning. The low level of loan loss provisioning reflects pbb's **conservative risk policy**, as well as the market environment, which has remained benign.

  Aggregate allowances for losses on loans and advances fell from €130 million to €71 million in 2017, because we further reduced our already low level of problem loans. Based on a gross residual non-performing loan portfolio of only €204 million, the **coverage ratio** decreased from 29% as of end-September 2017, to 12% at year-end. The reason for this low figure is that we worked out problem loans during the fourth quarter which were almost fully covered by loan loss provisions. A large part of the remaining problem loan portfolio is attributable to a synthetically hedged portfolio for which no loan loss provisions were necessary. Lest this effect, the coverage ratio would have remained at approximately 30%.

- **General and administrative expenses** climbed to €216 million (2016: €198 million).

  - This increase was due mainly to higher **personnel expenses** of €119 million (2016: €103 million) - despite the fact that the staffing level declined. The increase almost exclusively reflected technical factors: as reported, personnel expenses in 2016 benefited from the utilisation of provisions recognised in previous periods (approx. €12 million). Adjusted for this amount, the comparable figure is €115 million. On an operating level, personnel expenses remained broadly stable in 2017.

  - o **Non-personnel expenses** of €97 million in the year under review were also roughly in line with the previous year's figure of €95 million, even though additional expenses were incurred. These were related to phase 2 of our Bank-wide project to further optimise the finance and risk IT target architecture, in the scope of which requirements such as IFRS 9 and a large number of regulatory changes were implemented. In addition, non-personnel expenses included start-up costs for the establishment of the CAPVERIANT portal (for intermediating public-sector financings) as well as for the opening of a representative office in New York in 2018.

    Significant **cost savings** in all areas were able to nearly completely offset these additional costs.

  The **cost/income ratio** improved slightly to 50.9% compared to the previous year's figure, when adjusted for the Heta non-recurring income (2016: 51.4%).

- We tend not discuss measurement results. However, the change in **net income from financial investments** was so significant in 2017 that I would like to give a brief explanation. In 2016, net income from financial investments of €125 million was clearly positive – due to the Heta effect. In 2017, the negative net income from financial investments amounting to €–4 million was especially burdened by net additions of portfolio-based allowances following the changed risk assessment for some Southern European regions.

- **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 net provisions recognised.

- **Profit after taxes** amounted to €182 million or €1.35 per share as a result of a very low tax rate. The **tax rate** for current and deferred taxes decreased to 11% in 2017 due to the temporary differences between items carried on the balance sheet and their recognition under tax law, the capitalisation of future tax benefits, and the reversal of provisions for tax risks in previous years. The current tax rate remained at the projected level of around 20%.

2.2 Dividend proposal

Against the background of this good result and pbb's sound capitalisation, the Management and Supervisory Boards have resolved to implement a new **dividend policy** *(diagram 4)*.

- The current distribution ratio of between 40% and 50% of consolidated profit after taxes in accordance with IFRS is set to be raised to a **regular dividend of 50%** plus a **special dividend of 25%**, until 2019 inclusive.

- Over and above the increased dividend, we want to distribute profit (after taxes) over and above our original results guidance, in full, for the financial year 2017, equating to a dividend of €1.07 per share and a distribution ratio of 79%.

- The dividend policy is subject to **regular review** against legal and regulatory requirements, as well as in terms of commercial viability.

As I mentioned earlier, the new dividend formula basically means the following: instead of 40% to 50%, it is now 50% plus 25% for the years 2017 to 2019, in addition to distribution of the income exceeding the guidance in 2017.

Adopting our new dividend policy, we have considered our strong capital base, whilst bearing in mind ongoing considerable regulatory requirements, potential cyclical market fluctuations, as well as our planned strategic growth.

3. Statement of Financial Position

3.1 Total assets

pbb Group's consolidated total assets as at 31 December 2017 amounted to €58.0 billion, therefore implying a decrease of €4.7 billion (December 2016: €62.7 billion). The decrease reflects the significant reduction of excess liquidity in the items cash reserve, loans and advances to banks, and financial investments on the one hand, and further maturities of assets held in the non-strategic portfolio on the other hand – which directly led to lower funding requirements and lower funding costs. At €31.9 billion, the nominal volume of the strategic portfolio slightly exceeded the value as at year-end 2016 (€31.5 billion). The highest contribution came from Real Estate Finance which grew its business by €0.8 billion.

3.2 Financial statements

The **IFRS 9 accounting standard** superseding the IAS 39 standard for periods commencing on or after 1 January 2018, will – for one thing – fundamentally change the accounting of financial instruments. These mainly comprise loans, securities, financial liabilities and derivatives, which collectively represent more than 95% of pbb Group's total assets.

Overall and after deferred taxes, as of 1 January 2018 IFRS 9 results in a **positive first-time application effect**, recognised directly in equity in accordance with IFRS, of €109 million. The increase in equity is the result of a positive effect from the classification and measurement of €158 million before deferred taxes, which exceeds a negative impairment effect in the amount of €32 million before deferred taxes.

These impairment charges are attributable to a change in the **method for determining loan loss provisions**. In short, this change affects the trigger, moving from an 'incurred loss' model to an 'expected loss' model, as well as the determined amount, changing from the 'most probable value' (more likely than not) to the 'probability-weighted value' of various scenarios.
Changes to the values for loan loss provisions are therefore due to changing methodologies and do not necessarily reflect a change of the existing risk assessment. This also applies to the recognition (or non-recognition) of provisions for the synthetic securitisation transaction **ESTATE UK3**, or – more specifically – the assets hedged with this transaction. A predecessor institution of pbb had hedged loan defaults of a real estate portfolio with this transaction.

- Therefore and as communicated, the **2017 financial statements** according to IAS 39 do **not include loan loss provisions** for this securitisation, as we believe the prerequisites for a full allocation of losses have been met. Thus, we continue to believe that a default as at the end of 2017 is not highly probable.

- The **IFRS first-time application effect however includes a loan loss provision** for the receivable hedged by the ESTATE UK3 transaction; this effect is derived from the probability-weighted value of various conceivable scenarios.

- We continue to believe that a default is not highly probable.

4. Regulatory indicators 2017

4.1 Risk-weighted assets

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. As a result of this process, pbb's risk-weighted assets increased by approximately €2 billion in the third quarter of 2017 *(diagram 5)*. The so-called 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. A study by the European Banking Authority (EBA), published in December 2017, gives an indication of the impact these changes may have on pbb. Based on portfolio figures per year-end 2015, EBA estimates an RWA increase of around 15% for the large, systematically important institutions. However, the stricter requirements will not be effective immediately, but will be gradually phased in from 2022 onwards. EBA also published new Capital Guidelines in December 2017; we are still analysing them.

The increase in risk-weighted assets is obviously not only driven by regulation. We have to consider **cyclical market fluctuations** or stress factors as a reason for higher RWAs. Furthermore, a portfolio increase through **growth** – accompanied by higher RWAs – is to be considered.

Taking all these factors into account, pbb's CET1 ratio would be much closer to our medium-term target of 12.5% (or a CET1 ratio between 13% and 14%, which increasingly emerges as a standard in the banking sector).

4.2 Capital ratios

The current, fully phased-in, capital ratios are as follows. Despite the RWA increase in the third quarter and the above-mentioned potential additional RWA requirements, pbb has a very solid capital base (the capital ratios already include the 2017 result based on the previously-mentioned dividend proposal; the comparable figures for 2016 are to be understood as per appropriation of profits).

- The **CET1 ratio** amounted to 17.6% as at end-December 2017 (12/2016: 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 – including the so-called SREP ratios, which I will discuss in more detail later on.

- The **own funds ratio** climbed to 22.2% as per year-end 2017 (12/2016: 20.7%), as the issuance of additional subordinated liabilities (amounting to €0.5 billion) overcompensated the increase in RWAs.

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

4.3 SREP

Within the scope of the Supervisory Review and Evaluation Process (SREP), supervisory authorities assess and measure the risks individual banks are exposed to.

ECB reduced pbb's **SREP requirement** (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 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%).

In 2019, the capital conservation buffer will increase once more, by an additional 0.625 percentage points, for all banks. Currently, we cannot foresee whether an individual reduction will occur for pbb – as seen for 2018.

5. Performance of the operating business in 2017

5.1 New business

Once again – I mentioned it at the beginning – the year 2017 was defined by intense competition in our strategic business segments. Nevertheless, pbb **significantly expanded** its volume of new business – including extensions of more than one year – **to a total of €11.6 billion** (2016: €10.5 billion). We did not 'buy' the increase by applying lower risk standards; instead, we increased our efforts in order to select the right business.

The increase is attributable to Commercial Real Estate Finance, whilst the volumes in Public Investment Finance declined slightly. 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.

5.1.1 Real Estate Finance

New Commercial Real Estate Finance business climbed to **€10.7 billion** (2016: €9.5 billion). At approximately 17%, the share of extensions of more than one year was virtually unchanged *(diagram 6, SEGMENT REF, AP 15)*.

Growth was driven predominantly by the expansion of business activities into **new markets and client groups**, as well as by the **broadening of pbb's product range** – with unchanged conservative risk standards. This applies, on the one hand, to the US business. High net worth private clients also gained in importance; finally, more new business was generated in so-called 'low-leverage lending' – measures with the declared objective of enlarging the number of clients and business partners and thus the potential business volume on the basis of low loan-to-value ratios, strong equity, and a very good sponsoring background. Due to the estimated market developments, and as a result of the risk-conservative approach, the impact of these measures on the average gross interest margin is an accepted outcome. We want to prepare the Bank for the upcoming challenges, making it resilient and stable.

- 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: the share was also in line with the previous year (45%, compared to 42% in 2016).

- New business in the **United Kingdom** was markedly lower, both in absolute and relative terms – in 2017 it accounted for 13% (2016: 18%). We have adopted a 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 we expect that the UK will remain a core market for pbb.

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

- As I had mentioned, **gross margins** remained under pressure, far more than expected at the beginning of the year. The recovery we observed in the second quarter did not continue, and the fourth quarter's habitually higher margins failed to appear this year. The average gross margin on new business declined from >175 basis points (bp) to >155 bp in 2017.

  In addition to the conscious shift towards business with low loan-to-value ratios – the overall European market tendency of declining gross margins as a result of stronger competition was responsible for this development.

  Competition amongst finance providers is particularly strong for **business with conservative risk levels** – which pbb pursues.

  Nonetheless, **net margins on new business** remained stable, thanks to low funding costs, as outlined in the notes to the income statement.

- **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).

5.1.2 Public Investment Finance

At **€0.9 billion** (rounded), new business volume in Public Investment Finance was approximately €50 million lower year-on-year (2016: €1.0 billion). Encouragingly, **gross margins** rose from around 85 bp to over 100 bp *(diagram 7, SEGMENT PIF, AP 16).*

France was and is our most important market, albeit with a lower share of 57% (2016: 72%). With a share now amounting to 22% (2016: 12%), **Spain** gained importance.

5.2 Portfolio

This brings me to our portfolio *(diagram 8, PORTFOLIO AP 19)*. As you know, pbb has two strategic portfolios: Commercial Real Estate Finance and Public Investment Finance, and, in addition, the non-strategic Value Portfolio, which is being run off. As at year-end 2017, the **total portfolio** amounted to **€45.7 billion** (2016: €47.3 billion; both figures excluding 'Consolidation & Adjustments' with internal consolidation items and businesses not belonging to the operating segments).

- The **strategic portfolio** increased slightly as per year-end 2017, to €31.9 billion (December 2016: €31.5 billion).

  The **Real Estate Finance portfolio** also climbed marginally during the period under review, to €24.9 billion (December 2016: €24.1 billion). At the same time, the **Public Investment Finance portfolio** fell from €7.4 billion to €7.0 billion.

  We had anticipated a more pronounced increase for the Real Estate Financing portfolio. As in previous years however, besides regular **maturities**, early repayments contributed to this development.

- The **Value Portfolio** fell as scheduled, by €2.0 billion to €13.8 billion in 2017, almost entirely thanks to natural run-offs.

5.3 Funding and ratings

I will end the disclosures on the 2017 financial year by taking a look at pbb's successful funding activities. In this context, I will also mention aspects of our rating.

5.3.1 Funding volumes

In 2017, pbb realised new long-term funding of **€6.1 billion**, which was some 8% more than in the previous year (2016: €5.5 billion) *(diagram9, FUNDING AP 23)*. At €3.8 billion (2016: €2.9 billion), Pfandbriefe accounted for more than 60%, with €2.3 billion placed in unsecured issues. We 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.

5.3.2 Rating

Given that pbb predominantly realises its funding activities via the capital markets, our rating is crucial. We need to distinguish between the rating for unsecured issues and for Pfandbriefe.

- pbb's **unsecured ratings** were substantially influenced by legislative changes and, in this context, changes to rating methodologies. Rating actions took place particularly as a result of regulatory specifications concerning implementation of the EU Bank Recovery and Resolution Directive (BRRD).

    - S&P has **split the rating class** for “senior unsecured” debt, for instance. Depending on the future ranking in a bail-in or insolvency scenario, such debt will be allocated either to a new "senior subordinated" rating class or remain in the current "senior unsecured" rating class.

    - The long-term rating for pbb's **"senior unsecured"** debt was upped by two notches, from "BBB" to **"A–"** (with a negative outlook), therefore establishing pbb's new issuer rating.

      On the other hand, the long-term rating for **“senior subordinated”** liabilities **declined** by one notch, from “BBB” to **“BBB–”**.

- pbb's **Pfandbrief ratings** assigned by Moody’s remain unchanged, at **Aa1**.

6. Outlook

Ladies and Gentlemen, that completes my review of 2017 – let us now look ahead. I will discuss the challenges our sector is facing, and the measures we are planning to take, deriving a specific outlook with the relevant indicators for the year 2018.

6.1 Challenges and initiatives

You have all been following the real estate finance sector for years. In the last years, various aspects – especially the topics *competition* and *regulation* – were a common theme. Meanwhile, the topic of *digitalisation* is gaining momentum and importance.

6.1.1 Competitive environment

From pbb's view, the commercial **real estate markets** in Europe and the US are showing a mixed picture:

- The high price levels, unabated strong demand for residential and office premises due to demographic agglomeration in large centres and positive economic prospects, as well as the continued healthy availability of equity, all support the aforementioned development.

- On the other hand, we are seeing first signs of rising yields in some European markets. Generating 'real' primary market transactions is becoming increasingly challenging.

Competition remains intense – and the resulting **margin pressure** persists.

- The latter not only applies to new business and extensions; it is also reflected in the **early repayments**. A loan agreement is only protected by prepayment penalties in the first years of its term; as a general rule, penalties are completely cancelled after three years. At the latest then the competition for existing financings begins – in some cases, financings are terminated despite prepayment penalties, if another finance provider offers more attractive conditions. This margin pressure tends to lead to lower interest income, whilst – at the same time – the costs for capital adequacy requirements increase as a result of changed regulatory standards.

- Within this context, we are slightly concerned about the **state of the real estate markets** beyond the above-mentioned fundamental developments.

  In some markets, we are observing that other finance providers are softening **covenants**, i.e. waiving restrictive contractual terms and accepting less stable financing structures. This willingness varies by degrees. Occasionally, market participants overlook that covenants have a long-term impact: they protect lenders in challenging situations over the entire term of the loan, and create transparency for the borrower.

  At the same time, in some cases lenders as well as borrowers are entering into transactions **that are outside the scope of their traditional business**, a development which can be problematic if and when the markets turn around.

We have no choice, we will face the competition - adhering to our **risk standards and profitability requirements**. We turn away business that does not meet our requirements and select new business (even more) carefully regarding margin and risk. This is particularly important in the cycle of the real estate market, which – according to all market observers – is quite advanced already. Against this background, we have deliberately chosen a more cautious business plan, and are expecting a lower new business volume in 2018.

In this context, the **US** market is highly important for us as it holds large potential. We are thus expanding our solution space, in order to select the right business for pbb.

- As is our nature, we organised the market entry in a diligent and cautious manner. First we concentrated on **co-financing with strategic partners**.

- The successful performance of our business activities on the US market leads us to **expanding our exposure**.

  This makes a **local presence** essential. For this reason, we want to add a representative office in the United States to our network of foreign locations. We envisage opening an office in New York City in the first half of 2018 with sales experts with profound market expertise and property valuers on the ground in the second quarter of this year. We have all the necessary licences.

  By establishing a local presence, we create the conditions for **directly originating new business** and moderately expanding the business beyond the current **regional focus** on the East Coast metropolitan areas of New York, Boston, and Washington.

6.1.2 Regulation

In the aftermath of the financial crisis, supervisory authorities implemented many necessary and useful steps, significantly increasing **stability**. Whilst we welcome this, we are **concerned** about some developments:

- The efforts we, as banks, have to undertake, are very significant. This has translated directly into higher costs. At pbb, for example, this means additional personnel expenses in the areas of data security and Compliance.
- On a very general level, we are also observing that supervisory authorities de facto apply regulatory measures before they are legally bound to do so.
- We are critical of measures providing false incentives.

We need to find the right answers for these challenges. One approach is to generate income from business which does not burden equity – a goal we are following up with our finance portal for public-sector financings, as part of our digitalisation strategy.

6.1.3 Digitalisation

Digitalisation provides us with **opportunities**. We are not waiting for – possibly also new – competitors to attack our business model with new digital solutions; instead, we want to actively shape our model – based on the opportunities digitalisation is offering us.

As such, we are working on a **portal solution for public-sector budget financing**. Our newly established subsidiary CAPVERIANT is developing this portal, whose main function will be to intermediate loan supply and demand. CAPVERIANT will start in Germany, covering further countries and offering additional functional features and services we want to develop in cooperation with our clients.

Additional **digitalisation initiatives in pbb's core business** are planned. These will be placed at the interface between our clients and our internal processes. We want to provide added value for our clients, and increase our internal efficiency.

6.2 Objectives for 2018

This is the framework within which we are moving in 2018. Against this background, we have resolved to implement the following *(diagram 10 OUTLOOK 2018, AP 27)*:

- We are aiming for **new business volume** of between €10.0 billion and €11.0 billion, including extensions of more than one year. We would thus be below the previous year's level – nevertheless, due to the much advanced real estate market cycle, we think this cautious approach is necessary.

- We expect the strategic **financing volume** to slightly rise in the business segments Commercial Real Estate Finance and Public Investment Finance, because we anticipate lower early repayments.

  We assume **margins** on existing exposures will stabilise, whilst gross margins on new business will only mildly continue to fall.

- As a result of the new accounting standard IFRS 9, changes apply to individual income statement items. For this reason, comparing individual items with the previous year will only be possible to a limited extent.

  - Based on the aforementioned, we expect a slightly lower aggregate of **net interest and commission income**.
  - Despite our cautious new business selection, we assume a greater convergence of actual risk costs to anticipated risk costs – derived from historical data – in 2018. Thus, due to our cautious approach to business, we have considered an increase of **loan loss provisions** compared to the low actual level in 2017. We expect risk costs in the order of 10 to 15 basis points on the Real Estate Finance portfolio, without implying individual events or specific requirements. As such, the risk costs would be the main delta with respect to the previous year’s result.
  - Despite higher regulatory costs, we do not anticipate **general and administrative expenses** to increase year-on-year. Even so, we aim to keep these expenses below our medium-term guidance of €220 million in 2018 as well.

- We are targeting **profit before taxes** of between €150 million and €170 million for 2018.

With this guidance, we are more or less in line with the projections and indications we made when publishing our figures for the third quarter of 2017 – despite the fact that general market conditions deteriorated somewhat, instead of improving. Thus, pbb is promising a robust result, in accordance with the adjusted results of the previous years.

7. Summary

Ladies and Gentlemen; in short:

- pbb has **not swayed from its road to success** in 2017, indeed it has been working even harder than before.

    - By generating new business volume of €11.6 billion, we were only just below the record year 2015, and exceeded the year 2016.
    - Our pre-tax profit of €204 million was the second-highest in the history of pbb – after the year 2016, which benefited from a non-recurring effect.
    - Finally, we want to distribute our hitherto highest dividend of €1.07 per share; we have also raised our dividend policy for the next two years.

- We cannot afford to – and we will not – **rest on our laurels**, as our core business will not become easier in the near future.

    - We want to proceed prudently and maintain our conservative profile, faced with a highly advanced real estate market cycle.
    - With a wider presence in the US, and as a result of further digitalisation, we recognise further opportunities.

- We are entering the year **2018 with an ambitious guidance**. If we deliver on our projections, we would be able to take up the good results we generated in 2017 – structurally and before risk costs.

Thank you very much for your attention. Please do not hesitate to ask any questions.