Investitionsbank des Landes Brandenburg ILB

Management Report 2016

Investitionsbank des Landes Brandenburg

Consolidated Management Report 2016

Investitionsbank des Landes Brandenburg

I Fundamentals of the group

1. Business model of the group

1.1 Basis of business activities

Investitionsbank des Landes Brandenburg (ILB) is the central business promotion institute of the federal state of Brandenburg and in this capacity supports the implementation of business development policy in Brandenburg. The ILB law determines the framework for ILB's activities and forms the basis for its business which directly or indirectly serves the implementation of the bank's statutory task as a business development institute. The bank is authorised to issue official administrative decisions as an approval authority.

Pursuant to the ILB law, the bank bears public-sector responsibility and guarantor's liability and is protected by a federal-state guarantee. Pursuant to its articles of association, ILB conducts its business according to commercial principles whilst at the same time respecting the common interest and strict competition neutrality. ILB and its eleven subsidiaries form the ILB group. With a share of 99.9 % of the group's balance sheet sum, ILB accounts for almost the entire business development of the group.

The federal state of Brandenburg and NRW.BANK each hold a 50 % stake in the bank.

1.2 Mission

As the business development bank for the federal state of Brandenburg, ILB supports the federal state in implementing its structure and economic policy. In this capacity, it facilitates the support programmes of the federal state in the fields of business, labour, infrastructure and housing. As an intermediary, ILB approves funds from the ERDF (European Regional Development Fund), the ESF (European Social Fund) and from the EAFRD (European Agricultural Fund for Rural Development) in the federal state of Brandenburg. In this capacity, ILB is responsible for operative execution on behalf of the ministries of the federal state of Brandenburg. The bank's business management duties involve a wide range of tasks, such as consultancy services, application processing, preparation of proposals for funding committees, approval and disbursement of funds, comprehensive documentation and reporting obligations, verification of fund application documentation as well as the further development of guidelines.

Furthermore, the bank is entrusted with the administration of the trust funds assigned to it by the federal state of Brandenburg and with the formation and management of special funds. In this context, the bank holds the housing assets of the federal state of Brandenburg (LWV) in trust as legally dependent assets and awards funds for undertakings in the commercial and media sectors.

1.3 Aims of the business activities and strategies of ILB and the group

The purpose of the business development strategy is to ensure long-term fulfilment of ILB's business development mission pursuant to its articles of association and the ILB law. Implementation tools include the products offered by ILB as part of its business management activities and from its own portfolio.

The key aims of ILB's business management can be summarised as follows.

- ILB is continuously expanding its function as the central business development institution and supports the promotional and funding policy of the federal state of Brandenburg with its banking expertise and within the scope of its overall strategy.
- ILB's central functions which the bank pursues on behalf of the federal state of Brandenburg are strengthened for this purpose. The aim is for ILB to bundle all tasks related to monetary support measures by the federal land, in particular, EU support measures.
- Increasingly complex support processes are currently vetted under cost and efficiency aspects.

The key aims of ILB's own products can be summarised as follows.

- With its own portfolio, ILB supports the long-term and comprehensive availability of loans in the federal state of Brandenburg in order to finance investment projects in the fields of business, labour infrastructure and housing.
- In line with its risk policy, ILB is continuously developing its own portfolio (Brandenburg loan family) in order to compensate for the share of EU and federal-state funds which is set to decline in the medium term.

1.4 Products and services

ILB offers its customers low-interest loans, grants, interest rate subsidies, liability exemption, guarantees as well as venture and investment capital from funds of the federal state, the federal government and the European Union (EU) as well as from refinancing on the capital market. With its equity capital firms, the bank is improving the equity situation of undertakings in the federal state of Brandenburg. The property firms not only develop and rent out property projects, but also promote tourism in the city of Potsdam and the establishment of companies.

Apart from distributing budget funds, the bank itself grants loans, a significant share of which is secured by first-ranking land charges or public guarantees.

ILB's core business is loan business with commercial industries – including agricultural companies – as well as loans to the federal state of Brandenburg, its municipal authorities and social institutions. ILB grants low-interest global loans to banks (applicant's bank procedure) in order to enhance the loan supply to the commercial sector and, when necessary, also enters into syndicated loan agreements as a consortium partner. ILB also co-finances film productions in order to strengthen the Berlin-Brandenburg media region. Housing is another focus of the bank's loan portfolio.

The bank refinances most of the funds which it needs for its tasks from the European Investment Bank (EIB), KfW Bankengruppe (KfW), Landwirtschaftliche Rentenbank (LR), the Council of Europe Development Bank (CEB) and by issuing its own promissory notes.

ILB acts as the lead institute for the savings banks in Brandenburg. In this capacity, it supports the customer support staff of savings banks in their advisory services regarding KfW products, the structuring of support funds (also as part of package financing) and the forwarding of loan applications and pledges. In this context, ILB offers training and advisory meetings to customer support staff of savings banks and provides a web-based information portal.

II Economic Review

1. Economic conditions in Germany

Despite a high degree of international uncertainty, Germany's economic situation in 2016 was marked by strong and consistent economic growth. According to the latest calculations by the Federal Statistical Office, price-adjusted gross domestic product (GDP) grew by a good 1.9 % against the previous year, a figure recorded last in 2011. This marked a continuation of the positive economic trend of recent years. In the two years before, GDP growth reached comparable levels, i.e. 1.7 % in 2015 and 1.6 % in 2014.

Economic development was strongly driven by domestic factors. According to the Federal Statistical Office, private consumption was around 2 % up against the previous year, while government consumption spending increased by as much as 4.2 %, not least due to the large number of migrants seeking protection and the resultant expenditure. All in all, consumption grew by 2.5 % and was thus once again the strongest driver of German economic growth. Gross investment in capital assets also rose by 2.5 % and supported economic development.

Economic performance in 2016 fared slightly better than predicted at the beginning of the year. In spring, the German government still expected 1.7 % growth.

According to the Federal Statistical Office, economic development in 2016 can be summarised as follows:

- Consumption with its +1.9 percentage point growth contribution was once again the driving force.
- Gross investment made a slightly positive growth contribution (+0.2 percentage points).
- Exports, in contrast, had a slightly decelerating effect on economic growth because imports grew stronger than exports during the year.

Economic development in 2016 was driven not least by positive developments on the labour market. The number of people employed in Germany increased significantly and reached an all-time high of 43.5 million in 2016. At the same time, the unemployment figure fell on an annual average below the 2.7 million mark for the first time since 1991. Central drivers of domestic consumption were the good employment situation, strong development of incomes, low oil prices as well as low interest rates.

Public budgets continued their consolidation course in 2016, recording a surplus of EUR 23.7bn. According to the Federal Statistical Office, the surplus rate totalled 0.8 % in terms of price-based GDP.

In 2016, just like in the previous year, capital market interest was determined by the low-interest environment due to the ECB's bond purchasing programme, negative interest on deposits as well as certain political events. In the 1st quarter, the ECB reduced its interest rate on deposits further to 0.40 %, so that capital market interest rates reached the low levels of the previous year. Following Britain's decision to leave the EU, interest rates fell further, marking new lows. The returns on German government bonds fell to negative values even for long-term maturities. In the 3rd quarter, 10-year government bonds fell to a return of around 0.15 %, with the comparable 10-year interest swaps falling to around 0.25 % and thus just about managing to stay in the positive range. It was not until the 4th quarter of 2016 that long-term returns picked up significantly again, reaching 0.40 % for German government bonds and 0.80 % for interest rate swaps with a 10-year maturity. Reasons for this included the slightly increasing inflation, also due to higher oil prices, the surprising outcome of the US elections and finally the announcement of investments in infrastructure and the prospect of further interest rate increases in the US. In contrast to this, short maturities on the money market remained stable in the negative interest range.

All in all, 2016, just like the previous year, saw a very favourable capital market environment where public budgets were supported by lower interest spending and low financing costs facilitated investments and housing construction.

2. Economic conditions in the federal state of Brandenburg

Since 2003, the unemployment rate in the federal state has fallen continuously. This positive development on the regional labour market was also visible again in 2016. The average rate totalled around 8.0 % and thus fell to the lowest level since German reunification.

The number of people in jobs reached a new high in 2016, driven mainly by new jobs that were created in the service sectors. The processing sector in the federal state of Brandenburg also recorded a positive trend.

According to the federal state's statistical office, Brandenburg's industrial enterprises recorded total turnover of EUR 23.1bn in 2016, 0.1 % down against the previous year. Domestic turnover increased by 1.9 % to EUR 16.0bn, export turnover decreased by 4.2 % to EUR 7.1bn.

According to official statistics, order intake was generally lower than in the previous year. Orders on hand declined by 2.0 %, while domestic orders were up by 1.4 % and foreign orders down by 7.4 %.

Turnover for the construction industry increased in 2016 by 7.8 %, whilst order intake saw a 4.0 % increase.

According the data currently available, Brandenburg's GDP developed positively in 2016. According to the federal state's statistical office, Brandenburg's GDP grew strongly by 2.9 % in the first half of 2016. The federal state of Brandenburg thus recorded the third-strongest growth of all federal states.

3. Course of business

3.1 Promotional and development business

ILB's funding and support portfolio once again met with a very positive response from Brandenburg's business community, private households, municipal administrations and the housing sector. Demand for business development loans through savings banks acting as the applicants' banks in the federal state of Brandenburg was once again high. In 2016, ILB pledged a total volume of EUR 1,992m.

Promotional and development business in 2016 included, for instance, the following:

- The volume of EUR 1,909m to be pledged for 2016 was exceeded by EUR 83m (+4 %) and thus totalled EUR 1,992m.
- The previous year's volume of EUR 1,454m was exceeded by EUR 538m (+37 %).
- This was the highest sum pledged by ILB in the last twenty years.
- The main reason for the marked increase is growing demand for ILB's products, including financing of BER Airport. This meant a significant increase in the volume pledged of 48 % to EUR 1,454m (2015: EUR 983m).
- ILB's products in the total sum pledged in 2016 accounted for a share of 73 %.
- All the promotion areas in the field of managed activities recorded positive demand. The launch of the programmes of the new Operational Programme 2014 to 2020 was largely completed both in the ERDF and in the ESF.
- Although the federal state's budget was only adopted in early summer and despite the late coming into effect of new directives, the volume pledged in managed activities reached a total of EUR 537m.
- The volume pledged in managed activities was thus only slightly (9 %) below the budgeted figure of EUR 587m.
- Compared to the previous year, the sum pledged in managed activities increased by EUR 66m (+14 %) (2015: EUR 471m).

3.2 Earnings development

ILB and the group, which is predominantly determined by ILB, once again recorded positive business in 2016.

Net income from operative business developed well. Net income before provisions for risks totalled EUR 44.8m and is hence EUR 2.6m above budget. The increase in net income is due to lower administrative expenses, in particular, for material expenditure. Revenues were generally as expected in the budget.

The result after risk provisioning surpassed expectations and, at EUR 42.6m, was EUR 7.2m higher than budgeted for 2016. This was driven, first and foremost, by the positive development of write-down demand which, at EUR 3.3m, was significantly lower than originally planned (EUR 7m).

In order to continue generating stable interest revenue whilst at the same tine fulfilling regulatory liquidity requirements, the securities portfolio was largely left unchanged.

ILB's return on equity, a key indicator totalled 1.18 % (group: 1.17 %) as per 31 December 2016.

4. Income, net worth and financial position

In 2016, just like in previous years, ILB accounted for 99.9 % of the group's balance sheet sum. With a balance sheet sum of EUR 13,332.3m, the group once again recorded a good result in 2016.

The bank‘s income situation, net worth and financial position are satisfactory and stable.

4.1 Income position

In 2016, ILB’s profit for the year totalled EUR 11.6m (previous year: EUR 11.5m) and EUR 11.3m for the group (previous year: EUR 13.0m).

The group‘s income situation is determined largely by ILB. As part of the annual planning process, income and expenditure items are steered with defined budget variables. The planning variables are updated during the year and reviewed with a view to the goals set. The targets for 2016 were by and large reached. Material expenditure and fee and commission income were lower than budgeted, but ultimately still had a positive effect on profit. The overall profit recorded was much higher than planned.

The measure for ILB‘s financial success is the profit before risk provisions and the formation of reserves. In 2016, ILB recorded a good result of EUR 44.8m before risk provisioning and the formation of reserves which is higher than the figure for the previous year (EUR 42.8m).

In detail, development was as follows:

Net interest income totalled EUR 58.2m (previous year: EUR 58.6m), i.e. the same level as the previous year. Revenue from interest-earning promotional business, especially in the housing sector, recorded positive development. As expected, other interest income declined slightly. Just like the rest of the financial sector, ILB is facing special challenges due to the measures introduced in response to the financial market crisis. Direct impacts are particularly seen in conjunction with the bank’s treasury activities. The persistently low-interest environment and declining risk premiums due to the ECB’s continued purchasing programme generated pressure on interest income and resulted in a further decline in return on equity. Especially in short-term business, the negative interest environment expanded and consolidated as a result of the ECB’s further reduction in deposit rates to 0.40 %, which led to declining margin contributions for variable refinancing projects in existing business. At the same time, ILB also benefited from this exceptional interest situation through its short-term borrowings on the money market. In line with the default risk strategy, ILB continued to invest liquid funds in investment-grade securities. Revenue contributions were expanded further in 2016 despite a largely unchanged risk structure and investment volume.

Net fee and commission income of EUR 45.6m (previous year: EUR 40.9m) largely results from fees for the management of promotion and support programmes. This is made up of administrative cost contributions in conjunction with the granting of loans from trust funds, the handling of promotion programmes and the management of guarantees. The increase against the previous year results from taking over labour promotion activities from LASA Brandenburg GmbH i. L. and the gradual development of the business field.

ILB‘s personnel expenses totalled EUR 38.6m in 2016 (previous year: EUR 36.9m). The EUR 1.7m increase is especially due to the takeover of 53 employees of LASA Brandenburg GmbH i. L. with effect as of 1 July 2016. Adjustments of collective agreements with effect as of 1 October 2016 also led to an increase in expenditure. At the end of 2016, ILB employed a staff of 630 (active and passive). The increase in the average headcount for the year by 46 employees against the previous year was mainly the result of the takeover of staff of LASA Brandenburg GmbH i. L. as well as the filling of vacancies for new and expanded tasks. Vacancies were, in particular, filled in the field of ESF promotional business and in cross-sectional areas.

Other administrative expenses, including depreciation, amortisation and write-downs on intangible assets and tangible assets rose by EUR 1.4m to EUR 23.1m against the previous year. This increase is mainly due to investments which had an impact on depreciation on tangible assets.

Operating costs totalled EUR 20.7m and were hence only slightly above the previous year‘s level of EUR 20.5m.

Depreciation on tangible assets totalled EUR 2.4m and was thus higher than the previous year‘s figure (EUR 1.3m). Investments related to the introduction of the electronic docket (“e file”) in 2016 will now impact profit and loss due to depreciation.

The group's risk situation is determined largely by ILB. Itemised allowances are formed for identifiable risks in loan business, taking existing collateral into consideration. These risks are stable and at a low level, largely reflecting ILB's conservative risk culture. General allowances were formed to consider the development of the latent credit risk.

Fixed-asset securities are generally valued according to the less strict lower of cost or market principle. In line with the high quality of the securities held, no write-offs were required at the end of the year.

With regard to long-term loan business with fixed-interest periods of more than ten years, provident funds pursuant to section 340 f of the German Commercial Code [§ 340 f HGB] were formed in order to address the risk that statutory termination rights are exercised in this context.

Other operating net income, without allocations to the ILB promotional fund and to the Brandenburg fund, totalled EUR 2.6m in 2016 and was thus slightly higher than the previous year's figure of EUR 1.9m. This increase was due to the reversal of provisions.

Other operating income included revenues of EUR 1.5m from the appropriate use of ERDF funds within the scope of "Brandenburg-Kredit Mezzanine". Furthermore, funds of EUR 4.0m were carried from the early-phase and growth funds as well as funds of EUR 1.9m for the micro-loan. This revenue was appropriated to the Brandenburg fund.

Other operating income also includes expenditure for earmarked funds of the ILB promotional fund of EUR 3.3m that became necessary due to funds and support pledged in 2016.

EUR 5m was earmarked for the ILB promotional fund in 2016. This means that since 2006, EUR 85.0m of the bank's revenues has been made available for funding and support measures within the scope of ILB's Brandenburg loan product family.

Another EUR 33.7m was allocated to the fund for general banking risks from the current result (previous year: EUR 28.1m).

4.2 Net worth

ILB's balance sheet total, which accounts for 99.9 % of the group's balance sheet sum, declined in the 2016 financial year by EUR 344.3m to EUR 13,318.2m (previous year: EUR 13,662.5m). In light of ILB's dominant position in the group, separate reference to the group will only be made in the following if significant deviations exist.

The business volume, comprising business recorded in the balance sheet with current customers, contingent liabilities, administrative loans, as well as administrative guarantees, totalled EUR 13,545.8m at the end of the financial year (previous year: EUR 13,992.3m). The group's business volume totalled EUR 13,559.9m as per 31 December 2016 (previous year: EUR 13,938.1m).

The difference of EUR 14.1m results mainly from bank deposits of the subsidiaries – carried under "Other assets" in the group's balance sheet – as well as from tangible fixed assets.

ILB's loans and advances to banks declined by 4.2 % to EUR 2,217.7m (previous year: EUR 2,315.1m). The decline is mainly due to repayments of EUR 138.0m on global loans in business with commercial banks. At the same time, lending via domestic note loans was increased by EUR 30m.

ILB's loans and advances to customers also declined by EUR 215.2m to EUR 5,009.2m (previous year: EUR 5,224.4m). This was mainly due to repayment of around EUR 415.0m in loan business by the federal state of Brandenburg. At the same time, loan business with note loans and registered bonds increased by around EUR 200.0m. Trust loans declined by EUR 122.3m to EUR 2,600.7m as a result of scheduled and extraordinary repayments.

Bonds and other fixed-income securities at ILB totalled EUR 3,075.2m as per 31 December 2016 and are EUR 20.0m above last year‘s level.

Stocks and other variable-income securities are exclusively the shares for the special fund issued in 2014 with Union Investment Institutional GmbH which is a mixed fund that invests in European corporate bonds and which was increased by EUR 20.0m in the year under survey.

ILB‘s other assets totalled EUR 88.1m (previous year: EUR 75.6m), including EUR 57.1m for the adjustment item for USD exchange rate differences. In the group, this balance sheet item also primarily includes liquid funds of EUR 32.9m held by the group‘s subsidiaries with banks. At the end of the 2016 financial year, the group recorded other assets totalling EUR 121.5m (previous year: EUR 118.2m).

ILB enters into derivative interest rate hedging transactions for the sole purpose of steering interest rate and currency exchange risks. The nominal volume of business as per the balance sheet key date totalled EUR 10,935.0m (previous year: EUR 9,675.2m).

4.3 Financial position

The group’s financial position is also determined almost exclusively by ILB. ILB’s liabilities are secured by statutory public-sector responsibility, guarantor‘s liability and the liability guarantee of the federal state of Brandenburg.

In the 2016 financial year, short-term funds were primarily taken out through reverse transactions, time deposits and call money transactions, mostly with domestic banks. Funds were also taken out through open-market transactions with Deutsche Bundesbank.

Long-term refinancing was primarily taken out through bonded loans from domestic banks and global loans from the European Investment Bank (EIB), KfW-Bankengruppe, Landwirtschaftliche Rentenbank and the Council of Europe Development Bank, as well as from bond placements with domestic insurance companies.

Compared to the previous year, liabilities due to banks rose by EUR 30.2m to EUR 9,308.9m as per 31 December 2016 (previous year: EUR 9,278.7m). Whilst repurchase agreements and open-market transactions increased by EUR 238.7m, a smaller amount of EUR 220.8m was taken up through long-term refinancing.

Liabilities to customers as per 31 December 2016 were EUR 266.3m lower than in the previous year. The decline is primarily the result of expired time deposits of the German government totalling EUR 132.0m. Another reason was a decline of EUR 65.8m in call money and of EUR 79.0m in the federal state housing construction fund that was reduced as planned.

Off-balance sheet liabilities increased slightly in 2016 as a whole. Liabilities in relation to guarantees and warranties increased by EUR 7.8m. There are no indications that guarantees for contingent liabilities will be called on, except for one case for which a corresponding risk provision was made. Irrevocable loan commitments increased by EUR 49.0m to EUR 350.8m as per 31 December 2016. The decline of EUR 40.0m in loans and guarantees managed for the federal state Brandenburg by results from repayments for this business field which is reduced as planned.

The group‘s liquidity which is essentially determined by the ILB was secured at all times. At the end of 2016, the bank recorded more than EUR 241.7m in open loan commitments not yet called by other promotional banks.

The fund for general banking risks according to section 340g of the German Commercial Code [§ 340 g HGB] was increased to EUR 332.2m, including EUR 288.0m which must be classified as liable core capital.

ILB’s equity, including the fund for general banking risks totalled EUR 549.0m as per 31 December 2016 (previous year: EUR 509.8m). The group’s equity totalled EUR 553.5m (previous year: EUR 514.6m).

This increase is largely due to the allocation to the fund for general banking risks and to retained earnings. The appropriation to the fund for general banking risks totalled EUR 33.7m. This includes a demand-based appropriation to the ILB promotional fund with the budgeted sum of EUR 5.0m. Since 2006, EUR 85.0m of the bank's revenues has been made available for funding and support measures within the scope of ILB's Brandenburg loan product family.

The table below shows the development and composition of the ILB promotional fund and of the Brandenburg fund.

Thousand EUR	ILB promotional fund	Brandenburg fund
Date revised last: 01 January 2016	20,258	16,334
Additions	5,000	7,412
of which:		
Early-phase and growth funds		3,986
Brandenburg micro-loan		1,948
Brandenburg-Kredit Mezzanine II		1,478
Reversals	3,310	1,446
of which:		
Brandenburg-Kredit Mezzanine II		1,446
As per 31 December 2016	21,948	22,300

Due to the resolution regarding the appropriation of profits from the year 2015 adopted at the shareholders' meeting on 20 May 2016, a dividend of EUR 6.0m was distributed to the shareholders. Furthermore, EUR 5.0m was allocated to retained earnings, and EUR 0.1m was allocated to profit carried forward.

All in all, the strategic goal to strengthen equity each year by at least EUR 20m was clearly outperformed with an appropriation of around EUR 31.6m.

The equity requirements of the German Solvability Ordinance and of the Capital Requirement Regulation (CRR) of the EU were fulfilled at all times.

In 2016, ILB's total capital ratio according to CRR ranged between 14.75 % and 16.51 %.

In 2016, ILB's common equity according to CRR ranged between 13.11 % and 14.79 %.

4.4 Financial and non-financial performance indicators

In the 2016 financial year, ILB pledged promotional funds of around EUR 2.0bn for 5,074 projects, including EUR 537m for products related to managed activities for the federal state of Brandenburg and EUR 1,454m for ILB's own products.

The financial performance indicators relevant for ILB are shown and explained in section 3.2, “Earnings development”.

ILB's non-financial performance indicators are mainly related to employee issues.

534 people were actively employed in permanent jobs on 31 December 2016 (previous year: 487). The number of employees in temporary jobs rose from 49 to 67. 16.0 % of these employees worked part-time; this figure is 2.7 percentage points below the previous year's level.

29 employees were in the passive phase of semi-retirement, early retirement, parental leave or other forms of passive employment (previous year: 14 employees). The number of students (14) in co-operative study programmes remained flat against the previous year.

Female employees accounted for 67.1 % of the workforce at the end of the year. The average age of all employees was 46.8 years.

In 2016, ILB provided active support for its employees' further professional development through in-house and external training events. Seminar attendance totalled 1,450 (previous year: 1,074).

III Report on forecasts, opportunities and risks

1. Risk situation

The risk at group level corresponds to that of ILB because the risks in the subsidiaries can be considered to be insignificant from a group perspective. The following information in the opportunities and risks report hence refers to ILB and can be applied to the group.

ILB pursues business as a special lending institute. The bank's risk structure results from the promotional and structure-policy tasks assigned to it by the federal state of Brandenburg. Risks are taken to a very limited extent only. All identifiable risks were taken into account through appropriate evaluation and the formation of risk provisions.

2. Risk management

Risk management considers the capability to bear risks and includes the definition of strategies as well as the establishment of an internal control system, the compliance function and an internal audit function. The internal control system is made up of rules for structures and processes as well as risk steering and controlling processes. Risks are identified, limited and monitored as part of risk management.

ILB has established an integrated strategy and planning process. Contents and processes of the strategy and target process (including the capital planning process) as well as limitation process are aligned to each other. This interaction essentially includes the process steps of planning, implementing, assessing and adapting the business and risk strategy as well as monitoring targets and analysing deviations.

The risk strategy reflects ILB's individual risk tolerance and determines the general handling of risks, forming the basis for ILB's risk structure. Guidelines and measures are laid down for identifying, steering and monitoring risks. The risk strategy is based on continuous adherence to the regulatory requirements, the law and ILB's bye-laws as well as the risk policy issued by the Management Board.

The Management Board revises and adopts the strategy as required, however, at least once a year as part of the strategy process. The Management Board communicates the risk strategy to the Risk Committee of the Administrative Board and discusses this strategy with the latter.

ILB generally pursues a conservative risk policy. The aim of this policy is to diversify between the different types of risks, i.e., knowingly accepting risks but avoiding them in areas outside the bank's core expertise. The principles concerning risk tolerance laid down in the risk strategy form the general framework for the bank's business operations.

The risk monitoring system in place is geared towards the existing risk of default, market price risks and operational risks.

Risk monitoring and risk taking are separate functions throughout all levels of the organisation. Risks are identified and assessed and the risk management and controlling processes developed further by Risk Controlling/Finance as part of the risk controlling function. The risk controlling function additionally includes the ongoing monitoring of the risk situation and risk-bearing capability as well as reporting in line with the respective risk content and requirements under regulatory law. At operative level, risks are managed by the organisational units responsible for the respective risks.

The risk monitoring tools for steering the subsidiaries are adapted to the needs of the group and enable timely monitoring and assessment of the risk situation. The subsidiaries are integrated into ILB's planning process. The strategic shareholdings/management and controlling units are responsible for controlling in-year developments at the subsidiaries. Quarterly reports on economic conditions as well as target/actual deviation analyses of the result and risk structure serve to inform the Board of developments in shareholdings. As soon as the assessment of the risk situation shows the need for action, the reports are supplemented by proposals for further action.

The Board bears the overall responsibility for controlling the risks of the bank and of the institute group. In accordance with the minimum requirements for risk management, the Board informs the Risk Committee every quarter in writing of the bank's risk situation. Furthermore, ILB's risk situation is also explained during regular committee meetings to the Administrative Board as the control body of the Management Board.

3. Risk-bearing capability concept

In addition to defining the risk management process and responsibilities, the underlying processes and parameters that are used to measure and steer risks are also documented. The aim is to secure the bank's business and future success through efficient risk management.

In order to assess the risk profile, ILB obtains a risk overview for the bank as a whole on an annual and/or ad hoc basis as part of a risk stock-taking procedure. The major risks are the starting point for measurement and steering measures and are limited within the scope of the risk-bearing capability concept.

Risk-bearing capability is defined as the possibility to compensate for losses in value from the bank's own funds. ILB consistently applies the period-based going-concern approach for its risk-bearing capability concept. For this purpose, risk capital is determined on the basis of the profit and loss account/balance sheet and compared to the degree of actual risk in the form of negative deviations from the expected result under commercial law. The risk-bearing capability according to the going-concern approach is ensured if the available risk capital is greater than or equal to the total actual risk. This approach is designed to ensure that the institute can continue operating in conformity with the requirements of regulatory laws even if all items of the risk capital used to cover risks and identified as risk-prone were lost as a result of these risks actually materialising.

Risk-bearing capability is calculated on the basis of the determination of the risk capital. The risk capital determines the maximum amount of risk that can be taken by ILB. ILB determines its risk capital on the basis of the profit and loss account/balance sheet, by drawing up its balance sheet according to the rules of the German Commercial Code [HGB]. Accordingly, the risk cover capital is made up of its subscribed capital, reserves, reserves according to sections 340f and 340g of the German Commercial Code and the net profit forecast for the year after risk provisioning and reserve formation as well as planned allocation to the ILB promotional fund minus intangible assets. In addition to this, ILB can, when necessary, make use of undisclosed reserves from undervaluations in accordance with commercial law (such as unrealised gains from securities). However, these reserves are not included in the definition of risk capital because they can be subject to fluctuation and are therefore not permanent.

ILB determines the available risk capital on the basis of its risk capital by subtracting from the risk capital the regulatory capital required under pillar I for going-concern purposes. Within the scope of the risk-bearing capability concept, the available risk capital is the maximum sum available to cover risks.

As part of medium-term planning, the capital demand that will be needed in order to ensure the bank's risk-bearing capability and to comply with regulatory requirements is determined over a period of 5 years. The capital planning process considers future changes in the bank's own business activities and its relevant environment as well as the impact of unfavourable developments. Possible adverse developments are considered in addition to expected ones. The aim is to enable counter-measures at an early point in time in order to secure ILB's capital demand even under unfavourable conditions. For capital planning purposes, the three-year medium-term planning period is additionally expanded by a two-year forecast horizon.

Depending on the amount of available risk capital, the Management Board determines an upper loss limit for the bank as a whole. This is based not just on the targets of the bank as described in its strategy and implemented in its medium-term planning, but also ILB's risk tolerance and risk-bearing capability. In line with its bye-laws, ILB generally pursues a conservative risk policy. Its risk tolerance thus ranges between risk-averse and risk-neutral. The total loss cap at the level of the bank as a whole quantifies the risk tolerance as determined by the Management Board and determines the maximum risk capital which is to be applied at the level of the bank as a whole in order to cover all major risks. The loss cap thereby serves to limit ILB's total risk.

In line with the planned utilisation and ILB's strategic orientation, the sum available under the maximum loss cap is then allocated to the major risk types. A risk buffer is maintained as part of the loss cap in order to cover risks which, although they are classified as minor, are to be considered within the scope of the risk-bearing capability calculation. The risk caps are the absolute limits for the different risk types and are monitored within the framework of risk control and can be broken down further depending on the structure and degree of complexity of the particular business. This can be achieved either via further limits, threshold values or bandwidths or, if the risk cannot be quantified, in the form of qualitative requirements, by defining minimum standards, etc. Monitoring of the risk-bearing capability for the bank as a whole is thus replaced with operative steering of individual risks.

The risk level (risk amount) is measured in the risk-bearing capability concept on the basis of the profit and loss account in line with the period-based approach. This means that the impact of potential risks on certain items of the profit and loss account is analysed. The risk amount is defined as the negative deviation of the profit contribution of the profit and loss account within the risk horizon. A uniform confidence level of 99.0 % is used in this context in as far as the model permits so. The basis in each case are the latest extrapolations for the end of the year, related to the current year and the following year. The following year is analysed in order to comply with the regulatory requirement for a period-spanning perspective. By considering the current year and the following year, ILB thereby applies two steering groups in its risk-bearing capability concept.

Risk-bearing capacity is determined and verified for the bank as a whole on a monthly basis by comparing the actual utilisation rates of the individual risk types to the corresponding individual limits and the total loss cap on the level of the bank as a whole. The relevant escalation procedures applicable when defined alert thresholds are reached are applied to the different risk types for the bank as a whole. It is assumed that all the risks add up. Diversification effects which reduce risks are not considered.

The analysis of the expected net profit for the year serves to monitor the risk capital. In this context, quarterly extrapolation is carried out in order to examine whether the intended net profit for the year after risk provisioning will be achieved. Risks that have materialised during the year are considered in the extrapolation and reduce the available risk capital accordingly.

Quarterly reports are a control instrument that also informs the Board of the bank's overall risk situation. Risk-bearing capability analyses are supplemented by examining the impact of shaky market developments. For this purpose, scenarios are developed to simulate the effects of unusual, yet plausible, events on the bank's overall risk situation (stress tests). A special stress test is the annual simulation of the impact of a severe economic downturn.

The aim is to identify possible events or future changes that would have a negative effect on the bank's risk situation and its risk-bearing capability. The analysis of the stress tests helps to warrant the bank's stability beyond the regular course of business.

Furthermore, the bank's risk-bearing capability is tested using so-called "inverse stress tests". Taking the result of the impossibility to continue ILB's current business model as the basis, this stress test is used to model events that can cause such a condition. The aim is to identify strategically difficult situations which could threaten the institute's existence on a stand-alone basis, i.e., without statutory public-sector responsibility, guarantor's liability and the liability guarantee of the federal state of Brandenburg.

Monitoring of the risk-bearing capability is supplemented by risk steering at an operational level as well as monitoring of compliance with regulatory requirements. Deviating risk quantification methods are sometimes used in this context. Steering at an operational level is in line with the risk-bearing capability concept and the limits determined there. The limits of the risk-bearing capability concept and the limits of operational steering must be adhered to at the same time.

4. Different types of risks

ILB performs annual and demand-driven risk stock-taking. Demand-driven risk stock-taking can, for instance, be triggered by new product introductions or changes in the general environment. Risk stock-taking serves to identify ILB's overall risk profile. During risk stock-taking, the respective risk types are examined in terms of their relevance for ILB and these risks are then classified accordingly as being relevant or not relevant. A risk is relevant if it is explicitly defined as such in the minimum requirements for risk management (MaRisk) or if its impact exceeds the quantitative threshold for a risk to be relevant.

The following risks are considered to be relevant for ILB:

- Default risk
- Market price risk
- Liquidity risk
- Operational risk

Concentration risks, in particular, revenue concentration, are considered as part of the stock-taking process. The relevant risks identified during the stock-taking process are monitored and managed by the risk management process in accordance with the principles and loss caps determined as part of the risk strategy.

4.1 Default risk

The risk of default is the risk that a bank's debtor becomes insolvent and consequently fails to fulfil his contractual obligations. The risk of default covers lending, country, counterparty and shareholder risks.

A conservative risk policy is pursued in loan business. Treasury business focuses on investments that should be as ECB-enabled as possible and hence be limited in terms of their risks which enable additional revenue contributions in repo business. Declining revenue contributions due to the low-interest environment are to be compensated for through portfolio diversification with new products.

A rating-based method is applied to measure default risk for ILB's entire portfolio in analogy to the IRBA ((Internal Ratings Based Approach) concept provided for in regulatory law. Internal ratings are used as a basis for the risk-sensitive evaluation of items which are then consistently integrated into ILB's risk-bearing capability concept. Risk concentrations in the portfolio are also taken into account.

With this method, the decline in value of ILB's portfolio caused by defaulting debtors can be assessed which statistically will not be exceeded in 99.0 % of all possible cases (Value at Risk (VaR) with a confidence level of 99.0 %). This total portfolio loss represents the risk amount for default risks and can also be split up into sub-portfolios and/or portfolio items for steering purposes.

Application of this method is not possible in the case of sub-portfolios of a minor volume. If the items concerned are subject to a default risk, they are then valued according to the credit risk standardised approach as provided for by the regulator.

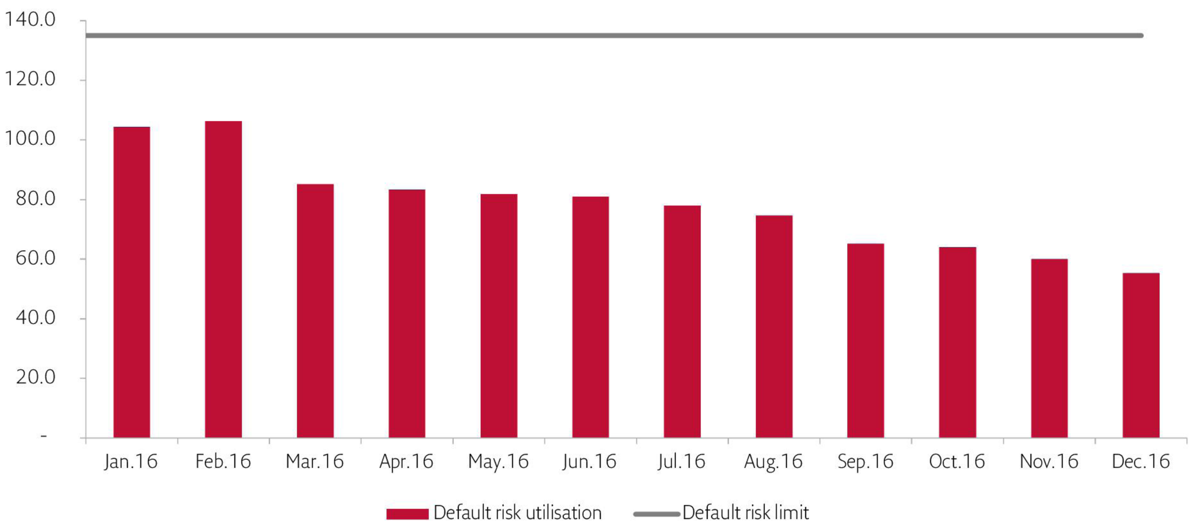
The default risk determined in this way applies to ILB's portfolio on the day of the analysis for a one-year risk horizon. The risk-bearing capability concept requires consistent periodisation of risks. As the year progresses, the period during which potential risks can materialise becomes shorter. In the determination of default risks, this is achieved by scaling default probabilities. The following year is analysed on the basis of the planned stocks at the end of the year assuming an unchanged risk structure in the planning items and for the bank as a whole.

Default risks are reflected in the valuation result of the profit and loss account. As part of planned risk provisioning, the planned net profit for the year and therefore the entire risk capital are burdened accordingly. Risks that have materialised during the current year are represented by itemised allowances, direct write-downs or provisions and are also reflected in the latest extrapolation of net income for the year. Planned and actual default risks are therefore already included in the planned net profit for the year and reduce the risk capital.

Any default risks over and above this within the meaning of a loss for the portfolio as a whole must be covered by available risk capital and are limited (risk utilisation).

Risk utilisation for default risks is represented by the following curve over the year:

Development of default risk and limit utilisation per relevant date for the one-year horizon (in million EUR)



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2017, is shown which refers to the one-year horizon throughout. Starting from a utilisation of EUR 104m at the beginning of the year, default risk rose to EUR 106m in February 2016 as a result of increased risk concentration. Risk utilisation declined continuously from March 2016, and risk utilisation for the year 2017 totalled around EUR 55m in December 2016.

The reason for the marked decline over the course of the year is the gradual establishment of the rating system of Sparkassen Rating- und Risikosysteme GmbH (SR) in October 2015. The replacement of the previously used internal rms risk classification methods leads to a reduction in overexposure. This was clearly seen in March 2016 when a fundamental adjustment of the processes of identifying default probabilities took place during the course of the change in risk classification methods for financial institutions and municipalities. In the 3rd and 4th quarter of 2016, further adjustments of ratings of customers with large promotional and support volumes mainly led to significantly lower default probabilities and hence to a lowering of risk. As per 31 December 2016, the rms rating method was limited to items where exposure totalled less than 1 % of the overall exposure. This exposure represented an internal risk of EUR 4.5m.

Operative default risk management is based on the minimum requirements for risk management (MaRisk) and is carried out in a portfolio and risk-orientated manner. Limit systems have been set up for country risks and product groups (securities, derivatives, money market paper, repo transactions, commercial banks) in order to steer default risks. In order to limit risks with these transactions, limits have been set up at borrower level. The limit system is supplemented by regulatory requirements regarding large exposure limits, the CRR as well as compliance with the leverage ratio requirements which will come into effect in 2018. Furthermore, the rolling one-year default risk utilisation has been limited since 1 January 2017 as part of operative management. ILB has established a working group to steer default risks. The working group is the central body for steering the bank's default risks. It advises the Board of Management and prepares resolutions by the Board of Management. The quarterly meetings are attended by the members of the Board of Management as well as the heads of the risk controlling function, treasury as well as front and back office. The working group meets regularly before the quarterly reports are due and during the course of the planning process. This body is additionally convened as required by decision-relevant issues at the chairpersons' request or in the case of important forthcoming individual decisions at the request of the manager responsible for the product area concerned.

The monthly "ILB risk report" compiles the most important implications of default risks according to the bank's risk-bearing capability.

The default risk cap was adhered to at all times during the year under review.

4.1.1 Loan risk

ILB's core business is the promotion of public and private investment projects, mainly using funds from the budget of the federal state of Brandenburg or through customer banks.

The bank does not bear any loan risks for the assets managed on a trust basis for the federal state, such as the State Housing Construction Fund (LWV), a special-purpose federal-state fund managed by the bank on the basis of approved budgets and management principles on behalf of the Brandenburg Ministry for Infrastructure and Regional Planning.

The sub-strategy for default risks is updated each year and forms the basis for lending. This strategy contains the guidelines of lending business and, at a sub-loan portfolio level, the qualitative and quantitative requirements for lending.

Loan risks result from housing loans, syndicated loans in the commercial sector, infrastructure loans as well as applicants' bank business. In transactions with applicant's banks, loans are passed on to the final borrower's bank without any risk on the part of ILB with regard to the default risk of the final borrower. In the case of such bank-to-bank loans, ILB bears the default risk of the applicant's bank which is additionally secured by the possibility to take recourse to the final borrower.

Risks from off-balance sheet transactions consist primarily of irrevocable loan commitments and contingent liabilities in the form of risk sub-participations in syndicated loan business.

In order to limit risks from loan business, precisely defined criteria are in place for these transactions, especially with regard to the borrower's creditworthiness, collateral and maximum loan sum (commercial syndicated loans only). Sufficient provision in the form of itemised allowances for bad debts has been made in the annual accounts to cover known risks.

Due to inter-state fiscal adjustment, the law on general fiscal adjustment with municipalities and the municipal associations in the federal state of Brandenburg as well as the "debt brake" laid down in the constitution, ILB still does not foresee any default risk in public-sector loan business as the bank's largest loan sub-portfolio.

Default risks are monitored by the back office/loan management unit. Risk controlling calculates limit utilisation on a quarterly basis and informs back office/loan management and subsequently the respective product areas. Back office/loan management evaluates the risk and, when necessary, draws up suitable recommendations for action.

At the end of each quarter, the controlling and loan secretariat functions perform a comprehensive analysis and assess the default risk for the bank as a whole for business involving loans guaranteed by ILB. The result of this analysis forms part of risk reporting to the group board and the risk committee of the administrative board. Besides presenting the loan portfolio, the risk report also assesses the default risk and, if applicable, recommends risk steering measures.

In keeping with ILB's conservative risk culture, the risk structure of the bank's loan portfolio can be classified as low-risk. ILB's entire own lendings portfolio totalled EUR 11,489m as per 2016. 99 % was rated as per the relevant date on the basis of the new rating system of Sparkassen Rating und Risikosysteme GmbH (S-Rating). 88 % of the loans in ILB's own lending portfolio (excluding special funds) were rated excellent (SR ratings 1 2) or collateral was provided (usually public guarantees or collateral in rem). The assessment of default risks at the level of the individual debtors was introduced gradually starting in 2015 by applying standardised, regulator-approved rating methods of S-Rating.

The following methods are applied:

- Sparkassen-Immobiliengeschäftsrating (SIR) mainly in real estate customers/leasehold property business
- Sparkassen-Standardrating (STR) mainly in commercial and public customer business.

Simplified procedures are applied in the case of municipal loans, financial institutions and debtors where ILB's own exposure is less than EUR 250,000.

The risk classification methods are applied on a regular basis and/or as required in loan approval and loan monitoring processes. The business and investment strategy in treasury is subject to an ongoing, risk-orientated analysis and adaptation process which ensures ILB's conservative investment policy.

Investment decisions are made after an independent risk analysis. Purchases are contingent upon a minimum "A" rating of the security concerned by an external rating agency (Moody's, Standard & Poor's or Fitch). An external minimum BBB rating was accepted for a limited part of the portfolio. Unsecured bonds are purchased subject to volume and term limitation, depending on the external rating. The loan risks were widely spread.

In 2014, ILB set up a special corporate bond fund (minimum rating: investment grade) with a volume that was increased in 2016 by EUR 20m to EUR 170m.

Controlling checks publications on a daily basis for changes in the standing of securities and/or issuers. In addition to these measures, the development of yield markups for securities on a watchlist is monitored and compared with risk-free investments in order to utilise the market's assessment as an early indicator of any change in risk.

The bank has specific limits in place for the purchase of securities, money market paper and derivatives as well as upper limits for each bank for loans channelled through customer banks, individual refinancing projects and global loans. The limits are set for each bank separately, based on an evaluation of its financial position, its external rating and other qualitative data. If the standing and/or external rating changes, appropriate adjustment of the limit is considered. Internal limits are generally reviewed once a year.

Controlling and the specialist unit regularly check adherence to the limits.

4.1.2 Counterparty risk

Counterparty risk is the risk that a party to a contract defaults when claims are due to be settled (fulfilment risk) or that a party fails to meet a payment deadline (performance risk).

In order to counter this risk, ILB generally conducts commercial business with selected market partners only who have a minimum external "A" rating according to the second-best rule. Counterparty limits are in place for these market partners.

Counterparty risk as part of default risk is generally of minor relevance at ILB. Within the scope of the European Market Infrastructure Regulation (EMIR), ILB started performing derivative transactions (mostly interest rate hedging swaps) in 2015 via a central counterparty and intermediate clearing brokers. Due to the protection mechanisms resulting from this regulation, such as a default management process, a margin process, margin calculation methods as well as general risk control methods of the central counterparties, the default risk is considered to be mostly secured and low.

In future, as existing business is phased out and cleared new business and/or business with bilateral collateral is developed, counterparty risk for derivatives will decline.

4.1.3 Country risk

Country risk includes the credit and market risk of a country. It represents the risk of partial or complete default with contractual interest and redemption payments by borrowers of the country concerned and the risk of a loss of value of securities and derivatives which depend on the country's market parameters.

In accordance with its promotional task, ILB's business is conducted almost entirely in Germany and more specifically in the federal state of Brandenburg. Existing foreign commitment is based almost exclusively on investment in securities from countries of the European Union and most of these in euro zone countries. In line with the counterparty risk sub-strategy, only selected debtors are generally accepted. German issuers should account for at least 40 %.

The country risk outside Germany is limited by country caps. These caps are determined on the basis of external ratings, as well as the gross debt and GDP of the country in question. The country limits are checked during the year with a view to their suitability on the basis of early warning indicators. In order to avoid risk clusters, separate limits are determined for country risks and included in the respective limits.

4.1.4 Shareholder risk

Shareholder risk is the risk that losses may be incurred due to the provision of equity for third parties.

In the performance of its statutory obligations, ILB holds strategic shareholdings only. It acquires shareholdings primarily in order to pursue important interests of the bank or to assume tasks resulting from federal state structure policy. ILB also provides national co-financing as part of EU financing instruments.

ILB holds shareholdings in three areas:

- Equity investment companies - Provision of equity for companies in the federal state of Brandenburg
- Property companies - Property development in the federal state of Brandenburg
- Others - Supporting other ILB activities

As per 31 December 2016, ILB held shares in companies with a book value of EUR 62.5m. Large parts of ILB's equity investments are secured by guarantees or financed by grants from the federal state of Brandenburg, so that ILB is not exposed to any potential loss from these commitments. Sufficient risk provision has been made for the risks attached to the remaining shareholdings.

4.1.5 Opportunities

In line with its mission as a business promotion institute, ILB accepts default risks to a very limited extent only. As part of its annual planning process, the bank addresses any uncertainties regarding the development of the value of its lendings through value adjustments based on conservative estimates. Opportunities result from positive deviations of the defaults actually materialising as compared to estimates.

4.2 Market risk

Market risk is generally the risk which negative developments on a market can pose to the bank. Market risks include interest rate risks as well as the exchange rate risk, currency risk and other price risks.

In order to fulfil its promotional and structure-policy tasks for the federal state of Brandenburg, ILB must carry out typical banking business, such as:

- loan business with small volumes and varying terms
- prefinancing until refinancable lot sizes are reached at acceptable prices
- adherence to offer deadlines in customer loan business and the resultant market price fluctuations
- investment of free liquidity necessary due to the delayed application of funds in loan business (such as EIB refinancing) on money and capital markets in conformity with general market conditions

The resultant term and deadline mismatches lead to market price risks under unfavourable market conditions characterised by high volatility and market distortions. This can have an adverse impact on ILB‘s revenue situation.

The following types of market risks were identified for ILB:

- interest change risk
- market price risk
- currency risk
- risk from implicit options

Market risks are steered by Risk Management based on the minimum requirements for risk management. ILB is classified as a non-trading book institute.

4.2.1 Interest rate risk

Interest rate risks exist for ILB with a view to different fixed-interest rate periods in lending and borrowing business. ILB‘s transformation function in conjunction with interest rate change risks is geared towards ensuring a long-term and stable contribution towards the bank‘s net interest income. Treasury is responsible for steering the interest rate risk. The interest rate risk is covered by transactions with a direct balance sheet effect as well as swaps, forward rate agreements, swaptions and caps.
The interest rate risk is calculated and limited in the risk-bearing capability risk by measuring the periodic interest rate change risk.

From the perspective of the profit and loss account, interest changes have a direct impact on interest income. The risk is defined here as the negative deviation between forecast and actual interest income. The last day of the current year and the last day of the following year are considered here. Interest changes particularly affect variable-interest business as a result of interest rate adjustment and the terms and conditions of new business. It must also be noted that changes in interest rates also influence the cash value of ILB‘s interest ledger. This influence can have a direct impart on net income if a potential reduction in cash value necessitates a provision for anticipated losses for ILB‘s interest ledger. A provision must be formed if the book value of ILB‘s interest ledger exceeds the cash value minus future administration and risk costs. These influences are quantified by analysing the impact of potential interest rate developments. The basis for this is the interest rate trend according to latest forecasts which is varied within the scope of scenario analyses. The scenarios applied are derived from history and are expected to represent interest rate developments in all possible directions (parallel shifts, rotation, etc.).

Risk utilisation for interest rate risks is represented by the following curve over the year:

Development of net interest income risk per relevant date for the one-year horizon (in million EUR)

In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2017, is shown which refers to the one-year horizon throughout. The limit of EUR 15m was adhered to at all times during the year under review, with maximum utilisation for the following year, i.e. 2017, totalling EUR 7m. Fluctuations during the course of the year are mainly due to changes in short-term cashflow structures which are primarily influenced by interest rate fixings in variable-interest business. The long-term cashflow structure of this investment is orientated towards the benchmark structure set for strategic reasons and is therefore relatively stable.

In addition to monitoring the periodic interest rate risk in risk-bearing capability, operative interest rate risk management is carried out by ILB by valuating the cash value of the payment flows of all transactions with interest rate change relevance. This addition enables adequate operative management combined with consistent consideration of interest rate risks in the risk-bearing capability analysis. In determining risk, the bank considers all interest-bearing items in the interest ledger up until their respective fixed-interest period. ILB does not have any variable-capital products with an indefinite term in its books. This means there is no need to integrate maturity scenario models into the bank's interest ledger.

The software used at ILB permits integrated interest ledger management. Besides period-based measurement of the interest rate risk in order to calculate risk bearing capability, operative measurement of the cash value of interest rate risks is also possible in this way. The transfer of profit and loss for the period to cash-value based presentation is thus possible with a single steering system.

The amount of the maximum interest rate risk to be taken is limited via the value-at-risk (VaR) on the basis of the "modern historical simulation" and a holding time of one month in line with the requirements of the periodic view. This is based on the impact which real changes in interest rates observed over a 10-year period have on the bank's interest ledger cash value by reference to 2,500 historical interest rate curves. The bank has determined a 99 % confidence level as the parameter.

Besides this value-at-risk-based measurement of interest rate risks, regulatory requirements in 2016 dictate yet another steering parameter. If the so-called Basel-II interest rate shock of 200 base points leads to a cash value loss in the interest ledger of more than 20 % of the relevant equity, an institute is then classified as an "institute with increased interest rate risks". These institutes must then demonstrate to the regulator that the increased interest rate risks are tolerable within the scope of risk-bearing capability which is to be warranted via an "extended test criterion". This criterion is also limited at ILB.

Since 31 December 2016, new requirements have resulted from the general regulation on equity requirements for interest rate risks. The equity requirement is derived here from the ratio between the cash value impact of the Basel II interest rate shock and the regulatory total risk amount.

Besides limiting interest rate risks, the efficiency of the open items entered through matching maturities is measured and steered by reference to a benchmark. The aim is to optimise ILB's opportunities-to-risk ratio in accordance with this benchmark and by observing a specified tolerance band.

In order to assess the impact of extraordinary market changes on the interest rate risk, hypothetical extreme or worst case interest rate scenarios are additionally simulated.

This means that the limits determined by the Board in order to limit interest rate risks were adhered to at all times during the 2016 financial year.

ILB determines the forecast quality of the model applied to measure risks by back-testing as of the report dates. To this effect, the value losses (VaR) are compared to the value losses actually incurred. The cash value changes were found to be below VaR on all the relevant dates tested. The back-testing results show that ILB‘s risk model sufficiently considers interest rate risks.

The interest rate risk is supervised by Risk Controlling/Finance. On every trading day, the value at risk, the extended test criterion and the benchmark lever are determined and checked for adherence to limits as part of operative management. The monthly risk report submitted to management by the head of risk controlling contains details of the interest rate risks taken from the perspective of operative management and with a view to risk-bearing capability. Furthermore, extreme and worst-case scenarios are simulated in order to assess the impacts of extraordinary market changes on the interest rate risk.

When limits are exceeded, the Risk Controlling/Finance function immediately informs the board and the Treasury function.

The report on the interest rate risk also contains the regulatory indicator concerning the impact of a standardised interest rate shock and the resultant equity requirements for interest rate risks.

4.2.2 Market price risk

ILB is classified as a non-trading book institute. This means that the bank does not actively trade any securities, fund shares, currencies, derivatives or raw materials in order to generate profit. This means that there are no market price or other price risks (for instance, in conjunction with foreign currency, precious metals, etc.).

ILB generally buys securities with the intention of holding them until final maturity (long-term portfolio). The investment horizon of the special fund is also orientated towards the long term. ILB therefore carries all securities and the special fund as investment holdings. The securities and the special fund are valued according to the diluted lower of cost or market principle, so that market price changes do not affect ILB‘s valuation result. As long as full redemption is secured, market price fluctuations will not lead to lasting losses. The market price risk is hence not one of ILB‘s major risks. Against this background, market price risks are not limited and counted towards the bank‘s total limit.

ILB's current plans for the special fund up until 2018 provide for the reinvestment of profits, so that there is no distribution risk.

Market price changes of securities are monitored by ILB in order to assess risks from a possible reduction of the refinancing potential of open-market securities and to identify market price changes which could suggest latent credit risks.

4.2.3 Currency risk

Transactions in foreign currencies are fully secured immediately on closing through foreign currency interest swaps so that ILB does not incur any currency risks in conjunction with these transactions.

4.2.4 Implicit options

Implicit options in the interest ledger are rights of customers having contractual extraordinary redemption rights as well as termination rights pursuant to the German Civil Code [BGB]. This is an option or right which the customer has, but not an obligation to effect extraordinary redemption payments. This right is a risk for ILB. Each time such an option is exercised, this constitutes a deviation from regular redemption payments and has implications especially for net interest income, cash value and the interest rate risks measured. In the current period of low interest rates, customers increasingly ask for and agree upon long-term, fixed-interest periods which are subject to statutory termination rights pursuant to section 489 of the German Civil Code [§ 489 BGB]. Inclusion of implicit options in interest ledger management was therefore resolved in the year under review and will be fully implemented by the beginning of 2017.

4.2.5 Other price risks

During the period under review, ILB did not hold any shares and was hence not exposed to any share price and other price risks.

4.2.6 Opportunities

ILB's transformation function in conjunction with interest rate change risks is geared towards ensuring a long-term and stable contribution towards the bank's net interest income. ILB therefore accepts interest rate risks to a limited extent only. This means that the volume of both risks and opportunities is generally limited. Additional opportunities arise if the interest structure becomes steeper with persistently low money market interest rates. ECB forecasts and the current economic situation suggest that the low-interest phase will continue. The general conditions for matching maturities are therefore seen to be positive and stable for the future.

Changes in the price of securities held in ILB's portfolio (market price risks) have no impact on the bank's net income situation since the bank is planning to hold these securities for a long term. No risks from market price fluctuations means that there are no opportunities either.

4.3 Liquidity risk

Liquidity risks can be distinguished in two dimensions. Liquidity risk in the narrower sense typically refers to the risk that the bank may not be able to meet payment obligations in full when they become due (illiquidity risk). However, there is also a liquidity spread risk (liquidity risk in the broader sense). This risk materialises when the bank, as a result of a change in its own credit standing, can obtain the required funds only subject to changed terms and conditions.

ILB is generally risk-averse with regard to liquidity risks. However, liquidity transformation is permitted in order to differentiate contributions to profit on condition that liquidity is ensured at all times.

4.3.1 Liquidity risk in the narrower sense (illiquidity risk)

The following types of illiquidity risks were identified for ILB:

- Refinancing risk: Follow-up refinancing risk due to different capital commitment periods on the assets and liabilities sides of the balance sheet.
- Maturity risk: Delayed repayment in loan business
- Call risk: immediate utilisation of open payment obligations, unexpected withdrawal of deposits
- Market value risk: value losses of open-market assets that can be used for refinancing purposes

Maturity risks and call risks are of minor importance at ILB. There is no passive call risk because ILB is not engaged in deposit business.

ILB's Treasury steers the bank's liquidity through its daily transactions. Funds are raised and invested on the basis of expected incoming and outgoing payments in order to meet the bank's contractual obligations and in accordance with the reports by the specialised departments. In line with its operations, ILB has a high share of payment flows that are fixed and can therefore be planned.

Due to the different nature of the risks compared to the period risk-bearing capability calculation, illiquidity risk is measured and managed on the basis of a comparison of the refinancing demand with the existing refinancing potential in a dedicated steering process. The focus is on warranting liquidity at all times.

In order to ensure that ILB can meet its payment obligations at all times, the bank has money market lines available with commercial banks and a portfolio of securities, loans and advances that can be used in open-market transactions for short-term funding through Deutsche Bundesbank and/or the European Central Bank or through repo transactions. ILB has a sufficient, sustainable liquidity reserve in the form of securities eligible as collateral at the central bank. This liquidity reserve enables the bank to cover additional liquidity requirements which may arise under stress conditions. This means that ILB has an extensive refinancing potential that enables it to generate sufficient liquidity, even under extreme circumstances and largely independent of the general market situation. If fixed limits are exceeded, appropriate measures are introduced in order to improve the liquidity situation depending on its severity. Risk Controlling/Finance is responsible for monitoring and issues a monthly risk report as part of monthly risk reporting to the Management Board. Reporting on the short-term liquidity situation is supplemented by a long-term forecast over a 10-year period as well as a report on compliance with the regulatory liquidity indicators.

In order to measure the liquidity risk, ILB uses a software that enables integrated interest rate and liquidity risk management. The effects of changes in business can hence be evaluated on a budget and actual basis from a revenue, interest risk and liquidity risk perspective.

In the year under review, ILB was always able to provide itself with sufficient liquidity, both on the interbank market and through repo transactions. ILB has also signed contracts with German and European development banks to secure long-term refinancing options. During the course of the year 2016, ILB‘s unused liquidity potential was at all times sufficient. It was at no time necessary to resort to the liquidity reserve.

The regulatory liquidity requirements in their current version were met with a substantial buffer: According to the monthly regulatory reporting, the liquidity coverage ratio, which represents the short-term liquidity risk, ranged between 196 % and 769 % (required: minimum of 70 %) during the financial year.

4.3.2 Liquidity risk in the broader sense (liquidity spread risk)

Even when liquidity is maintained, liquidity costs constitute a risk. Given an incomplete match between the maturities of incoming and outgoing funds, there is a risk that follow-up business will be subject to higher refinancing costs should ILB‘s creditworthiness decline (expansion of the liquidity spread). When ILB‘s liquidity spreads increase, the existing refinancing gap must be closed at higher cost. This risk is reflected in the period-related risk analysis by declining net interest income.

The bank's liabilities are secured by statutory public-sector responsibility, guarantor's liability and the liability guarantee of the federal state of Brandenburg.

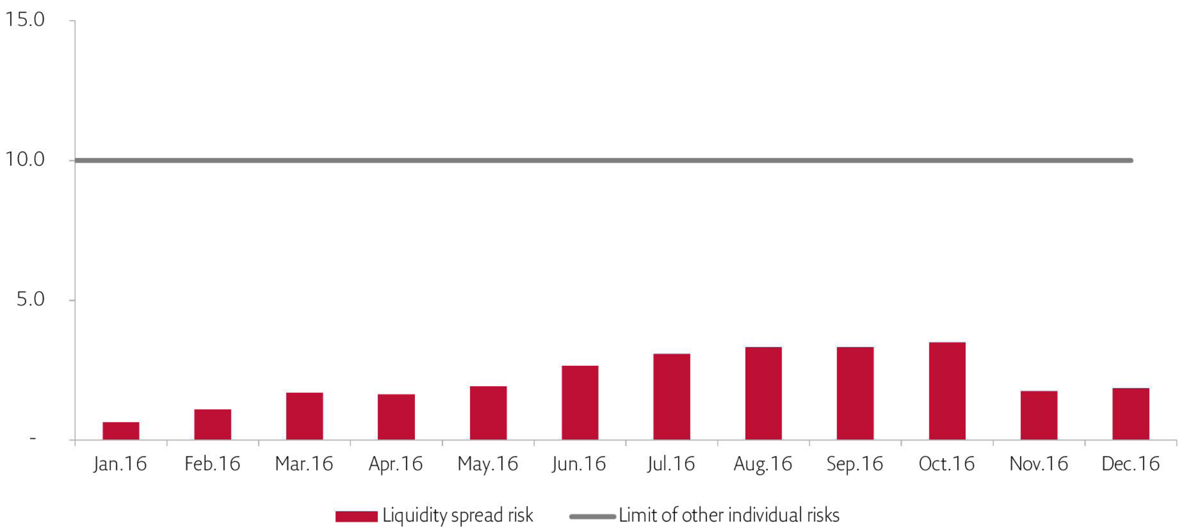
ILB is hence able to obtain liquidity at competitive terms because counterparties regard its creditworthiness to be comparable with that of the federal state of Brandenburg.

The bank hence expects to be generally able to obtain refinancing at prime terms in the future.

The impact of a potential and realistic increase in liquidity spread is considered to be low. However, the risk-bearing capability concept includes a model for quantifying this risk type. On the basis of historical changes in ILB's liquidity spreads, this model simulates the impact of potential increases in refinancing costs on net interest income for the current and for the next year. Risk utilisation is counted towards the limit for other individual risks. Monitoring is carried out on a monthly basis and is integrated into the risk report for the bank as a whole as well as the monthly risk report.

Risk utilisation for liquidity spread risks is represented by the following curve over the year:

Development of liquidity spread risk per relevant date for the one-year horizon



In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2017, is shown which refers to the one-year horizon throughout. The limit of EUR 10m for other individual risks was adhered to at all times during the year under review, with maximum utilisation for the following year, i.e. 2017, totalling EUR 3.5m due to liquidity spread risks. The fluctuations in the liquidity spread risk are related to the development of the short-term refinancing gap and can be considered to be non-critical with a view to their absolute amount.

4.3.3 Opportunities

Thanks to its status as a promotional bank and the liability guarantee of the federal state of Brandenburg, ILB is in a position to refinance its activities at favourable terms and conditions on the money and capital markets. As already seen when financial markets were tight, additional opportunities result from a further reduction of the bank's own risk spread whilst at the same time expanding the refinancing spread in the finance environment.

4.4 Operational risk

Operational risk (OpRisk) is the risk of losses due to the unsuitability or failure of internal procedures, people and systems or due to external factors.

ILB cannot rule out operational risks as part of its business. Risks that would jeopardise the continued existence of the bank are generally avoided, or appropriate provision is made by passing on the risks (for example through insurance) or reducing the risks (through damage prevention measures).

ILB strives to diversify its risk and revenue profile further by continuing existing and taking over new managed activities in conjunction with the deliberate taking of operational risks.

ILB uses an integrated IT system based on SAP. Operational risks are therefore managed and minimised, amongst other things, on the basis of IT systems with comprehensive checks and controls as well as connections to management systems with special monitoring, steering and information logic.

An information security management system (ISMS) is at the heart of IT governance. This ISMS is the basis for standards and responsibilities for the management of authorisations, change processes, IT security and contingency plans, events and problems. Risks remaining despite comprehensive IT risk management processes are addressed as part of operational risk within the scope of the risk-bearing capability.

The loss potential from operational risks is not quantified in detail for management purposes at ILB. Risk reporting addresses losses resulting from operational risks in the form of damage or losses when such losses exceed the threshold relevant for reporting. Qualitative management is carried out according to the following approach: The method employed to manage operational risks is backed by transparent communication and documentation throughout the bank. Avoiding operational risks is always a top priority for ILB.

In order to manage operational risk, ILB has established an OpRisk controlling function to co-ordinate the entire management of operational risks. OpRisk controlling belongs to the bank's Risk Controlling/Finance function. All queries regarding the bank's operational risks are generally forwarded to this organisational unit. Furthermore, responsibility for partial risks has also been assigned within the bank. Those in charge of partial risks ensure that these are suitably assessed and that measures are initiated according to the risk type concerned. This takes place as part of the annual risk stock-taking procedure, regular evaluation of risk indicators as well as membership in the expert committee. The expert committee meets twice a year and addresses damage/risk cases reported for the previous six months. Furthermore, useful information for OpRisk controlling and its further optimisation is discussed. These meetings are attended by those in charge of partial risks as well as employees from exposed organisational units at the bank where indications of operational damage/risks could become apparent: risk controlling, customer accounting, compliance and internal auditing.

In 2016, risk stock-taking for operational risks was expanded. Besides a complete revision of the underlying questionnaire, an additional self assessment exercise was introduced involving all departments and central functions. The quantitative and qualitative evaluation of the first self-assessment cycle did not reveal any unexpected risks. ILB has basically implemented general control systems, such as the four-eyes principle or competence rules, written procedures as well as a cautious risk policy. This reduces the risk of loss, a fact that is also reflected by occurrence probabilities which are mostly rated “very low” to “low” as well as loss levels which are also rated “very low” to “low” in most cases. Concepts for IT security and contingency plans are additionally in place.

The specific problems of the areas are known. Suitable measures are taken and/or developed. No new risks or risks not discovered by measures were identified.

Self-assessment generally provided an overview of the risks for the bank as a whole. In future, it can serve as a basis for a detailed view of OpRisk of the different areas and departments.

The monetary evaluation showed that the expected loss is limited and below the relevance threshold, whilst the values in the scenario analysis are significantly below the limit of EUR 15m for operational risks.

ILB regularly compiles information on operational risks and damage. Each employee must also carefully monitor their environment for operational risks and damage cases.

Generally speaking, the “discoverer“ of a risk or damage case is obliged to report this to the respective head of their organisational unit who is responsible for identifying operational risks and reporting damage cases, i.e. passing these on to OpRisk Controlling. ILB records damage, for example, in a damage database, and analyses its operational risk using risk inventories, risk maps or risk indicators in order to identify potential damage at an early point in time. These instruments already consider stress test requirements in that they include scenarios describing the possible occurrence of operational damage. Every six months, all members of ILB‘s management analyse and report on the risk potential of their areas as part of the operational risk controlling process. This helps the bank in its efforts to better handle and identify operational risks.

The board is informed of any cases of damage in ad hoc reports. OpRisk Controlling additionally informs the board of the risk situation in its quarterly reports.

In order to map operational risks within the scope of the bank‘s risk-bearing capability, the loss potential is determined using the calculation method according to the base indicator approach pursuant to the CRR and therefore on a generalised basis,. In order to ensure the consistent integration of the risk-bearing capability concept, distribution assumptions are made in order to adapt the risk measurement method to a confidence level of 99.0 %. Linear distribution of the risks over the year is assumed, so that the risks are also linearly allocated to the periods on a pro-rata temporis basis. The calculation is carried out on the basis of the extrapolated result on a monthly basis for the current and for the next year. The analysis of the current year includes operational risks already carried in the profit and loss account as expenditure so that the extrapolated net income for the year and hence risk capital are reduced.

Operational risk utilisation is represented by the following curve over the year:

Operational risk development as per the balance sheet date for the one-year horizon

In order to ensure the comparability of risks over the course of the year, risk utilisation for the following year, i.e. 2017, is shown which refers to the one-year horizon at all times. The limit of EUR 15m for operational risks was adhered to at all times, with the maximum utilisation volume reaching a level of EUR 12.1m. Due to the calculation method and the stable results forecast for ILB, the risk amount remains very constant over time.

4.4.1 Operating risk

Minor risks are taken when justified from a commercial perspective. ILB counters these operational risks with a suitable system of internal control. Furthermore, sufficient insurance has been taken out to cover any damage that may occur.

A business impact analysis served as a basis for a contingency manual for all areas of ILB. This manual documents measures to maintain critical bank processes in extreme situations.

ILB is building a new administration building in Potsdam's inner city and aims to move there during the first half of 2017. This new building project is of considerable relevance for the bank. With this in mind, the project is managed throughout its term by a dedicated organisational unit (ILB new building unit) and the services of external experts. Internal processes and reporting ensure that the board is informed in due time. Although ILB recognises this project as a certain risk, this is considered to be manageable in its totality and with a view to its impact on the bank's risk-bearing capability.

4.4.2 Legal risk

Legal risks exist with a view to the material effect of agreements, decisions, powers of attorney/powers of representation as well as compliance with formal requirements, especially with regard to new legislation and court decisions.

ILB counters these legal risks by using standardised documents which are approved by the Legal function and continuously updated. Furthermore, the legal department is also involved at an early stage in any decisions that may commit or favour the bank.

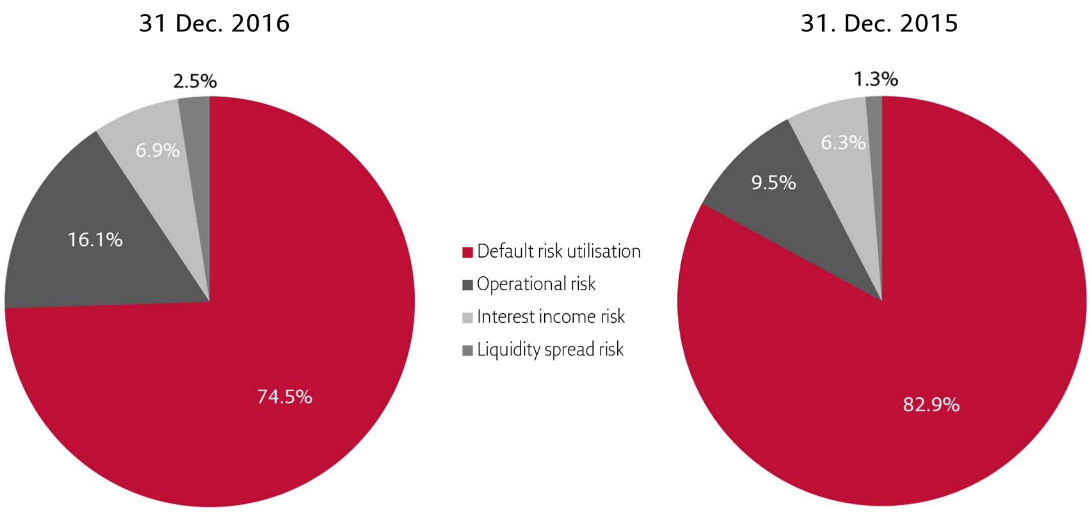
4.4.3 Model risk

The model risk is the risk which a bank could suffer as a result of decisions made primarily on the basis of the results of internal models and which are incorrect in terms of development, implementation or application.

ILB counters this risk through a conservative approach for determining risks without consideration of diversification effects as well as through the timely performance of validation measures and checks of the measuring methods for the risk types.

5. The risk situation in summary

As per 31 December 2016, the bank's overall risk compared to the previous year was distributed as follows to the different types of risk, expressed as a percentage of total utilisation of the bank's overall risk exposure:



The comparison of the percentages of the individual risk times with the figures for the previous year does not show any major change in the composition of the overall risk profile. Absolute risk utilisation declined significantly compared to the previous year, so that the relations changed.

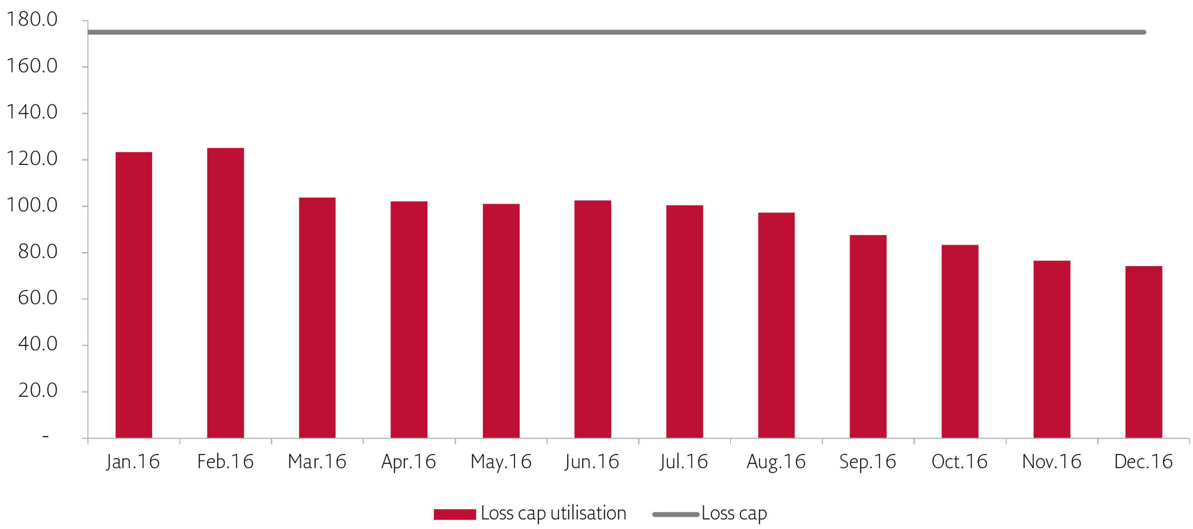
The default risk accounted for 74.5 % and hence remained the greatest share. Compared to 31 December 2015, this represents a decline of nine percentage points. At the same time, overexposure is reduced as a result of the introduction of the SR rating system. Default risk accounted for the greatest share of the decline in overall risk utilisation.

Market price risk reached a share of 6.9 % in ILB's overall risk and hence remained flat against the previous year. This reflects interest rate risks resulting from matching maturities.

The loss potential from operational risks was determined on a general basis and accounted for 16.1 % of ILB's total risk, with the absolute risk amount remaining almost flat against the previous year.

The share of other risks totalled 2.5 % and was higher than for the previous year. In this item, ILB considers the risk of being forced to refinance itself at less favourable conditions only (liquidity spread risk). Liquidity spread risk continues to be of minor relevance in terms of its absolute amount.

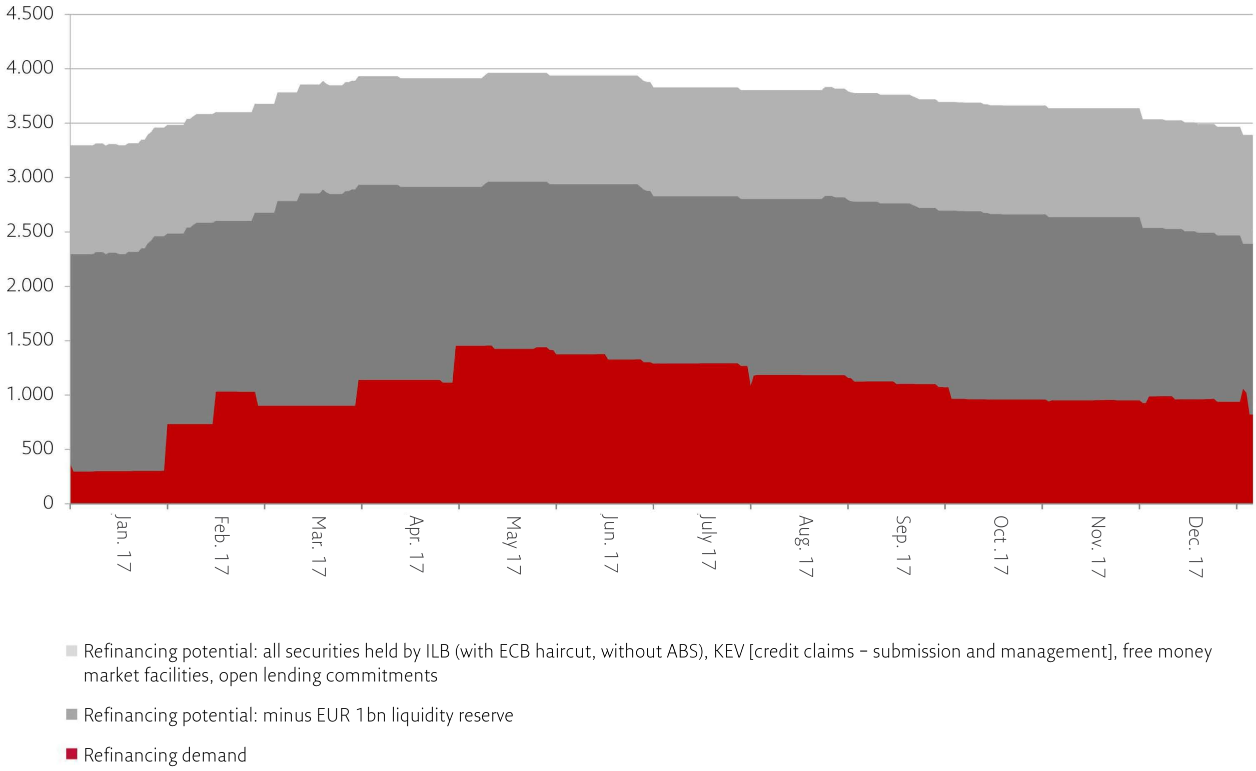
Development of the utilisation of the loss cap as per the balance sheet date for the one-year horizon



In order to ensure the comparability of risks over the course of the year, total risk utilisation for the following year, i.e. 2017, is shown which refers to the one-year horizon throughout. The limit to risk items of EUR 175m laid down in the loss cap was adhered to at all times during the 2016 financial year, with maximum utilisation reaching a level of 72 % in February 2016. As per 31 December 2016, utilisation for the following year totalled only EUR 74m, corresponding to 42 % of the loss cap. The utilisation of the loss cap was generally dominated by the decline in default risks. The risks taken were hence consistent with ILB's risk strategy. Utilisation generally corresponded with the bank's willingness to take risks as laid down in its risk strategy.

The following diagram illustrates the liquidity risk within the meaning of the bank's illiquidity risk as per 31 December 2016, which is limited by a dedicated management process by comparing the bank's refinancing requirement with its refinancing potential:

Normal scenario (volume in million EUR)



Refinancing demand never exceeded the refinancing potential. Refinancing demand accounted for a maximum of 37 % of the refinancing potential. The extrapolation suggests that ILB has a sufficiently large liquidity buffer which is made up of an unused refinancing potential of at least EUR 2.3bn. The liquidity reserve of EUR 1.0bn is not used. Liquidity is therefore ensured.

IV Outlook

1. Economic factors

Germany's economic situation in 2016 was characterised by solid growth that was driven mainly by domestic consumption. According to calculations by the Federal Statistical Office, gross domestic product increased against the previous year by a price-adjusted 1.9 %.

The German government expects the good economic situation to continue in 2017. In its annual economic report for the year 2017, the German government forecasts 1.4 % growth of price-adjusted gross domestic product for the current year. According to the report, this slightly weaker growth is not the result of worsening economic prospects, but mostly due to a smaller number of working days in 2017.

ILB does not expect a significant increase in interest rates in 2017, not least due to the ECB's bond purchase programme which will initially continue until the end of March 2017. However, slight increases for longer maturities are possible in the Eurozone in view of the prospect of interest rate increases in the US. If and to what extent the ECB's bond purchase programme is to be renewed will become relevant by the end of the year at the latest. Furthermore, the outcome of general elections in many Eurozone countries, especially in France and Germany, will probably also impact capital markets.

Positive economic development can also be expected for the federal state of Brandenburg in 2017. The latest 2017 economic report issued at the beginning of the year by the working group of the Berlin and Brandenburg Chambers of Industry and Commerce drew a generally optimistic picture of the economic situation in the region. According to the report, the economy in Berlin-Brandenburg was found to be doing extremely well at the beginning of the year despite global political risks. The business climate index retained its high level of 135 points. The economic survey shows a stable, mild economic climate for the economy as a whole with no signs of overheating or cooling down. Around 94 % of the companies surveyed rated the current business situation as "good" or "satisfactory", with around 88 % expecting "rather favourable" or "rather constant" business for the current year. The shortage of skilled labour remains the key challenge for the regional economy.

Summing up, the report from the beginning of 2017 shows the following further results for the federal state of Brandenburg:

- A good investment climate: Around 73 % of companies are planning to invest in 2017. Around 88 % of these investing companies are expecting investment volumes either to increase (33 %) or at least to remain flat (55 %).
- Positive employment expectations: 24 % of the companies surveyed are planning to create new jobs in 2017. 62 % of companies are expecting employment to remain flat, with 14 % expecting layoffs.

2. Major influences

ILB considers the following influence factors to be essential for its business activities:

Promotion and development business

- In the positive economic environment currently forecast for the federal state of Brandenburg, ILB is expecting a pledged volume of at least EUR 1.0bn for the current year. ILB's promotion and development business in 2017 will be strongly influenced by the transposition of the directives within the scope of the current EU programming period.

Market environment:

- The continued measures by the European Central Bank (ECB) to boost economic development in Europe reinforce the low interest rates and hence at times the insufficient risk premiums on markets for fixed-interest securities. The extension of the bond purchase programme initially until December 2017 currently suggests that the present situation will continue.

Regulatory framework conditions:

- Regulatory obligations within the scope of CRR as well as successively stricter provisions for internal risk management by banks mean more demanding requirements for ILB's equity. Against this background, the bank is working to increase its relevant equity from its own revenues.

- ILB expects regulatory requirements to be further expanded and consequently high investment costs for the necessary IT infrastructure.

Liquidity situation:

- The bank obtains short-term liquidity from the ECB (European Central Bank) and/or the Bundesbank through securitised borrowings in the form of repo transactions as well as open-market transactions. It also raises money unsecured as time deposits and call money. In light of ILB's good refinancing possibilities, it boasts a comfortable liquidity situation.

- The bank sources long-term financing mainly from national and supranational business development banks (KfW, European Investment Bank, Landwirtschaftliche Rentenbank, Council of Europe Development Bank) and through note loan and registered bond issues. Access to these refinancing sources will also be possible in the future. The refinancing basis is to be broadened by issuing listed bearer bonds.

- ILB's refinancing demand can be covered at all times taking current developments into account.

Administration building:

- In 2017, ILB will move to its new administrative building in Babelsberger Straße. The bank's ability to act and conduct business will be ensured at all times.

3. Development of income situation and financial position

The group's future income situation and financial position will continue to depend heavily on ILB. Since 1 January 2014, LASA Brandenburg GmbH i. L. has been part of the ILB group. ILB together with LASA Brandenburg GmbH i. L. performs employment promotion measures on behalf of the Ministry of Labour, Social Affairs, Women and Families of the federal state of Brandenburg. The employees of LASA Brandenburg GmbH i. L. were integrated into ILB with effect as of 1 July 2016. The related personnel expenditure was therefore also included in ILB's profit and loss account. In line with the agreed form of remuneration of activities performed by the new employees on a cost basis, no major effects on net income will be seen either at ILB or group level.

ILB's liquidity is ensured thanks to its excellent refinancing possibilities. ILB has signed long-term contracts with German and European development banks to secure refinancing. The refinancing basis will be broadened by placing note loans and registered bonds with institutional investors. ILB can also obtain additional liquidity at short notice from the ECB and/or Bundesbank. It also raises money unsecured as time deposits and call money.

The increasingly restrictive regulatory conditions (Basel III/SREP) may in the longer term result in implications for ILB's equity. In order to achieve the planned business development, ILB will continue to accumulate profits in order to strengthen its equity. It is planned to accumulate profits of at least EUR 20m in order to strengthen equity.

The new debt and liquidity ratios implemented under Basel III, especially the leverage ratio, liquidity coverage ratio and the net stable funding ratio, will be monitored with a view to their possible impact, and measures will be taken in time for the implementation of the corresponding standards.

The chart below illustrates the planned development of ILB's net income without compensatory entries from the ILB promotional fund and from the Brandenburg fund.

Item	2016 Thousand EUR	Plan 2017 Thousand EUR	Change in %
Net interest income	58,219	60,055	3.2
Net commission income	45,643	51,241	12.3
Other operating net income *	2,549	2,441	-4.2
Personnel costs	38,569	42,524	10.3
Material costs	20,697	21,083	1.9
Depreciation on operating equipment	2,390	5,946	148.8
Profit before risk provisioning/formation of reserves	**44,755**	**44,184**	**-1.3**
Value adjustments of receivables	-3,277	-6,300	92.2
Operating profit from securities	1,885	-387	-120.5
Addition to provident funds	-804	-1,000	24.4
Result after risk provisioning	**42,559**	**36,497**	**-14.2**
Formation of reserves	-26,000	-20,500	-21.2
Addition to ILB promotional fund	-5,000	-5,000	0.0
Net income for the year	**11,559**	**10,997**	**-4.9**

* including net extraordinary result, other taxes

ILB expects the income situation and financial situation to remain satisfactory in 2017.

Profit before risk provisioning and the formation of reserves is planned to total around EUR 44.2m in 2017 and will therefore be only insignificantly lower than in the previous year.

Net interest income of EUR 60.1m will continue to account for the greatest share in ILB's revenues. As a result of once-off effects, planned net interest income in 2017 will be EUR 1.8m above the previous year's level of EUR 58.2m. The key driver for the increase is the delayed receipt of payments from contract amendments from 2016 to 2017 with an effect of EUR 1.5m on net interest income.

ILB expects the easy money policy to continue or even to expand further in 2017. A low-interest environment with negative interest rates on money markets and long-term capital market rates of clearly below 1.0 % are therefore expected.

ILB will benefit from this trend in the short term in the form of favourable refinancing conditions with variable-interest borrowings. Benefits due to negative interest rates can be realised in this context. Furthermore, the interest situation also enables positive effects from matching maturities. In the long term, however, negative consequences will prevail so that declining interest income from treasury business is expected in future.

Interest income from promotional and development business is expected to remain stable. The bank's existing business and its newly created products will contribute to this stability. Possible effects of extreme ad hoc changes in the interest curve on the following year were simulated as part of scenario analyses. Net interest income planned for 2017 will move accordingly within a band from EUR 49.3m to EUR 83.5m. Net interest income shows a strongly negative response to a major increase in short-term interest rates with an inverted interest structure or a major increase in the entire interest rate structure. Positive effects compared to the initial planning can be seen in continuously low money market rates and steeper interest rates or further base lending rate reductions. The changes in interest rates assumed are extreme scenarios which are unlikely to occur. The assumptions made for 2017 are confirmed for the majority of the moderate interest scenarios.

Net fee and commission income is becoming increasingly important for net income and is likely to total EUR 51.2m in 2017, i.e. around EUR 5.6m higher than in 2016. Net fee and commission income largely results from fees for the management of promotion and support programmes. Around one quarter of this income is from administrative cost contributions in conjunction with the granting of loans from trust funds and three quarters from the handling of promotion programmes and a small amount from the management of guarantees and loan processing. The increase in net fee and commission income is particularly due to the expansion of business as a result of the expansion of employment promotion and EAFRD measures.

ILB, in its capacity as a central funding and support platform for the federal state of Brandenburg, will enter into further management agreements with the federal state. According to the fee structure based on the refunding of costs actually incurred, which prevails in this business field, no major positive or negative impact on ILB's result are to be expected. On the other hand, revenues are generated from loans granted in the past from trust funds in housing and from ongoing fee payments on the basis of foreign exchange. Due to the continued low interest level, additional extraordinary redemption payments cannot be ruled out above and beyond the special redemption payments already included in the planning scenario. A scenario simulation suggests a decline in fees of EUR 0.5m.

Other operating net income in 2017 will probably total EUR 2.4m compared to EUR 2.5m in 2016.

Administrative expenses (personnel, material expenditure and depreciation on operating equipment) will probably increase in 2017 by EUR 7.9m to EUR 69.6m. The main driver of the increase will be the integration of LASA Brandenburg GmbH i. L. as per 1 July 2016 that will be effective for all of 2017, however, with increased personnel costs being compensated for by corresponding cost refunds. The move to the new building will lead to shifts in the cost of rooms and premises from material expenditure to depreciation on operating equipment (investment in the new building) and net interest income (financing costs for the new building). As agreed with the ILB construction committee, the date of ILB relocating to the new administrative building was postponed from December 2016 to the first half of 2017. The effects on the 2017 result do not impact profit or loss with the exception of the shifting of relocation costs between periods. EUR 27.0m is planned for material expenditure and depreciation on operating equipment for 2017, i.e. EUR 3.9m more than the actual value from 2016. Key reasons are the expected, increasing external costs for managing specialist applications and basic operations as well as IT consultancy services needed in conjunction with projects driven by regulatory requirements. Most of ILB's administrative expenditure is subject to long-term fixed rates. Deviations from budget can result from deviations in actual project costs compared to planned retainers of external service providers. In line with cautious planning principles, however, opportunities here outweigh potential risks.

The 2017 budget includes a flat EUR 6.3m as a cautious estimate of value adjustments of receivables.

Securities held by the bank are valued according to the diluted lower of cost or market principle. According to the principle of prudence, potential valuation demand for securities totalling EUR 0.7m is additionally considered as an expected loss. Altogether, a negative valuation result of EUR 0.4m is recorded here.

In order to consider implicit options due to statutory termination rights within the scope of loan business, a sum of EUR 1.0m is allocated to provident funds, corresponding to the same amount as in the previous year.

Net income for the year is mainly planned at the same level as last year.

ILB's profit will continue to be stable and satisfactory in the year to come, creating the basis for further successful business by the bank to the benefit of the federal state of Brandenburg. In light of this, ILB plans to step up the ILB promotional fund in order to offer attractive loan products by drawing on its own revenues. In line with demand, a sum of EUR 5m is planned for the ILB promotional fund for the following year. Considering current planning, ILB will probably achieve its goal of strengthening its equity by EUR 20m once again in 2017.

According to the 2017 budget, the balance sheet total will be in the order of around EUR 13.0bn.

By the end of 2017, the number of employees will probably increase once again slightly. The share of female employees and the share of part-time employees will remain largely unchanged. We expect to see a slight increase in the share of fixed-term employees.

The number of employees in the passive phase of semi-retirement, early retirement, parental leave or other forms of passive employment is expected to increase slightly.

The number of students in co-operative study programmes will remain flat against the previous year.

The professional development offering will be continued at the same level.

V System of internal control and risk management for the accounting process

The system of internal control for accounting includes, in particular, organisational rules for structures and processes with clear differentiation between areas of responsibility as well as processes, methods and measures to ensure the correctness and reliability of internal and external accounting.

Accounting-related business transactions are mostly handled by the respective units and departments. ILB's Board is responsible for the design and effectiveness of a reasonable system of internal control for accounting. Risk controlling/Finance is responsible for implementation in cooperation with Bank Operations and Corporate Steering. The respective areas are responsible for complete and correct recording and for performing and documenting the necessary related controls. The Risk Controlling/Finance function is in charge of accounting rules, posting methods, balancing and definition of valuation rules. The Risk Controlling/Finance function is responsible for transaction-independent valuation and result determination.

The annual and consolidated financial statements are prepared by the Risk Controlling/Finance function and set up by the Board. The Administrative Board elects an Audit Committee from among its members. According to the business rules, the tasks of the Finance Committee include, but are not limited to, resolutions regarding accounting, the selection and monitoring of the necessary independence of the auditor, the appointment of the auditor, the determination of key audit tasks and fee agreements. The Audit Committee also supervises the accounting process as well as the effectiveness of the risk management system, especially the internal control system and internal auditing. The Audit Committee controls the prompt elimination by the Board of points of criticism identified by the auditor. ILB's general meeting approves the annual and consolidated financial statements pursuant to its articles of association. The auditor attends the discussions of the Administrative Board and of the committees regarding the annual and consolidated financial statements and reports on the key results of his audit. The auditor is elected by the general meeting at the recommendation of the Administrative Board/Audit Committee.

The consolidated financial statements include ILB and ten affiliated companies on a fully consolidated basis.

The consolidated financial statement is carried out by the Risk Controlling/Finance function on the basis of the annual financial statements of the consolidated companies. Receivables and liabilities as well as expenses and revenues are fully consolidated in line with the relevant provisions of the German Commercial Code. This function is also responsible for the entire bookkeeping, preparation of annual financial statements as well as adjustment to the accounting and valuation rules applicable to the entire group.

In light of the business model of ILB and its affiliated companies to pursue tasks in the public interest, a more in-depth analysis of the market compliance of transactions with related persons was not carried out.

ILB's accounting process has been laid down in manuals and procedures in its written rules which are updated on a continuous basis.

In the standardised management and monitoring process for new products and processes, the Risk Controlling/Finance function is responsible, amongst other things, for the accounting-related analysis and the assessment of risks related to new products in order to ensure adequate presentation in the books.

In addition to the minimum requirement of the four-eyes principle, the use of standard software, which is protected against unauthorised use by competence-related authorisations, is another key element of the system of internal control for accounting. The functions and organisation of the market areas are separate from the areas responsible for handling, supervision, control and accounting.

The internal control systems of the accounting processes are identical for ILB and its consolidated subsidiaries.

The functioning of the accounting-related internal control system is monitored by the Internal Audit function in the form of regular, process-independent audits according to the minimum requirements for risk management (MaRisk) published by the Federal Financial Supervisory Authority (BaFin). The Management Board and the Administrative Board are informed about the results of the audit soon after they become available.

Potsdam, 27 March 2017

The Board of Investitionsbank des Landes Brandenburg

Tillmann Stenger	Jacqueline Tag
Chairman of the Board	Member of the Board

Annual Balance Sheet as of 31 December 2016

Investitionsbank des Landes Brandenburg

Assets	EUR	EUR	31 Dec. 2015 Thousand EUR
1, Cash			
a) Cash in hand	5,417.26		7
b) Balances with central banks	10,963,699.29		9,695
of which:		10,969,116.55	9,702
at Deutsche Bundesbank EUR 10,963,699.29 (previous year: EUR 9,695,000)			
2. Loans and advances to banks			
a) Payable on demand	39,698,578.96		27,305
b) Other loans and advances	2,178,021,668.21		2,287,824
		2,217,720,247.17	2,315,129
3. Loans and advances to customers		5,009,173,190.53	5,224,400
of which:			
Secured by liens EUR 776,468,332.69 (previous year: EUR 738,064,000)			
Public-sector loans EUR 3,607,949,297.46 (previous year: EUR 3,576,017,000)			
4. Bonds and other fixed-income securities			
a) Bonds and notes			
aa) Issued by public institutions	1,579,006,223.23		1,622,943
of which:			
eligible as collateral at Deutsche Bundesbank EUR 1,574,934,113.03 (previous year: EUR 1,618,861,000)			
ab) from other issuers	1,496,173,151.49		1,432,215
of which:		3,075,179,374.72	3,055,158
eligible as collateral at Deutsche Bundesbank EUR 1,455,050,572.69 (previous year: EUR 1,405,579,000)			
5. Stocks and other variable-income securities		169,832,880.80	149,878
6. Shareholdings		30,000.00	30
7. Shares in affiliated companies		62,442,701.86	65,703
8. Trust assets		2,600,729,292.64	2,722,966
of which:			
Trust loans EUR 2,414,068,410.34 (previous year: EUR 2,564,113,000)			
Securities held in trust EUR 181,814,489.00 (previous year: EUR 148,600,000)			
9. Intangible assets			
a) Acquired concessions, industrial property rights and similar rights and values as well as licenses thereto		3,451,022.38	2,351
10. Tangible assets		70,319,323.24	31,318
11. Other assets		88,068,543.07	75,645
12. Prepaid expenses		10,290,916.09	10,194
Total assets		13,318,206,609.05	13,662,474

Liabilities	EUR	EUR	EUR	31 Dec. 2015 Thousand EUR
1. Liabilities to banks				
a) Payable on demand		125,978,536.78		3,911
b) With an agreed term or notice period		9,182,927,750.84		9,274,804
			9,308,906,287.62	9,278,715
2. Liabilities to customers				
a) Other liabilities				
aa) Payable on demand		99,623,748.51		239,906
ab) With an agreed term or notice period		635,703,244.03		761,688
			735,326,992.54	1,001,594
3. Trust liabilities			2,600,729,292.64	2,722,966
of which:				
Trust loans EUR 2,414,068,410.34 (previous year: EUR 2,564,113,000)				
Securities held in trust EUR 181,814,489.00 (previous year: EUR 148,600,000)				
4. Other liabilities			13,336,620.79	22,231
5. Prepaid expenses			80,447,147.54	88,782
6. Provisions				
a) Provisions for pensions and similar obligations		1,401,997.00		1,353
b) Other provisions		9,277,076.35		10,090
			10,679,073.35	11,443
7. Special item for investment allowances			19,751,507.04	26,928
8. Fund for general banking risks			332,248,005.36	298,592
9. Equity				
a) Subscribed capital		110,000,000.00		110,000
b) Retained earnings				
ba) Statutory reserve	10,763,265.80			10,185
bb) Other retained earnings	85,000,000.00			80,000
		95,763,265.80		90,185
c) Net retained profit		11,018,416.37		11,038
			216,781,682.17	211,223
Total liabilities and shareholders' equity			13,318,206,609.05	13,662,474
1. Contingent liabilities				
a) Liabilities in relation to guarantees and warranties			44,988,948.46	37,166
2. Other obligations				
a) Irrevocable loan commitments			350,818,145.32	301,835
3. Administration loans			67,675,475.60	84,007
4. Administration guarantees			114,869,683.31	138,554

The annual financial statements of ILB for 31 December 2016 were prepared according to the relevant regulations of the German Commercial Code (HGB), the Regulations on the Accounting of Banks and Financial Institutions (RechKredV) and the German Stock Corporation Act (AktG).

Profit and Loss Account for the period 1 January to 31 December 2016

Investitionsbank des Landes Brandenburg

	EUR	EUR	EUR	1 Jan. – 31 Dec. 2015 Thousand EUR
1. Interest income from				
a) lending and money market transactions	161,741,656.42			156,651
minus negative interest from money-market transactions	53,574.87			18
	161,688,081.55			
b) fixed-income securities and debt register claims	41,475,845.14			59,899
		203,163,926.69		216,532
2. Interest expenditure				
Interest expenditure from banking business		150,892,939.98		159,574
minus positive interest from banking business		5,947,671.88		1,684
		144,945,268.10		157,890
			58,218,658.59	58,642
3. Fee and commission income		46,018,528.34		41,349
4. Fee and commission expenses		375,157.79		442
			45,643,370.55	40,907
5. Other operating income			10,938,786.33	6,256
6. General administrative expenses				
a) Expenditure on personnel				
aa) Wages and salaries	32,706,971.19			31,061
ab) Social security contributions and expenditure on pensions and other benefits				
of which for pensions:				
EUR 6,549.00 (previous year: EUR 156,000)	5,861,384.74			5,797
		38,568,355.93		36,858
b) Other administrative expenses		20,697,374.19		20,451
			59,265,730.12	57,309
7. Depreciation, amortisation and write-downs on intangible assets and tangible assets			2,390,114.90	1,285
8. Other operating expenses			4,190,110.83	2,708
9. Amortisation and write-downs on accounts receivable and certain securities as well as additions to reserves in loan business			5,489,424.20	807
10. Revenues from additions to investments, shares in affiliated companies and securities treated as fixed assets			1,846,122.89	6,046
11. Allocations to the fund for general banking risks			33,655,719.26	38,128
12. Results from ordinary activities			11,655,839.05	11,614
13. Extraordinary expenses			42,693.00	43
14. Other taxes			54,810.28	57
15. Net income for the year			11,558,335.77	11,514
16. Profit brought forward from the previous year			37,997.39	99
17. Appropriation to retained earnings				
a) to the statutory reserve			577,916.79	575
18. Net retained profit			11,018,416.37	11,038

The annual financial statements of ILB for 31 December 2016 were prepared according to the relevant regulations of the German Commercial Code (HGB), the Regulations on the Accounting of Banks and Financial Institutions (RechKredV) and the German Stock Corporation Act (AktG).