

Interim Report 2011

Financial Highlights

Financial Highlights		1.1.–30.6.2011	1.1.–30.6.2010
Operating performance according to IFRS			
Pre-tax profit/loss	in € million	216	– 719
Net income/loss	in € million	163	– 700
Key ratios			
Return on equity before taxes	in %	5.6	– 11.2
Cost-income ratio ¹⁾	in %	55.3	> 100.0
Balance sheet figures			
Total assets	in € billion	233.8	328.1
Equity (excluding revaluation reserve) ²⁾	in € billion	7.9	7.7
Equity ²⁾	in € billion	7.8	7.8
Key regulatory capital ratios³⁾			
Core capital	in € billion	7.0	7.1
Own funds	in € billion	9.6	9.7
Risk-weighted assets ⁴⁾⁵⁾	in € billion	18.1	20.4
Core capital ratio ⁴⁾	in %	38.9	34.7
Own funds ratio ⁴⁾	in %	52.8	47.7
Personnel			
Employees		1,396	1,366

¹⁾ The cost-income ratio is the ratio of general administrative expenses and operating revenues

²⁾ Contains hybrid capital instruments of the subsidiary DEPFA Bank plc which are a part of equity according to IAS 32

³⁾ Pro forma as per prepared annual financial statements and after result distribution

⁴⁾ Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5

⁵⁾ According to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach

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Interim Financial Review

Macro-economic Situation

As was the case in the whole of 2010, discussions at the macro-economic level in the period under review were again dominated by problems of financial policy in numerous countries. In addition to Greece and Ireland, Portugal has now also been taking advantage of aid from this fund. For Greece, a further rescue package was made available in July in order to prevent a default. In addition, private investors are expected to bear some of the costs of restructuring the national budget by way of voluntary rescheduling with lower interest and longer maturities. A new aspect in the period under review is the increasingly critical assessment of fiscal stability in the USA, despite the agreement reached regarding the increase in the US debt ceiling. This is the context in which all major rating agencies are now discussing whether to downgrade the rating even of US bonds.

Contrary to some fears, the (global) economic consequences of the catastrophe of March 2011 in Japan have been very moderate, even if this event interrupted several international delivery and production chains for substantial periods. But even the Nikkei index, which was trading at around 10,500 points before the catastrophe, has to a large extent recovered from the low at 8,605 points, and was again aiming for the level of 10,000 points at the end of the reporting period.

Following the collapse seen in 2009, the real economy continued to recover, although to varying degrees on the international scene. Particularly in the countries with the fiscal problems detailed above, growth is relatively low, or – as is the case in Ireland and Greece – is even negative. In the first half of 2011, Germany saw production return to the level before the crisis. This was accompanied by a further improvement in the situation on the labour market. The number of persons unemployed fell below three million, and the unemployment rate was 7.40% (EU 9.5%). On the other hand, the unemployment rate in the USA remained at around 9%.

The developments in the field of finance policy detailed above as well as these differences between real economies were some of the factors which resulted in a relatively significant strengthening of the euro against the US dollar in the period under review, even if the development in this particular field was also volatile.

Sector-specific Situation

Situation of the Bank Sector

In the countries in which the economy posted a positive performance, the volume of loans which were extended in the first half of 2011 increased for the first time since the outbreak of the financial crisis. Provisions for losses on loans and advances also declined on average for the sector. Nevertheless, the difficult situation in Greece was a problem affecting the entire bank sector. Continuing pressure of the rating agencies on the other European countries which are the focus of attention (Greece, Portugal, Ireland and Spain) again depressed the bond portfolios of many banks. Because the situation of the American national economy is also difficult, many institutional investors have already reduced their holdings of American government bonds. The entire sector is searching for possibilities of obtaining additional capital in order to meet the new Basel III requirements in the future. As a consequence of the financial crisis, American credit institutions in particular are still involved in criminal or composition proceedings with investors of securitised mortgage loans. Considerable damages have already been paid in certain cases.

Public Sector Financing

In view of the government debt crisis and also as a result of the considerable differences at present between the ratings of individual Euro countries, the public sector finance market is undergoing a process of far-reaching structural change.

Overall, the demand for public sector finance is opposed by a stable supply, because leading banks have withdrawn from the market and have been replaced by other players, such as regional banks.

There has been a considerable change in credit check conditions. It is true that public sector finance is still considered to be a low-risk investment class which is in demand. However, as a result of the government debt crisis, the risk assessment of individual borrowers will be much more critical.

Many factors of a public sector finance market which has been very stable for many years are now subject to unusually significant changes. In the strategic core markets of HRE Group, local and regional credit institutions have assumed the main role in the public sector finance market. Despite parallel consolidation efforts for public finances, these core markets still report strong demand for financing for public sector products or services such as in the field of health, education and also in culture and sport. In addition, there are also signs of additional prospects resulting from increasing demand for investment in public sector infrastructure (for example, expansion of public sector means of transport and environmental projects).

In Germany, margins have stabilised at a level which is still low. However, a stronger distinction is made between the different ratings. In view of the unsolved problems in connection with the financial situation of German cities and municipalities, this trend will probably continue and result in greater differentiation. Financing of public sector projects before 2010 was characterised particularly by the conditions of the government package designed to stimulate the economy. Investments capable of attracting subsidies were prioritised. On the other hand, public private partnership projects (PPPs), for which the process of awarding public sector contracts proved to be difficult, were postponed. There are now signs of a slight increase in the field of public sector investment finance by way of PPPs.

In France, margins continued to recover in the first half of 2011 due to higher levels of caution of some local investors. In Spain, demand is limited as a result of the ban on Spanish municipalities raising new debt imposed in 2010. Nevertheless, margins in direct business with the Spanish regions with stronger credit standing and other public sector enterprises, measured in terms of their fundamental data, continue to be very high. Because necessary follow-up financing for Spain still has to peak, the level of margins overall is expected to continue to be high compared with the past. In Italy, the adjustment of statutory maximum interest rates for municipalities and regions is also enabling higher margins to be achieved than was the case in 2010. Overall, in the first half, it is apparent that most EU countries are pressing on ahead with their consolidation efforts.

Real Estate Finance

On the real estate markets which are relevant for the HRE Group, the positive development again continued in the first half of 2011. This is reflected in the speed of economic performance in the individual countries. There are a growing number of indications that most European property markets are increasingly emerging from the financial crisis. This positive development is also benefiting from the general macro-economic upturn. In particular, companies and retailers and wholesalers in Northern and Central Europe are showing signs of stronger demand for purchasing and occupying premises.

However, the risk propensity of investors in relation to the properties and locations is still very limited. Market events in the first half of 2011 were dominated particularly by the market segment of high-quality properties let on long-term leases in very good to good locations (core properties).

The German market for commercial real estate reported a positive performance in the first half of 2011 compared with the corresponding previous year period. Low interest rates, concern about inflation and the sustainable economic upswing mean that German properties are becoming attractive for investors. The percentage of international investors in particular expanded strongly in the first half of 2011. Buyer interest, however, is still focusing on high-quality properties in very good to good locations. On the other hand, sub-prime locations and emerging secondary locations are becoming more important as a result of the shortage of core properties, a problem which is being exacerbated by simultaneous price increases.

Overall, retail properties followed by office premises accounted together for most of the traded volume in the first half of 2011. The growth in employment in Germany had a slight, positive impact on demand for premises in the first half of 2011. On the other hand, the fact that structural vacancies are still high at some locations has had a negative impact on the existing demand for properties.

German housing construction also reported strong growth in the first half of 2011. This growth focused particularly on the metropolitan areas. However, prospects have also improved in some less expensive secondary locations.

Some other European commercial real estate markets also posted a positive performance in the first half of 2011, and reported higher transaction volumes. The development particularly in Great Britain, France and Eastern Europe was particularly positive in the first half of 2011. Spain and Portugal again had to report a decline, and are affected by the weakest user demand of all major European countries.

Overall, the first half of 2011 in Europe was characterised by a gradual improvement in user demand. Several European major cities reported a significant increase in property turnover – mainly thanks to major individual contract completions.

The stronger demand and the decline in completed construction resulted in a gradual decline in vacancy rates on the main European markets towards the end of 2010, although the structural vacancies remains high. This positive trend continued in the first half of 2011, albeit at a somewhat slower rate, because some markets reported either a further increase in completed construction or weaker user demand (for instance in Spain). Prime rents remained essentially stable on the main European markets in the first half of the year.

In recent months, the London office market in particular was able to report a strong upturn. Office rents in the West End of London have increased at a rate which is considerably higher than the European average. The market benefited particularly from the strong demand for mid-price offices. In addition, this development was boosted by some very large contract completions. On the other hand, vacancy rates in Madrid and Barcelona reached an all-time high in the first half of 2011, and are thus failing to match the positive trend in Europe.

Competition for small and mid-size financing arrangements continued to be very fierce in the first half of 2011. There is very strong competition particularly on the market for financing core property. In the case of large financing arrangements in excess of approx. €50–100 million, investors are still experiencing problems in finding a financing partner. Project developers in particular are required to have a corresponding amount of capital in combination with an adequate level of preletting to tenants with strong ratings. There are also signs of speciali-

sation on certain regions and segments at present for real estate financiers. In addition, it is evident that some players are considerably reducing their real estate financing operations, whereas other credit institutions and insurance companies are generating considerably more new business.

Refinancing Markets

In the first half of 2011, the international refinancing markets were characterised by a strong volume of covered bonds. In January alone, more than €40 billion of covered bonds were placed, the highest volume ever reported for a single month. Most of the issues were placed very successfully on the market. However, the current very mixed performance reflects the uncertainty of investors due to the state debt crisis.

The trend towards covered issues is being exacerbated by continuing discussions regarding the possible involvement of private investors in the restructuring of state bonds in conjunction with the new regulations (Basel III for banks and the Solvency II for insurers). As a consequence of this development, it was much more difficult for uncovered bonds to be placed on the capital market.

Due to the high level of issuing activity on the international capital market, the private placement market for German banks made a relatively weak start. Investors preferred public placements as a result of liquidity and risk premium, and are also attempting to include regional diversification in their portfolios.

The securitisation market has also not yet fundamentally recovered in the first half of 2011. Investor confidence has still not returned.

Company-specific Conditions

Major Events

Liquidity Situation As a result of an adequate liquidity cushion and the fact that the final decision of the EU was still outstanding as of 30 June 2011, HRE Group did not issue any benchmark issues for financing new business in the first half of 2011, and instead restricted itself to private placements of relatively small volumes. The secondary market prices for the outstanding benchmark issues of Deutsche Pfandbriefbank AG have improved considerably in recent months.

Project Measures In preparation for reprivatizing the entities of the HRE Group, a project is currently being carried out to sever the links between the DEPFA sub-group and the Deutsche Pfandbriefbank sub-group. Another project is currently being carried out to further harmonise information technology at Deutsche Pfandbriefbank AG. A further project involves optimising the customer-oriented primary processes of the Bank. The main objectives are to achieve greater customer focus by way of shorter throughput times, higher process reliability as well as achieving a competitive process landscape which focuses on cost efficiency.

Personnel

As of 30 June 2011, Dr. Markus Kerber laid down his mandate on the Supervisory Board at HRE Holding AG.

Ratings

The bank ratings of HRE Group entities remained unchanged in the first half of 2011 and until 5 August 2011. However, the following changes regarding covered bond and subordinated debt ratings occurred:

- The rating of the Mortgage Covered Bonds issued by Deutsche Pfandbriefbank AG was upgraded by Moody's from Aa3 to Aa1. Moody's also concluded its review of the Asset Covered Securities issued by DEPFA ACS Bank and confirmed the Aa3 rating. Standard & Poor's lowered the rating of Hypo Pfandbrief Bank International's Lettres de Gage from AA to AA-, removed them from Credit Watch Negative and assigned a stable outlook. Fitch Ratings affirmed the rating of Deutsche Pfandbriefbank's Mortgage Covered Bonds at AA+ and removed it from Credit Watch Negative.
- Moody's published the results of its review of subordinated debt issued by German banks and DEPFA Bank plc. The rating for subordinated debt issued by Deutsche Pfandbriefbank AG is now B2 with positive outlook and for DEPFA Bank plc B3 with stable outlook. Standard & Poor's has downgraded the Lower Tier 2 ratings of Deutsche Pfandbriefbank AG, DEPFA Bank plc and DEPFA ACS Bank from BBB- to BB-.

The EU Commission's approval of state aid had no immediate implications for the ratings of HRE Group entities.

Based on the rating methodologies applied, DEPFA Group entities' ratings *inter alia* benefit from linkages between DEPFA and FMS Wertmanagement resulting from the transfer of assets and the related services for FMS Wertmanagement. Under the current circumstances, we consider the maximum rating level has been achieved for these banks.

The current bank and covered bond ratings are shown in the table on the following page.

HRE Group's bank and covered bond ratings¹⁾

as of 5 August 2011

		Fitch Rating	Moody's	Standard & Poor's
Deutsche Pfandbriefbank AG	Long-term rating	A-	A3	BBB
	Outlook	Stable	Stable	Stable
	Short-term rating	F1	P-1	A-2
Public sector covered bonds		AAA	Aaa	AA+
Mortgage covered bonds		AA+	Aa1	AA+
DEPFA Group entities²⁾	Long-term rating	BBB+	Baa3	BBB
	Outlook	Negative	Stable	Stable
	Short-term rating	F2	P-3	A-2
Asset-covered securities		AAA ³⁾	Aa3	AA
Lettres de Gage ²⁾		—	—	AA-

¹⁾ Ratings from mandated rating agencies

²⁾ Hypo Pfandbrief Bank International S.A. and its Lettres de Gage are rated by Standard & Poor's only.

³⁾ Rating Watch Negative

Development in Earnings

HRE

In the first half of 2011, HRE reported a positive pre-tax profit of €216 million, and was thus profitable as forecast at the beginning of the year.

In the period from 1 January to 30 June 2010 the pre-tax result was very negative at €-719 million. However, the income statement of this period included effects from the positions which were transferred to FMS Wert-

management in October 2010. In particular, those positions entailed material impairments on loans and advances and deterioration in the market values of trading assets. Furthermore, expense for liquidity support was necessary in the previous period but not in the current period.

The following table sets out in detail the development in results in the first half of 2011 compared with the previous year period:

Key Financials		1.1.–30.6.2011	1.1.–30.6.2010	Change
Operating performance				
Operating revenues	in € million	437	-15	452
Net interest income and similar income	in € million	359	478	-119
Net commission income	in € million	8	-198	206
Net trading income	in € million	5	-278	283
Net income from financial investments	in € million	-35	59	-94
Net income from hedge relationships	in € million	-21	-64	43
Balance of other operating income/expenses	in € million	121	-12	133
Provisions for losses on loans and advances	in € million	-20	454	-474
General administrative expenses	in € million	242	252	-10
Balance of other income/expenses	in € million	1	2	-1
Pre-tax profit/loss	in € million	216	-719	935
Taxes on income	in € million	53	-19	72
Net income/loss	in € million	163	-700	863
Key ratios				
Cost-income ratio	in %	55.3	> 100.0	
Return on equity after taxes	in %	5.6	-18.9	

Operating Revenues The operating revenues amounted to €437 million and were thus higher than in the first half of 2010 (€–15 million). The increase in operating revenues is mainly attributable to net commission income and net trading income, which in the previous year were still affected by the costs of the SoFFin guarantees and the deterioration in the market values of some portfolios.

Net interest income declined from €478 million to €359 million, because the portfolio contracted as a result of the transfer of positions to FMS Wertmanagement and also as a result of repayments. On the other hand, a positive effect was attributable to profits of €158 million from liabilities which were redeemed before maturity as a result of customer wishes and for market management purposes (1.1.–30.6.2010: €2 million). Most of these profits (€141 million) were attributable to DEPFA Bank ACS.

Net commission income of €8 million was considerably higher than the corresponding previous year figure of €–198 million. The figure for the first half of 2011 contains one-off income from a material loan repayment and the sale of the financed asset (€7 million). In the previous year, net commission income was depressed by the charges for the SoFFin guarantees (€–239 million).

Apart from some minor holdings of DEPFA, HRE does not have any trading books in the regulatory sense of the term. Net trading income of €5 million is mainly attributable to stand-alone derivatives which no longer satisfy the criteria of IAS 39 for hedge accounting. In the previous year, net trading income (€–278 million) was mainly affected by costs of provisioning for the increased default risk of customer derivatives (€–179 million) and Halcyon & Pegasus portfolios (€–78 million).

The net income from financial investments (€–35 million) was depressed by losses from the disposal of bonds of €–34 million. After the return of the corresponding liabilities, the bonds were no longer secured for refinancing purposes, and it was thus possible for them to be sold. The losses generated by the sale of the bonds are opposed by higher profits generated by the return of liabilities (shown in net interest income). In the previous year, the net income from financial investments amounted to €59 million, and was mainly attributable to sales of bonds of DEPFA for which impairments had been recognised in previous periods.

The net income from hedge relationships (€–21 million; 1.1.–30.6.2010: €–64 million) was affected by declines in the market values of assets designated at fair value through profit or loss (dFVTPL) (€–21 million; 1.1.–30.6.2010: €–52 million). The market values of these assets which were hedged against interest risks changed primarily as a result of the credit spread movements in particular from securities from the Republic Portugal. Hedge inefficiencies within the range of 80 % to 125 % permitted in accordance with IAS 39 had no impact to net income/loss (1.1.–30.6.2010: €–12 million).

Income of €107 million from servicing FMS Wertmanagement is the main single item in the balance of other operating income/expenses (€121 million, 1.1.–30.6.2010: €–12 million). The income compensates for the additional costs of HRE for servicing shown in general administrative expenses. Currency translation (in particular US dollar) also resulted in income of €18 million (1.1.–30.6.2010: €–11 million).

Provisions for Losses on Loans and Advances The partial improvement of some real estate markets and success in court and arbitration proceedings have resulted in a net reversal of €20 million in provisions for losses on loans and advances (1.1.–30.6.2010: additions of €454 million). Only in the case of few financing arrangements was there any significant need for payments into provisions for losses on loans and advances. However, recoveries in the case of other exposures meant that it was possible for impairments to be reversed, resulting in total income of €3 million from individual allowances (1.1.–30.6.2010: expense of €387 million). With regard to the portfolio-based allowances, the fundamental recovery of the market also had a positive impact on ratings and probabilities of default. In consequence, a figure of €16 million had to be reversed from the portfolio-based allowances (1.1.–30.6.2010: additions €68 million).

General Administrative Expenses General administrative expenses declined from €252 million to €242 million. This decline is mainly attributable to lower other general administrative expenses (€144 million; 1.1.–30.6.2010: €171 million). Amongst others, the costs of IT and consultancy were considerably reduced following the completion of the project for transferring of positions to FMS Wertmanagement. However, the other general administrative expenses are affected by costs of projects for optimising the processes and the IT infrastructure. On the other hand, personnel expenses increased from €81 million in the previous year to €98 million, mainly due to an increase in personnel deployment related to FMS Wertmanagement. The costs of rendering the services are opposed to income shown in the balance of other operating income/expenses. The ratio between general administrative expenses and operating revenues (cost-income ratio) decreased to 55.3 % (1.1.–30.6.2010: > 100.0 %).

Balance of Other Income/Expenses As in the previous year in other income and expenses there was income from the reversal of restructuring provisions (1.1.–30.6.2011: €1 million; 1.1.–30.6.2010: €2 million).

Pre-tax Profit/Loss The pre-tax profit/loss amounted to €216 million. Compared with the previous year (€-719 million), this figure is positive, thus underlining the profitability of HRE. However, the extent of the profit has benefited from some one-off effects.

Taxes on Income The current taxes of €46 million and the deferred tax expense of €7 million results in a total tax expense of €53 million (1.1.–30.6.2010: tax income of €19 million).

Net Income/Loss Net income after taxes amounted to €163 million in the first half of 2011 (1.1.–30.6.2010: €-700 million).

Operating Segment Public Sector Finance

Key financials Public Sector Finance		1.1.–30.6.2011	1.1.–30.6.2010	Change
Operating performance				
Operating revenues	in € million	44	44	–
Net interest income and similar income	in € million	57	50	7
Net commission income	in € million	–2	–3	1
Net trading income	in € million	3	8	–5
Net income from financial investments	in € million	3	–11	14
Net income from hedge relationships	in € million	–25	–	–25
Balance of other operating income/expenses	in € million	8	–	8
Provisions for losses on loans and advances	in € million	–	5	–5
General administrative expenses	in € million	33	29	4
Balance of other income/expenses	in € million	–	–	–
Pre-tax profit/loss	in € million	11	10	1
Key ratio				
Cost-income ratio	in %	75.0	65.9	

The operating segment Public Sector Finance comprises the public sector financing arrangements which are eligible for cover funds under German law.

The pre-tax profit/loss in the Public Sector Finance segment slightly increased to €11 million (1.1.–30.6.2010: €10 million). Improved net income from financial investments, higher interest income and other operating income offset lower net trading income, negative net income from hedge relationships and higher general administrative expenses.

Operating Revenues Operating revenues amounted to €44 million as in the previous year period. Net interest income of €57 million was higher than the corresponding previous year figure (1.1.–30.6.2010: €50 million), which is mainly attributable to higher income from return of liabilities and closing of derivatives. Despite a strong increase in new business, the volume of interest-bearing assets declined as a result of higher repayments. The interest margin of new business was considerably higher than the margin of existing business. Net commission income (€–2 million) does not include any major individual items, and was at the previous year level (1.1.–30.6.2010: €–3 million). The net trading income of €3 million (1.1.–30.6.2010: €8 million) is attributable to the valuation of

interest rate derivatives in the bank book. The net income from financial investments of €3 million (1.1.–30.6.2010: €–11 million) is almost exclusively attributable to the sale of LaR financial investments. In the first half of 2011, net income from hedge relationships resulted in €–25 million (1.1.–30.6.2010: €0 million). The change mainly related to Portuguese bonds valued at fair value affecting income whose credit spreads have widened significantly. The balance of other operating income/expenses (€8 million; 1.1.–30.6.2010: €0 million) contained an income from currency conversion (€6 million).

Provisions for Losses on Loans and Advances It was not necessary for any additions to provisions for losses on loans and advances for this reporting period (1.1.–30.6.2010: €5 million).

General Administrative Expenses General administrative expenses increased to €33 million (1.1.–30.6.2010: €29 million). Because the general administrative expenses increased and the operating revenues did not change, the cost-income ratio diminished to 75.0% (1.1.–30.6.2010: 65.9%).

Operating Segment Real Estate Finance

Key financials Real Estate Finance		1.1.–30.6.2011	1.1.–30.6.2010	Change
Operating performance				
Operating revenues	in € million	144	258	-114
Net interest income and similar income	in € million	121	303	-182
Net commission income	in € million	22	42	-20
Net trading income	in € million	1	-79	80
Net income from financial investments	in € million	—	-4	4
Net income from hedge relationships	in € million	-2	—	-2
Balance of other operating income/expenses	in € million	2	-4	6
Provisions for losses on loans and advances	in € million	11	395	-384
General administrative expenses	in € million	72	94	-22
Balance of other income/expenses	in € million	—	—	—
Pre-tax profit/loss	in € million	61	-231	292
Key ratio				
Cost-income ratio	in %	50.0	36.4	

The operating segment Real Estate Finance comprises all commercial real estate financing arrangements of the Group.

Pre-tax profit/loss in the Real Estate Finance segment was positive at €61 million, compared with a loss in the corresponding previous year period (1.1.–30.6.2010: €-231 million). A considerably lower requirement for additions to provisions for losses on loans and advances was the main reason for the improvement in net profit/loss compared with the previous year period.

Operating Revenues Operating revenues declined in the first two quarters of 2011 to €144 million (1.1.–30.6.2010: €258 million). Net interest income declined to €121 million (1.1.–30.6.2010: €303 million), due to the transfer of interest-bearing assets to FMS Wertmanagement and also to the reduction of loans. On the other hand, the new business volume (includes prolongations with maturities of more than one year) of €2.9 billion (in line with overall strategy) had a positive impact. New business was written mainly in Germany. The interest margin for the new business in the segment in the first six months of 2011 was slightly higher than the margin applicable for existing business. Net commission income of €22 million

was lower than the corresponding previous year figure (1.1.–30.6.2010: €42 million). The main reason for the decline is lower net income from lending operations. However, a positive effect in net commission income resulted from a material loan repayment and the sale of the financed asset (€7 million). Net trading income in the first half of 2011 of €1 million is attributable to changes in the market values of interest rate derivatives which are used as instruments of active interest rate management. The net trading income of the previous year period (€-79 million) was almost completely attributable to provisioning which had to be created in view of a higher probability of default of customer derivatives (so-called counterparty risk adjustment). The affected customer derivatives were mostly transferred to FMS Wertmanagement in the fourth quarter of 2010 together with the receivables. In the first half of 2011, there were neither effects arising from disposals of financial assets, nor were there any write-downs and write-ups in relation to such holdings. Accordingly, the net income from financial investments amounted to €0 million. In the previous year period, the net income from financial investments was negative at €-4 million, and was mainly attributable to impairments recognised in relation to securities. In the first half of 2011, there were costs of €-2 million attributable to hedge relationships

which were not completely effective within the range permitted in accordance with IAS (1.1.–30.6.2010: €0 million). The balance of other operating income/expenses amounted to €2 million (1.1.–30.6.2010: €–4 million).

Provisions for Losses on Loans and Advances The net additions to provisions for losses on loans and advances remained at a moderate level (€11 million) in the first six months of 2011 (1.1.–30.6.2010: €395 million). They are attributable to a small number of individual cases. Overall, the net additions to individual allowances amounted

to €16 million (1.1.–30.6.2010: €422 million). At the portfolio level there was no significant effect (1.1.–30.6.2010: reversals of €–26 million).

General Administrative Expenses The general administrative expenses of €72 million were lower than the corresponding figure for the previous year period due to lower other general administrative expenses (€94 million). Because operating revenues declined to a greater extent than general administrative expenses, the cost-income ratio deteriorated to 50.0 % (1.1.–30.6.2010: 36.4 %).

Operating Segment Value Portfolio

Key financials Value Portfolio		1.1.–30.6.2011	1.1.–30.6.2010	Change
Operating performance				
Operating revenues	in € million	254	–257	511
Net interest income and similar income	in € million	155	133	22
Net commission income	in € million	–12	–237	225
Net trading income	in € million	10	–207	217
Net income from financial investments	in € million	–38	74	–112
Net income from hedge relationships	in € million	7	–29	36
Balance of other operating income/expenses	in € million	132	9	123
Provisions for losses on loans and advances	in € million	–31	54	–85
General administrative expenses	in € million	128	82	46
Balance of other income/expenses	in € million	1	1	–
Pre-tax profit/loss	in € million	158	–392	550
Key ratio				
Cost-income ratio	in %	50.4	> 100.0	

The Value Portfolio segment comprises non-strategic portfolios of HRE which were not transferred to FMS Wertmanagement. It mainly comprises all assets and liabilities of the DEPPFA sub-group. In addition, this segment also included the income and expenses attributable to the services for the on going operation of FMS Wertmanagement.

The net profit/loss of the Value Portfolio segment was positive at €158 million (1.1.–30.6.2010: €–392 million). This was mainly due to much lower commission and trading expenses as well as net reversal of provisions for losses on loans and advances.

Operating Revenues In the first half of 2011, the operating revenues improved considerably compared with the corresponding previous year period (€254 million; 1.1.–30.6.2010: €–257 million). At €155 million, net interest income was higher than the corresponding previous year figure (1.1.–30.6.2010: €133 million). The increase is attributable to one-off income of €141 million resulting from the return of liabilities (1.1.–30.6.2010: €0 million). On the other hand, net interest income declined as a result of the transfer of interest-bearing assets to FMS Wertmanagement. Net commission income of €–12 million (1.1.–30.6.2010: €–237 million) is mainly affected by the expenses of guarantees in connection with positions transferred synthetically to FMS Wertmanagement. The previous year figure mainly included expenses for the guarantees in connection with the liquidity support. Net trading income of €10 million was positive as a result of changes in fair value of derivatives (1.1.–30.6.2010: €–207 million). The previous year was affected by valuation losses of €–78 million in relation to the Halcyon & Pegasus portfolios and also by a higher default risk of customer derivatives. Both of the portfolios as well as most of the customer derivatives were split off in the fourth quarter of 2010. Compared with the previous year period (1.1.–30.6.2010: €74 million), the net income from financial investments of €–38 million is negative. The expense is attributable to the loss-making sale of bonds. Following the return of liabilities, the bonds were no longer earmarked for refinancing purposes and it was thus possible for them to be sold. The loss in net income from financial investments is opposed by higher profits from the return of the corresponding liabilities in net interest income. The net income from hedge relationships of €7 million (1.1.–30.6.2010: €–29 million) is positive mainly as a re-

sult of hedge inefficiencies within the range permissible in accordance with IAS 39. In the previous year, there were valuation losses due to credit spread narrowing of dFVTPL assets for which the market value had declined. The balance of other operating income/expenses of €132 million (1.1.–30.6.2010: €9 million) this year mainly included income of €107 million for offsetting additional costs of services for the ongoing operation of FMS Wertmanagement shown in general administrative expenses.

Provisions for Losses on Loans and Advances A figure of €31 million was reversed from provisions for losses for loans and advances in the first half of 2011 (1.1.–30.6.2010: additions of €54 million). The reversals are attributable to individual cases, for which no further litigation expenses are expected. On the other hand, there was no need to create new individual allowances. In addition, the model reserve for uncertainty relating to the valuation of collateralised debt obligations (CDOs) was almost completely reversed, because there are almost no longer any CDOs in the portfolio.

General Administrative Expenses The general administrative expenses of €128 million were higher than the corresponding figure for the previous year (1.1.–30.6.2010: €82 million). This includes expenses in connection with services for the on going operation of FMS Wertmanagement. The cost-income ratio was 50.4 % (1.1.–30.6.2010: >100.0 %).

Consolidation & Adjustments

Key financials Consolidation & Adjustments		1.1.–30.6.2011	1.1.–30.6.2010	Change
Operating performance				
Operating revenues	in € million	–5	–60	55
Net interest income and similar income	in € million	26	–8	34
Net commission income	in € million	—	—	—
Net trading income	in € million	–9	—	–9
Net income from financial investments	in € million	—	—	—
Net income from hedge relationships	in € million	–1	–35	34
Balance of other operating income/expenses	in € million	–21	–17	–4
Provisions for losses on loans and advances	in € million	—	—	—
General administrative expenses	in € million	9	47	–38
Balance of other income/expenses	in € million	—	1	–1
Pre-tax profit/loss	in € million	–14	–106	92

In the Consolidation & Adjustments column, the sum of the segment results is reconciled with the consolidated results. This column contains consolidations as well as certain expenses and income which do not fall under the responsibility of the various operating segments.

The pre-tax profit/loss in the Consolidation & Adjustments column of €–14 million was less negative compared to the corresponding previous year figure (1.1.–30.6.2010: €–106 million). This was due mainly to lower consultancy fees in general administrative expenses and net income from hedge relationships of roughly zero.

Development in Assets

Assets		
in € million	30.6.2011	31.12.2010
Cash reserve	537	2,507
Trading assets	22,504	39,114
Loans and advances to other banks	20,435	32,614
Loans and advances to customers	121,273	175,724
Allowances for losses on loans and advances	-573	-661
Financial investments	60,692	66,819
Property, plant and equipment	5	6
Intangible assets	45	49
Other assets	7,253	10,244
Income tax assets	1,662	1,703
Current tax assets	72	76
Deferred tax assets	1,590	1,627
Total assets	233,833	328,119

The total assets of the Deutsche Pfandbriefbank Group amounted to €233.8 billion as of 30 June 2011, and were thus €94.3 billion lower than the corresponding figure at the end of the previous year (31 December 2010: €328.1 billion).

The decline is mainly attributable to a further reduction of the opposite effects which had raised total assets in the course of the transfer of positions to FMS Wertmanagement. These opposite effects, which, for instance, resulted from the handling of refinancing arrangements for FMS Wertmanagement or the transfer of risks by way of back-to-back derivatives, were reduced further in the first half of 2011:

- FMS Wertmanagement refinanced its operations on a stand-alone basis to a much greater extent in the first half. Accordingly, the Deutsche Pfandbriefbank Group only has to pass on a minor volume of refinancing to FMS Wertmanagement. Overall, the volume of reverse repos declined from €97.2 billion at the end of the previous year to €45.4 billion as of 30 June 2011, resulting in a decline in loans and advances to customers.
- The back-to-back derivatives were to a certain extent replaced by direct business relations between FMS Wertmanagement and the external customers (novation of derivatives). In addition, the market value of the back-to-back derivatives also declined as a result of the

higher level of market interest rates. Overall, the market value of back-to-back derivatives amounted to €14.9 billion as of 30 June 2011, compared with €27.8 billion as of 31 December 2010. The decline is reflected in trading assets.

- The lower derivatives and reverse repos with FMS Wertmanagement has meant that there has also been a decline in the need for collateral, which has resulted in a further decline in the balance sheet total.
- The volume of securities issued by FMS Wertmanagement in the portfolio declined from €8.8 billion at the end of the previous year to €5.2 billion as of 30 June 2011, resulting in a decline in financial assets.

The total assets would also have declined even without the decline in the opposite effects resulting from the transfer of positions to FMS Wertmanagement. This was due to repayments, which exceeded the new business. Market-related factors also had the effect of reducing total assets. Accordingly, the fact that the euro strengthened against the US dollar, the Japanese yen and sSterling resulted in lower carrying amounts of the foreign currency positions translated into euros. In addition, the higher level of interest rates resulted in a decline of the market value of the derivatives, which was also reflected in a decline in total assets.

Development in the Financial Position

Equity and liabilities		
in € million	30.6.2011	31.12.2010
Liabilities to other banks	55,404	101,382
Liabilities to customers	31,241	43,216
Liabilities evidenced by certificates	94,350	107,898
Trading liabilities	21,789	39,109
Provisions	313	313
Other liabilities	18,010	23,226
Income tax liabilities	1,673	1,714
Current tax liabilities	153	129
Deferred tax liabilities	1,520	1,585
Subordinated capital	3,239	3,508
Liabilities	226,019	320,366
Equity attributable to equity holders	5,678	5,617
Subscribed capital	2,668	2,668
Additional paid-in capital	8,091	8,091
Retained earnings	-5,168	-4,260
Foreign currency reserve	-46	-44
Revaluation reserve	-30	72
AfS reserve	-427	-421
Cash flow hedge reserve	397	493
Consolidated loss 1.1.–31.12.2010	—	-910
Consolidated gain 1.1.–30.6.2011	163	—
Non-controlling interest in equity	2,136	2,136
Hybrid capital instruments	1,137	1,137
Silent participation	999	999
Equity	7,814	7,753
Total equity and liabilities	233,833	328,119

Shareholders' equity amounted to €7.8 billion as of 30 June 2011, as in the previous year. A slightly change compared with the end of the previous year is mainly attributable to the positive result of the first half of 2011. On the other hand, the cash flow hedge reserve declined slightly as a result of maturities.

The total consolidated liabilities amounted to €226.0 billion as of 30 June 2011, compared with €320.4 billion as of 31 December 2010. As was the case on the assets' side of the balance sheet, the changes on the liabilities' side of

the balance sheet were also mainly attributable to the decline in the opposite effects which increased the total assets at the point at which positions were transferred to FMS Wertmanagement. Accordingly, trading liabilities declined as a result of the lower market values and the novation of back-to-back derivatives. Liabilities to other banks declined because less funding had to be raised for FMS Wertmanagement.

In addition, the liabilities evidenced by certificates also declined because expiring issues were not replaced to the same extent by new issues. For instance, benchmark placings were not issued as a result of a sufficient liquidity cushion and the EU aid proceedings which have not been completed in the first half of 2011. As was also the case on the assets' side of the balance sheet, market-related factors on the liabilities' side of the balance sheet had the effect of reducing the balance sheet total. Accordingly, the stronger euro was one of the main reasons behind the decline in liabilities to other banks and liabilities to customers. The market values of the derivatives declined as a result of the higher level of yield curve.

The contingent liabilities amounted to €0.1 billion as of 30 June 2011 (31 December 2010: €0.2 billion). The other liabilities amounted as in the previous year to €1.1 billion. The loans which have not been paid out, or which have not been paid out completely, are reflected in the irrevocable loan commitments, and amounted unchanged to €1.1 billion as of 30 June 2011.

Regulatory Indicators according to German Solvency Regulation

To calculate the regulatory figures, the definition of capital according to SolvV was utilised. The risk-weighted assets were also calculated on the basis of SolvV. For these credit risks, the amounts were calculated according to the Advanced Internal Rating-Based Approach for those portfolios, for which HRE has received the approval from the German Federal Financial Supervisory Authority. This applies primarily to the portfolios of the former Hypo Real Estate Bank AG, the former Hypo Public Finance Bank and Hypo Pfandbrief Bank International S.A. For the entities of the former DEPFA Group, the risk-weighted assets were calculated according to the standardised approach. For calculating the capital requirements for operational risks, the standardised approach was applied across the entire Group.

The calculation of own funds as of 30 June 2011 and 31 December 2010 included the net profit for 2010 in each case.

For HRE the capital for regulatory purposes (according to German Solvency Regulation [SolvV]) is as follows:

Own funds ¹⁾		
in € million	30.6.2011	31.12.2010
Core capital (Tier I)	7,041	7,074
Supplementary capital (Tier II)	2,513	2,647
Equity capital	9,554	9,721
Tier III capital	—	—
Total	9,554	9,721

¹⁾ Consolidated pursuant to section 10 a German Banking Act [KWG]; pro forma as per prepared annual financial statements and after result distribution

The regulatory capital ratios were calculated on the basis of the definition for regulatory capital according to SolvV and risk-weighted assets according to Basel II. The resulting capital ratios as of 30 June 2011 and as of 31 December 2010 were thus as follows:

Key capital ratios ¹⁾		
in %	30.6.2011	31.12.2010
Core capital ratio ²⁾	38.9	34.7
Equity capital ratio ³⁾	53.8	49.1
Own funds ratio (overall indicator) ²⁾	52.8	47.7

¹⁾ Pro forma as per prepared annual financial statements and after result distribution

²⁾ Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5

³⁾ Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

In September 2010 the Basel Committee on Banking Supervision adopted new recommendations, which are also known as Basel III. These include a tightening-up of the regulations regarding equity backing, a new equity ratio which is not linked to the risk weighting of assets and new standards for the supply of liquidity. HRE simulated the effects of the future requirements based on the data as per 31 December 2010. As a result HRE regards itself to a large extent as well-prepared for being able to fulfil the requirements by Basel III in the future.

Summary

HRE has continued its positive development in the first half of 2011. With a pre-tax profit of € 216 million it has underlined its profitability, although the extent of the profit has benefited from some one-off effects. With new business of € 4.1 billion, HRE has again stepped up its

operations on the market. The balance sheet total has declined appreciably, because the back-to-back derivatives and the handling of refinancing for FMS Wertmanagement have been significantly reduced.

On 18 July 2011, the European Commission approved the state aid provided to HRE by the Federal Republic of Germany. With its positive decision, the European Commission has also accepted the viability of the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate finance and public sector investment finance.

The decision of the European Commission relates to all elements of aid granted to HRE since the autumn of 2008, i.e. capitalisations, guarantee lines and the transfer of assets to the deconsolidated environment FMS Wertmanagement, and requires HRE to take appropriate compensation measures, in particular a reduction of total assets of Deutsche Pfandbriefbank Group.

The compensation measure for Deutsche Pfandbriefbank AG as the strategic core bank of HRE as a specialist bank still active on the market are as follows: Deutsche Pfandbriefbank AG will operate new business in real estate finance and public sector investment finance. No new business will be realised in public sector finance activities by Deutsche Pfandbriefbank AG. Deutsche Pfandbriefbank AG has limited its geographical activities to selected countries in Europe. The growth of Deutsche Pfandbriefbank AG will be limited and the new business must have a determined minimum yield. The agreed guidelines will be applicable until Deutsche Pfandbriefbank AG is reprivatised, and will be applicable at least until December 2013. The existing contractual links with the deconsolidated environment FMS Wertmanagement (in particular servicing, refinancing and back-to-back derivatives) will be terminated by no later than the end of September 2013. The entities of the DEPFA sub-group are free to provide services to FMS Wertmanagement after 30 September 2013.

The companies of the DEPFA sub-group will not conduct any new business until they are reprivatised. This is not applicable for measures carried out as part of risk and refinancing management which is necessary for regulatory purposes and which has the aim of maintaining value, efficient administration and also within the framework of managing the cover funds.

Both Deutsche Pfandbriefbank Group and the DEPFA sub-group respectively its entities and/or loan portfolios may be sold in the medium term. Measures have already been initiated to sever the links between the entities of the DEPFA sub-group and the other companies of HRE.

In addition, the European Union has imposed a payment condition (stipulated by the FMSA) in relation to the aid proceedings, namely the complete fulfilment of the payment of €1.59 billion to avoid distortions of competition in connection with the utilisation of the deconsolidated environment. In consequence, this payment condition has resulted in a subsequent purchase price adjustment in the companies of HRE which have transferred assets to FMS Wertmanagement. On the basis of data collected, the payment condition will probably mainly relate to the DEPFA Group, however depending on the future development, the entities of the Deutsche Pfandbriefbank Group may also be required to pay. The exercise by FMSA of its right to impose a payment condition by the issuance of one or more decrees will result in the payment condition being recognised in equity at that time and consequently has no impact on the income statement.

Furthermore, the European Commission has set conditions for interest and profit participation payments HRE makes to third parties outside the Group for certain instruments and until further notice. These conditions apply to a series of profit-related capital instruments, which existed on 30 September 2010 and which were not provided by SoFFin. As a result of further conditions, in line with the “burden sharing” principle specified by the European Commission, from the time at which the payment condition of €1.59 billion is completely settled up to the time of privatisation, the DEPFA Group will have to pay further annual fees to the Federal Republic of Germany; the precise form of this payment still has to be agreed in contractual form between the affected companies of the DEPFA Group and the Federal Republic of Germany. Profits of the Deutsche Pfandbriefbank Group will be used to repay the silent participation of SoFFin.

On 15 July 2011 European Banking Authority (EBA) published the results of a European stress test. HRE exceeds all requirements stipulated by the EBA for all scenarios. Even when applying tougher stress factors under the so-called adverse scenario, projecting a two-year stress period through the end of 2012, the analysis shows that

HRE would still have a core Tier I ratio of 10.0%, well in excess of the minimum level of 5.0%. The payment condition of €1.59 billion was already taken into account for the purposes of the stress test.

No other reportable events have occurred after 30 June 2011.

In the first half of 2011, the situation on the capital markets was again affected by the uncertain development of the debt situation of the European countries which are currently the focus of attention. In particular, the dramatic downgradings of some European countries by the rating agencies as well as the rescue packages which had been adopted were followed with great attention, not only in Europe.

On the real estate market, the first half of 2011 saw stronger demand for retail properties and rented office space particularly in Germany. There are also signs of a positive development on the real estate market throughout Europe. However, there are considerable differences between the strongly expanding market of Eastern Europe and the weaker markets of Southern Europe.

The stronger euro against the US dollar in the first half of 2011 automatically resulted in a slight reduction in the exposure at default (EaD) of HRE Group. The currency fluctuation has not had any major impact on the liquidity situation of HRE Group.

Organisation and Principles of Risk and Capital Management

HRE has set up a Group-wide risk management and risk controlling system. This also represents important precondition for the application of the so-called waiver. All tasks in accordance with Section 25a KWG for uniform risk identification, measurement and limiting as well as risk management are defined centrally by HRE. Operational implementation is the responsibility of the respective subsidiary.

Organisation and Committees

The Management Board of HRE Holding is responsible for the Group-wide risk management system, and is responsible for taking decisions relating to all strategies and the main issues of risk management and organisation. The risk management system is a system which covers all business activities of the Group, and comprises the plausible and systematic identification, analysis, valuation, management, documentation and communication of all major risks and related monitoring on the basis of a defined risk strategy which is revised annually.

The following are major components of the risk management system for which the Management Board is responsible:

- Defining, updating and communicating business and risk strategies as the basis of business activities and risk acceptance for all units in HRE
- Defining and improving organisation structures within HRE and in particular for risk management, which ensures that all major risks are managed and monitored
- Adopting credit competences as a decision-making framework along the credit processes
- Taking decisions regarding (portfolio) management measures outside the competences which have been transferred.

The Management Board notifies the Supervisory Board of HRE Holding with regard to changes in the business and risk strategies as well as the risk profile of HRE.

The Risk Management and Liquidity Strategy Committee (RLA) of the Supervisory Board is mainly responsible for controlling the overall risk situation and for monitoring, establishing and improving an efficient risk management system, and is also responsible for the liquidity management and assurance of the Group. The Management Board notifies this committee of all increases to individual allowances and the creation of new individual allowances in excess of €5 million and has also notified this committee at regular intervals of major exposures with higher levels of risk.

Risk management of HRE is organised centrally and – as shown in the following diagram – comprises the Management Board and Supervisory Board as well as several committees which have been established by the Management Board of HRE Holding and the Management Board of the subsidiaries:

Organisation of Risk Management of HRE Holding

as of 30 June 2011



Since the previous reporting date, there have not been any major changes in the composition and duties of the Risk Committee (RC), the Watchlist Committee and the Risk Provisioning Committee; composition and duties of these committees are reported in the risk report of HRE Group in the Annual Report 2010.

At the level of the individual subsidiary banks, the Credit Committee consists of the Chief Risk Officer (CRO; chairman) of HRE Holding and the CRO of the respective subsidiary bank (at pbb: the same person as the CRO of HRE Holding), the CCOs of the operating segments, the Senior Credit Executives and the head of Risk Management & Control as well as representatives of the front office. The front office representatives have a voting right as part of front office responsibility. In general, the committee meets at least once every week, and is responsible for competence-based credit decisions for new business, prolongations and material changes in the credit relationship. It also votes on all credit decisions which come under the responsibility of the Management Board of the subsidiary institutions or which have to be approved by the Supervisory Board. The Credit Committee ensures that the credit decisions are consistent with the prevailing business and risk strategy.

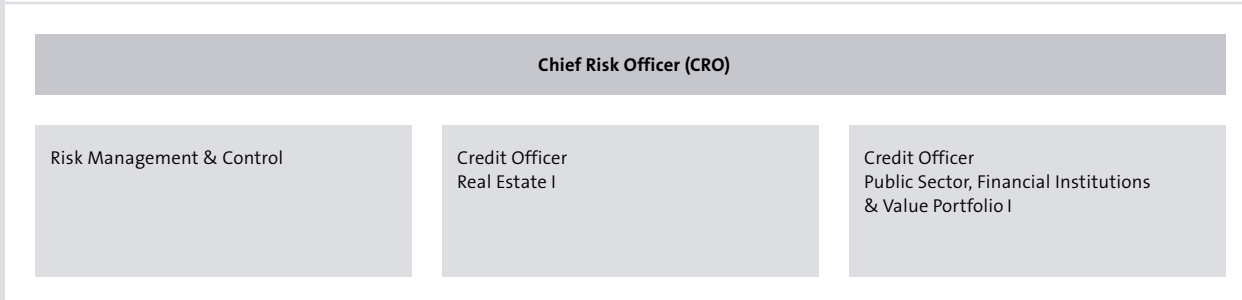
The New Product Process Committee ensures that, before business commences with new products or in new markets, the resultant risks as well as the related impact on processes, controls and the infrastructure are systematically analysed and addressed. Operations with new products or in new markets are only commenced when they have been approved by the New Product Process Committee.

The Asset and Liability Committee (ALCO) of HRE is chaired by the member of the Management Board responsible for Treasury and Asset Management comprises the CRO, the Chief Financial Officer (CFO), the head of Treasury, Finance, Risk Management & Control and the member of the Management Board responsible for Treasury at DEPFA. It meets on a monthly basis. Its tasks comprise liquidity management, management of the balance sheet structure, funds transfer pricing as well as market risk management and management of the regulatory capital ratios. This committee is also responsible for preparing draft decisions for liquidity and refinancing strategies; following discussions in the Risk Committee, these are decided by the Management Board, as is also the case with acquisitions and disinvestments.

Chief Risk Officer (CRO) In addition to the above-mentioned committees, the following organisation units of the CRO form an integral part of the risk management system:

Organisation of Chief Risk Officer of HRE Holding

as of 30 June 2011



The organisation of the CRO function comprises the following monitoring and back office entities:

- The entity **Risk Management & Control** which is also responsible for monitoring and managing Group-wide market, counterparty, operational and liquidity risks and which is also responsible for Group-wide uniform risk measuring methods, risk reports and credit processes
- The entities **Credit Officer Real Estate I** and the **Credit Officer Public Sector, Financial Institutions & Value Portfolio I**, who are each responsible for portfolio management and the analysis of selective new business
- The unit Global Workout Real Estate I, which is responsible for the restructuring and workout of all critical exposures in the Real Estate Finance segment and the Credit Secretary, which in particular is responsible for the organisation of the Credit Committee, were allocated to the Credit Officer Real Estate I unit in the first half of 2011. For the Public Sector Finance and Value Portfolio segments global workout processing is performed in the respective Credit Risk Management (CRM) areas. ImmoTrading which – inter alia – is responsible for the management of properties which have been included in the portfolio, was allocated to the Global Workout Real Estate I unit in the reporting period.

In the period under review Property Analysis & Validation, which is responsible for the analysis and uniform valuation of the collateral properties using market and LTV methods, reported to the CEO.

In addition to the CRO function, the Compliance/Corporate Governance entity and the Audit entity extend the risk management system of HRE. The area of responsibility of Audit comprises the regular as well as the event-driven audit of processes and systems and significant transactions. Risk management is also supported by the Legal entity. In addition to assessing its own portfolios, HRE also handles servicer functions for the FMS Wertmanagement, the extent of which is set out in service level agreements and a cooperation agreement. There are only minor decision-taking powers within the predefined framework.

Risk Strategy and Policies

The risk strategy of HRE Group is based on the business strategy and the results of the group-wide financial planning process. It is applicable for the operating segments and legal entities of HRE, and also forms the framework for the Group-wide risk manual. The risk strategy was adopted in December 2010 by the Management Board of HRE Holding; it was updated in June 2011 and will be presented to the Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE Group in order to be noted and discussed.

The risk strategy reflects the strategic refocusing of HRE Group with its core bank Deutsche Pfandbriefbank as a specialist for real estate finance and public sector investment finance in Germany and selected countries in Europe with Pfandbrief-oriented refinancing. It is integrated in the business planning process and is updated at least annually.

Operational specification of the risk strategy is carried out via risk policies for the individual operating segments as well as for all major risk types (credit risk, market risk, liquidity risk and operational risk); these risk policies describe risk measurement, risk monitoring, risk management, the limit process as well as the escalation process if a limit is exceeded. The policies are regularly reviewed and updated where necessary.

Risk Reporting

The regular reports addressed to the Management Board of HRE Holding and the management boards of the subsidiary institutions include the following:

- Daily liquidity risk report for the liquidity position and preview
- Weekly summary of the markets, the market risk development as well as relevant management information
- Quarterly Group risk and credit risk report
- Monthly, short Group risk report concerning major parameters relevant for management purposes

The CRO and the member of the Management Board responsible for Treasury also receive market risk reports on a daily basis.

These reports provide the Management Board with a comprehensive overview and detailed information concerning the risk situation for each risk type and company as well as with further information relevant for managing purposes. In addition, special reports are prepared on an ad hoc basis or at the request of the Management Board or Supervisory Board; these special reports consider specific and acute risk aspects, for instance in relation to critical markets, products or counterparties.

In the individual committees described above, the members of the Management Board receive further detailed reports concerning the risk position with specific management information and recommendations.

The Supervisory Board or the Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE Holding as well as the Supervisory Board of the subsidiary institutions are informed about the portfolio structure, the risk situation and specific risk-relevant issues at regular intervals, at least quarterly and at short notice, if necessary.

They receive the Group risk and credit risk report on a regular quarterly basis.

The Risk Management and Liquidity Strategy Committee of the Supervisory Board of HRE Holding has been notified of all major exposures as well as individual allowances over €5 million.

Risk Quantification and Risk Management

The value at risk (VaR) approach is used for quantifying risk and also for determining the economic capital for the main risk types apart from liquidity risk. The individual calculation methods are described in detail in the section “Result of Risk-bearing Capacity Analysis”.

Further risk types considered to be material as a result of the regular internal risk inventory, such as strategic, regulatory and model risk as well as pension, participation and property risk which are considered to be immaterial, are not measured quantitatively. Instead, they are managed and limited by means of regular detailed reports, clear specifications, e.g. regulations concerning compliance and corporate governance.

At the portfolio level and at the level of individual transactions, risk in HRE Group is managed by:

1. Monitoring the risk-bearing capacity on the basis of comparing economic capital and the available financial resources of HRE Group, also considering stress test results.

2. Monitoring of the risk-weighted assets (RWA) at the portfolio level by means of stress tests which are intended to ensure that the Tier I ratio does not fall below 10 %.
3. Operational risk management via:
 - The use of Basel-II-compliant risk parameters in the lending business. The Basel-II-compliant management approach shows the average expected loss at the borrower level, and is therefore a major component in risk early recognition and ongoing profitability monitoring. The parameters are reviewed and recalibrated annually. The management approach was also implemented in the DEPFA entities in the first half of 2009 as part of the process of introducing the Advanced IRB approach. The final result of the Basel II review by the banking supervisory authorities is expected in the second half of 2011.
 - A limit system for counterparty and issuer risks on the basis of a standard application which has been tested in the market with a risk measurement method that is uniform throughout the Group.
 - Intensive monitoring and management of individual exposures.
 - Monitoring the risk of losses by way of appropriate impairment triggers in accordance with IAS 39.

Economic Capital and Monitoring of Risk-bearing Capacity

HRE Group has established a risk-bearing capacity analysis which is based on the Internal Capital Adequacy Assessment Process (ICAAP). The audit of internal capital adequacy is based on the concept of economic capital. The method for calculating the economic capital of HRE Group takes account of regulatory requirements (Basel II Pillar 2, MaRisk) and also the business activities of HRE Group.

Economic capital is defined as “the quantity of capital required by a bank in order to cover the largest potential unexpected total loss with a defined probability over a time horizon of one year”. The use of a confidence level of 99.95 % is justified in detail in the risk report of the Annual Report 2010.

The methods of calculating the individual VaR for the individual risk types and the current figures are described in greater detail in the chapter “Result of Risk-bearing Capacity Analysis”. As is normal for the sector, economic capital is not calculated for liquidity risk; however, the risk is taken into consideration in stress scenarios.

In order to evaluate the adequacy of the capital resources of HRE Group, the amount of economic capital is compared with the financial resources available to the Bank within one year. The definition of the “available financial resources” for one year comprises customary components such as essentially the shareholders’ equity in accordance with IFRS and components similar to shareholders’ equity (subordinated and hybrid capital with a holding period of at least one year). These components are suitable for alleviating the impact of potential losses and for maintaining a corresponding risk buffer. The available financial resources must always be greater than the economic capital.

The results of the capital adequacy assessment process and of the stress tests are regularly presented to the central Management Board and the Risk Committee. The results are discussed and if necessary management measures are defined by the central Management Board and the Risk Committee.

Major Projects in Risk Management

Limit System The Group-wide limit system for credit risks, which covers all borrowers and products of all consolidated legal entities of the Group, was implemented in the first quarter of 2010. Further improvements were implemented in the first half of 2011.

Harmonisation of Market Risk As part of the Group-wide process of harmonising the management of market risk which was implemented in phases, the first half of 2011 focused on the further development of method aspects relating to the central market database. Further project phases – particularly system consolidation of the front office systems – are planned in the following

releases under the programme New Evolution – TOPP 2011.

Liquidity Risk Management The fourth quarter of 2010 saw the development of an application which meets the reporting requirements in relation to Group-wide and uniform liquidity risk management. This was implemented in January 2011, and was consistently further developed in the first half of 2011. In 2011, there will be a further stage which adequately takes account of the constantly expanding regulatory aspects.

If the mentioned projects are affected by a major delay or they fail, this might result in inappropriate management signals.

Risk Types

HRE Group distinguishes the following major risk types for its business activities:

- Credit risk
- Market risk
- Liquidity risk
- Operational risk
- Business risk

Economic capital is calculated for all risk types, apart from liquidity risk. However, liquidity risk scenarios are also taken into account in the course of stress tests in connection with the review of risk-bearing capacity at HRE Group level.

The following are major risk types which are not quantified but which are limited by means of suitable reports, guidelines and policies:

- Strategic risks
- Reputational risks
- Regulatory risks
- Model risks

Credit Risk

Definition

Credit risk is defined as the risk of the loss of value of a receivable or the partial or complete default of a receivable due to the default or downgrading of the rating of a business partner. The credit risk also comprises the counterparty, issuer and country risk, which are defined in the risk report of the Annual Report 2010.

Credit Risk Strategy and Principles

As part of the restructuring process, HRE Group has broken down the overall credit portfolio into a strategic portfolio (Real Estate Finance and Public Sector Finance) and a Value Portfolio. The adopted risk strategy already reflects the new revised portfolio structure.

The strategic portfolio comprises the following:

- Public Sector Finance (PSF) segment, which comprises the public sector finance operations of Deutsche Pfandbriefbank AG
- the Real Estate Finance (REF) segment which comprises the former commercial real estate finance portfolio

In the Public Sector Finance segment, the new business of HRE will concentrate on public sector investment finance in selected countries in Europe. New business in Real Estate Finance segment focuses on Pfandbrief-eligible financing of commercial real estate with sustainable cash flow within selected countries in Europe. The main target customers of these operations are professional investors, institutional clients, real estate funds and selective developers. The intended range of products comprises less complex loan structures, selectively extended to include derivative hedging products.

New business is to be refinanced largely via Pfandbrief issues with matching maturities.

The Value Portfolio comprises non-strategic portfolios of HRE Group as well as (at present) most of the transactions which exist with the counterparty FMS Wertmanagement. With regard to the non-strategic portfolios, the Value Portfolio comprises public finance business of the DEPPFA subgroup as well as capital market business and a minor part of infrastructure financing operations. In the Value Portfolio, emphasis is placed on the reduction of existing assets in a manner which poses minimum strain on capital and which is designed to maintain value.

Credit Risk Reports

The following reports are the main pillars of reporting credit risks, with due consideration being given to the additional requirements under MaRisk:

The **Group Risk Report** contains the development in volumes as well as relevant credit risk management indicators such as the development of the expected loss as well as the unexpected loss via value at risk. The report shows the credit risk at the Group level and also at the level of the Bank in the context of the overall bank risk and the risk-bearing capacity, it reports limit utilisations and violations of existing limits, and also identifies risk concentrations. Key indicators which are relevant for management purposes, such as the development of the EaD, the EL and the credit VaR are integrated in this report and are discussed by the Management Board.

The **Credit Risk Report** contains details concerning the portfolio and risk parameters at the Group level and also at the level of the subsidiary institutes; it is discussed in the Management Board, and the Risk Management and Liquidity Strategy Committee of the Supervisory Board is notified accordingly.

For decisions relating to new business and adjustments of conditions, major parameters, contents and analyses are presented to the Credit Committee and discussed.

In the active business, further regular reports support operational management with regard to the management and timely recognition of risks at the sub-portfolio level.

Unusual developments which might result in a major deterioration in the risk position of an individual exposure are reported to a wider group by way of so-called “credit issue notes”.

Credit Risk Quantification via Economic Capital and Risk-weighted Assets under Basel II Credit Portfolio Model For calculating the economic credit risk capital (credit risk value at risk), HRE Group uses a credit portfolio model which is described in greater detail in the section “Result of Risk-bearing Capacity Analysis”.

Stress Tests The methods of the stress tests regarding the economic capital in the counterparty default risk are unchanged compared with the end of 2010, and are described in the Risk Report of the Annual Report 2010.

In addition to the stress tests for economic capital, there are also RWA reverse stress tests. They investigate the extent to which a certain risk parameter (e.g. rating, LGD, currency) can change before the minimum Tier I ratio (currently 10%) is no longer met. Tolerance change levels have been defined for all tested risk parameters; these levels must not be violated if the test is to be successfully completed.

Credit Risk Quantification According to Basel II All subsidiary institutions of the Group – apart from DEPFA Bank plc, ACS Bank and the former DEPFA Deutsche Pfandbriefbank AG (which is now part of the merged Deutsche Pfandbriefbank AG) – which have already received regulatory approval to apply the so-called Advanced Internal Rating-Based Approach (Advanced-IRBA) for determining the regulatory capital backing. The final result of the regulatory audit for the introduction of the Advanced IRBA at DEPFA Bank plc, DEPFA ACS Bank as well as the former DEPFA Deutsche Pfandbriefbank AG is expected in the second half of 2011.

Credit Risk Management and Monitoring

Credit Risk Management At the portfolio level, the intended portfolio structure is defined in the risk strategy by means of structure components. The limits are also based on the available financial resources and include:

- Limiting of country risks
- Definition of strategic risk parameters (e.g. target customers, regions, financing duration)

The following reports and measures are key elements for monitoring compliance with the defined limits and the intended risk and return parameters at the portfolio level and also at the level of individual transactions:

- Determining the credit risk VaR at the portfolio level by way of a credit portfolio model; analysis of concentration risks and various stress tests
- Central Group-wide monitoring of risk concentrations by way of special regular and ad hoc evaluations, such as regional, product-specific evaluations
- Continuous analysis of the portfolio and the relevant markets by the local Credit Risk Management units
- Regular evaluation of the collateral
- Special reports for exposures which are potentially at risk (e.g. “credit issue notes”)

The credit competences also define the decision-making powers of the individual credit risk managers for prolongations in existing business, depending on the counterparty group and expected loss class. A new set of powers for new business, governing the delegation of powers, has been applicable since the beginning of February 2011.

Credit Risk Management and Monitoring At the level of individual transactions, the credit process guidelines define the necessary steps of assessing risk for new business and prolongations as well as the procedures for transferring exposures to the watchlist or workout.

Core processes of credit risk management and monitoring as well as the relevant areas of the CRO function which are involved are described in the following:

The credit risk management entities (Credit Officer Real Estate I and Credit Officer Public Sector, Financial Institutions & Value Portfolio I) carry out the initial risk analysis for new business and annual risk analysis for existing business. PD and LGD rating tools, which are developed by Credit Risk for Risk Management & Control (RMC) and annually validated and calibrated, are used for valuation purposes and for preparing the credit decision in new and prolongation business. Property Analysis & Valuation Germany/Property Analysis Europe provides support for analysing and valuing the securities. The application is checked by the relevant credit risk management entity.

The Legal department, where appropriate together with external lawyers/lawyers' offices, is responsible for the contract and collateral organisation.

Defined early warning indicators are constantly analysed by Credit Risk Management (CRM). If any problems are identified, an exceptional test is performed on the credit default risk (including a review of the value of collateral) and appropriate alternative actions are identified. Such cases are also included in a monthly monitoring cycle and presented in the Watchlist Committee.

If there are any indications of an impairment, the extent of such an impairment is determined. In the Risk Provisioning Committee (see also overview for organisation and committees), the results are discussed and, where necessary, decisions are taken with regard to creating or reversing impairments.

A restructuring plan or a workout plan for critical and impaired exposures is drawn up. The decision regarding restructuring or workout takes account of scenario analyses for the potential development of the borrower, the collateral or the relevant market. These are presented and approved in the Risk Provisioning Committee.

Critical exposures (watchlist) as well as restructuring and workout cases (non-performing loans) are reported monthly in the Group risk report and in the Risk Committee and also, upon request, in special analyses to the Management Board and Supervisory Board.

Hedging and Minimising Risk by Collateral

At HRE Group, property liens relating to the financed properties are particularly important in the Real Estate Finance segment. Other financial securities and guarantees in particular are also accepted as collateral (e.g. credit insurances, guarantees, fixed-income securities, etc.) in the Public Sector Finance field.

The credit officers review the value of the collateral as part of the regular annual rating assessment of borrowers. In the case of property collateral, the value, where necessary, is reviewed by external or internal experts.

Credit Portfolio

The entire credit portfolio of HRE Group has been calculated using a standard method in line with the Basel-II-compliant exposure at default (EaD) since 31 December 2009.

The EaD recognises the current utilisation as well as pro rata credit interest in relation to which a borrower may default before an exposure is defined as having defaulted (maximum default of 90 days), as well as those credit commitments which a borrower will still be able to utilise in future despite a major deterioration in credit-worthiness. In the case of derivatives, the EaD is defined as the sum of the current market value and the regulatory add-on, which constitutes a cushion for future potential increases of the market value.

The Group-wide EaD of the credit portfolio amounted to €172.2 billion as of 30 June 2011; this is a considerable decline compared with the end of 2010 (EaD: €216.8 billion). Most of the decline is due to the reduction of €61.2 billion in the EaD with regard to the counterparty FMS Wertmanagement as of 31 December 2010, namely to €31.3 billion as of 30 June 2011.

The EaD with regard to FMS Wertmanagement is broken down as follows: for most of the derivatives earmarked to be transferred to FMS Wertmanagement, it was not possible initially to arrange for beneficial ownership to be transferred, which meant that the market price risks of the derivatives were transferred to FMS Wertmanagement by way of concluding derivatives with identical conditions between HRE and FMS Wertmanagement. These so-called back-to-back transactions account for an EaD of €12.3 billion (31 December 2010: €30.5 billion). Because FMS Wertmanagement does not have the status of a bank, HRE also handles certain refinancing functions for the deconsolidated environment, for instance with the ECB or in bilateral repo transactions, which accounted for an EaD of €13.8 billion as of 30 June 2011 (31 December 2010: €22.8 billion). And finally, HRE Group still holds bonds with an EaD of €5.2 billion (31 December 2010: €7.9 billion) issued by FMS Wertmanagement, which were provided by FMS Wertmanagement in connection with the claim for compensation of HRE Group for the transferred assets and liabilities.

In addition, the credit portfolio EaD of €172.2 billion also includes assets with an EaD of €5.7 billion (31 December 2010: €6.1 billion) which have been selected to be transferred to FMS Wertmanagement but which were not able to be transferred via the originally envisaged method as a result of various considerations, including considerations of tax law. With effect from 1 December 2010, the credit risk of these assets was transferred by means of guarantees provided by FMS Wertmanagement, so that HRE Group ultimately retains a counterparty risk with regard to FMS Wertmanagement in connection with these positions.

In order to constantly avoid EaD fluctuations and distortions in the strategic operating segments of HRE Group resulting from the refinancing function which has been taken on, and also to properly reflect the actual economic risk in HRE Group, the above EaDs attributable to transactions with FMS Wertmanagement have been detailed merely for information purposes in the following overviews of the portfolio development and structure. The EaD for the total exposure of HRE Group determined without the above positions amounted to €135.2 billion (31 December 2010: €149.5 billion).

The new business of HRE Group which is identical with the new business of Deutsche Pfandbriefbank Group comprises commitments totalling €4.1 billion; of this figure, €2.9 billion is attributable to the Real Estate Finance segment, and €1.2 billion is attributable to the Public Sector Finance segment. Of the figure of €2.9 billion for the Real Estate Finance segment, €1.3 billion is attributable to the selected prolongations of existing business.

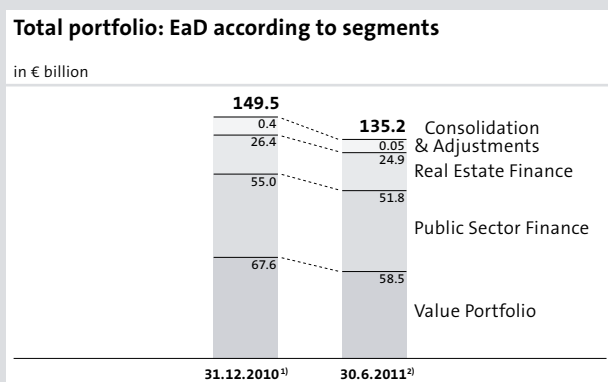
Overview of the Total Exposure of HRE Group: €135.2 Billion

EaD The credit portfolio of HRE Group is broken down into the following strategic segments:

- Public Sector Finance (PSF)
- Real Estate Finance (REF)

as well as the non-strategic Value Portfolio (VP) which is earmarked for being wound down

In addition, the category “Consolidation & Adjustments” includes internal reconciliation and consolidation positions as well as a small number of individual positions which cannot be allocated to any other category.



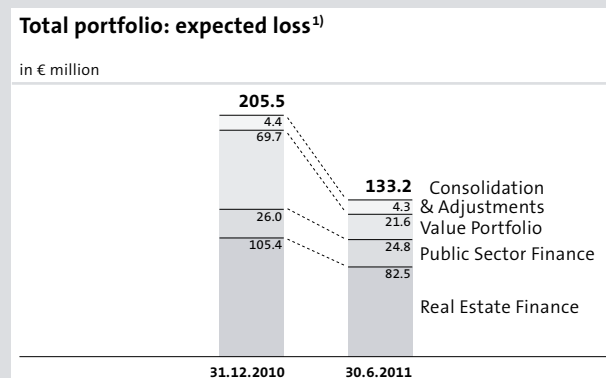
¹⁾ In addition, € 67.3 billion EaD to the counterparty FMS Wertmanagement including guaranteed positions of € 6.1 billion (PSF: € 27.7 billion; VP: € 39.6 billion)

²⁾ In addition, € 37.0 billion EaD to the counterparty FMS Wertmanagement including guaranteed positions of € 5.7 billion (PSF: € 10.9 billion; VP: € 26.1 billion)

The total exposure (EaD) of HRE Group declined in the first half of 2011 to €135.2 billion (31 December 2010: €149.5 billion). The decline in EaD is mainly attributable to regular expiries of financing arrangements in the portfolio of HRE Group. The appreciation of approx. 6 % of the euro against the US dollar between the end of 2010 and the end of June 2011 also reduced the EaD to a minor extent. Within the segments, there has been a minor shift in relative significance, benefiting the Public Sector Finance segment. The Value Portfolio segment is contracting, whereas the relative significance of the Real Estate Finance segment has remained virtually stable.

Risk Parameters Expected Loss The expected loss (EL), which is calculated from the annual probability of default (PD), the loss-given default (LGD) and the exposure at default (EaD), amounted to €133.2 million as of 30 June 2011 using the parameters specified by Basel II (31 December 2010: €205.5 million).

The expected loss for a period of one year is a key management parameter for the portfolio. It is calculated for the entire exposure, with the exception of trading book positions and non-performing loans for which an individual allowance has already been recognised. The ratio is spread over the segments as follows:



¹⁾ The expected loss is calculated for the entire exposure in the banking book, with the exception of non-performing loans for which an individual allowance has already been recognised.

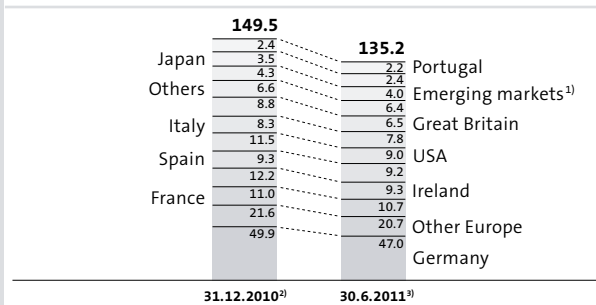
Economic Credit Risk Capital The unexpected loss of the credit portfolio, the credit risk value at risk, is calculated using a credit portfolio model for a period of one year and a confidence level of 99.95% within the framework of risk-bearing capacity analysis of HRE Group, and amounted to €1.8 billion as of 30 June 2011 (31 December 2010: €1.9 billion), disregarding diversification effects to other risk types. Details regarding the calculation are set out in the section “Result of Risk-bearing Capacity Analysis”.

Regional Breakdown of the Portfolio The exposure of HRE Group focuses on Western Europe. Germany alone accounts for approximately one-third (€47.0 billion; 31 December 2010: €49.9 billion) of the total exposure of HRE Group. There have been significant reductions in the exposure to the USA (€9.0 billion; 31 December 2010: €11.5 billion) and also to Great Britain (€6.5 billion; 31 December 2010: €8.8 billion). The exposure of €9.3 billion to Ireland (31 December 2010: €12.2 billion) contains €8.6 billion EaD from refinancing transactions with the Irish central bank (31 December 2010: €11.5 billion).

The percentage of the “Other Europe” category in relation to the total portfolio has remained largely stable compared with the end of the previous year. The relative distribution of the exposure within this category is also very stable. The largest positions are Austria (€8.6 billion; 31 December 2010: €8.5 billion), Belgium and the Netherlands (unchanged at €2.8 billion and €2.1 billion respectively), Sweden (€1.9 billion; 31 December 2010: €2.1 billion) as well as Switzerland (€1.6 billion; 31 December 2010: €1.9 billion). The percentage of the exposure to emerging markets in accordance with the IMF definition in relation to the total portfolio is virtually unchanged (€4.0 billion or 2.9%; 31 December 2010: €4.3 billion or 2.9%), and in particular comprises Poland (€2.9 billion; 31 December 2010: €3.0 billion) and Hungary (€0.7 billion; 31 December 2010: €0.8 billion). There has been a complete withdrawal from the emerging markets countries of India and Russia.

Total portfolio: EaD according to regions

in € billion



¹⁾ Emerging markets in accordance with the IMF definition

²⁾ In addition, €67.3 billion EaD to the counterparty FMS Wertmanagement including guaranteed positions of €6.1 billion. The figure without guaranteed positions is fully attributable to Germany. The guaranteed positions mainly relate to Italy (65.1%), Great Britain (21.3%), Canada (6.7%) and France (3.6%).

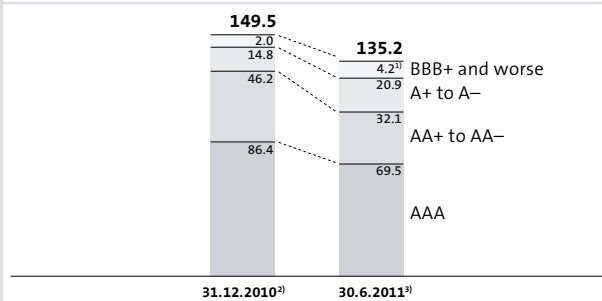
³⁾ In addition, €37.0 billion EaD with regard to the counterparty FMS Wertmanagement, including guaranteed positions of €5.7 billion. The content without guaranteed positions of €31.3 billion is fully attributable to Germany. With the exception of guaranteed real estate finance positions, the risk relating to the guaranteed positions has now been allocated to the countries of the guarantor. Accordingly, the guaranteed positions now relate mainly to Germany (94%), whereas Italy accounts for only 6%.

Depending on the results of the internal rating process, maximum limits in certain rating ranges are defined for each individual country or groups of countries; these limit the operations of HRE Group. All country ratings and country limits are reviewed at least once every year by Risk Management & Control.

With regard to the breakdown of the exposure based on internal country rating, there has been an absolute and relative decline in the exposure in the rating AAA as well as AA+ to AA- compared with the end of the previous year. At the same time, there has been an increase in the exposure in countries with a rating of A+ to A- as well as, to a lesser extent, in the rating BBB+ and worse.

Total portfolio: EaD according to internal ratings

in € billion



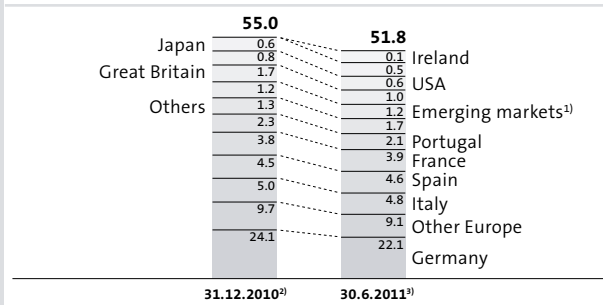
- ¹⁾ Excluding an EaD of € 8.63 billion which results from receivables due from the Irish central bank and which is not ascribed to the Irish country rating because the Irish central bank belongs to the European System of Central Banks (ESCB)
- ²⁾ In addition, € 67.3 billion EaD to the counterparty FMS Wertmanagement including guaranteed positions of € 6.1 billion. The figure without guaranteed positions is fully attributable to the rating AAA. The guaranteed positions are spread over countries with AAA ratings (10.6%), countries with AA+ to AA- ratings (21.3%), countries with ratings A+ to A- (65.2%) and countries with ratings BBB+ and worse (2.9%).
- ³⁾ In addition, € 37.0 billion EaD to the counterparty FMS Wertmanagement including guaranteed positions of € 5.7 billion. The figure without guaranteed positions is fully attributable to the rating AAA. The guaranteed positions are spread over countries with AAA ratings (94%) and countries with ratings A+ to A- (6%).

Public Sector Finance: € 51.8 Billion EaD Portfolio Development and Structure The portfolio of the strategic operating segment Public Sector Finance (PSF) amounted to € 51.8 billion as of 30 June 2011, and is thus lower than the comparison figure of € 55.0 billion at the end of 2010. It consists exclusively of public sector financing recorded at Deutsche Pfandbriefbank AG.

Most of the exposure is in Western Europe. The relative country percentage in relation to the segment portfolio are to a large extent stable, with minor exceptions such as Great Britain or Germany. The main countries shown under “Other Europe” are Austria (€ 6.8 billion; 31 December 2010: € 6.8 billion) and Switzerland (€ 0.7 billion; 31 December 2010: € 0.9 billion). The exposure in the USA relates almost exclusively to financial institutions based in the USA.

Public Sector Finance: EaD according to regions

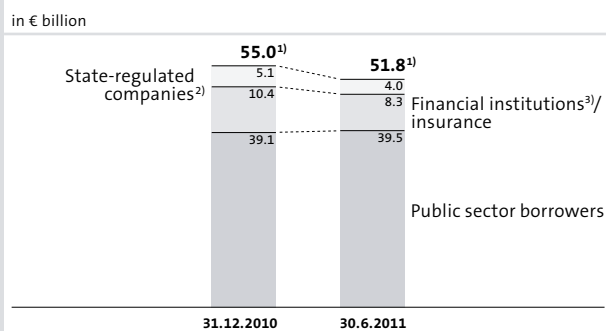
in € billion



- ¹⁾ Emerging markets in accordance with the IMF definition
- ²⁾ In addition, € 27.7 billion EaD to the counterparty FMS Wertmanagement, which is fully attributable to Germany; the Public Sector Finance segment does not include any positions guaranteed by FMS Wertmanagement
- ³⁾ In addition, € 10.4 billion EaD to the counterparty FMS Wertmanagement, which is fully attributable to Germany, as well as € 0.5 billion positions guaranteed by FMS Wertmanagement which, from the point of view of risk, also allocated to Germany

The position “Public sector borrowers” includes receivables due from sovereigns (26 %), public sector enterprises (34 %) and municipalities (40 %).

Public Sector Finance: EaD according to counterparties



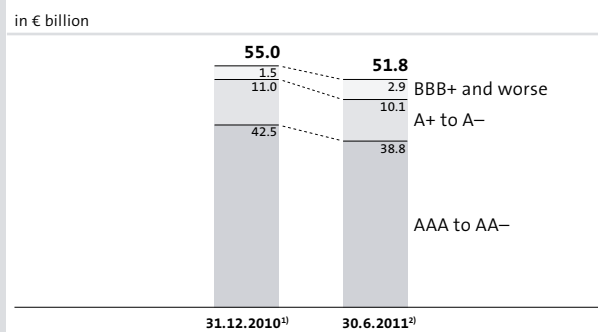
¹⁾ The June 2011 figures include an additional amount of € 45 million (0.1 %) and the December 2010 figures include an additional amount of € 0.4 billion (0.6 %) attributable to the counterparty category “Others”.

²⁾ E.g. water utilities, power supply utilities, etc.

³⁾ Financial institutions with a state background or state guarantee

The still high percentage of public sector borrowers in this segment, which are mostly still classified as “investment grade”, is reflected in the rating. The content of positions with a rating of BBB and worse has increased from € 1.5 billion as of 31 December 2010 to € 2.9 billion. The exposure in the non-investment-grade field is € 0.1 billion or 0.1 % (31 December 2010: € 0.1 billion).

Public Sector Finance: EaD according to internal ratings



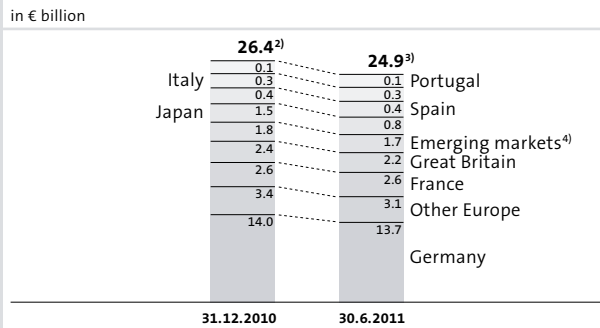
¹⁾ In addition, € 27.7 billion EaD to the counterparty FMS Wertmanagement, which is fully attributable to the rating class AAA. The Public Sector Finance segment does not include any positions guaranteed by FMS Wertmanagement.

²⁾ In addition, € 10.9 billion EaD to the counterparty FMS Wertmanagement, including € 0.5 billion positions guaranteed by FMS Wertmanagement, which is fully attributable to the rating class AAA to AA-

Risk Parameters The forecast loss for the portfolio of the Public Sector Finance segment indicates very stable figures for the first half period. The minor reduction in expected loss is mainly attributable to reductions in terms of exposure.

Real Estate Finance: € 24.9 Billion EaD Portfolio Development and Structure The EaD of the Real Estate Finance portfolio has declined by a total of €1.5 billion compared with 31 December 2010. The customer derivatives included in this figure amounted to €0.5 billion as of 30 June 2011, compared with €0.6 billion EaD at the end of 2010. Whereas the relative percentage of Germany in relation to the total portfolio increased slightly, the percentage of Japan declined to approximately half of the exposure as a result of the regular expiry of financing arrangements.

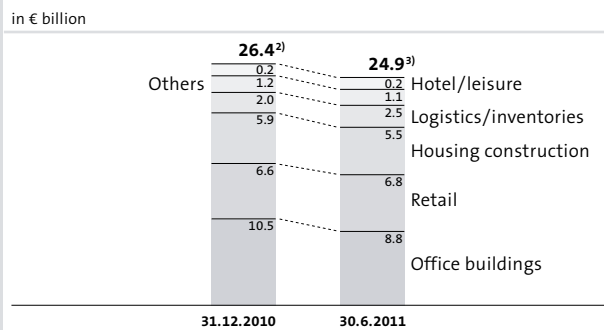
Real Estate Finance: EaD according to regions¹⁾



¹⁾ In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement.
²⁾ Breakdown including customer derivatives approx. € 0.6 billion
³⁾ Breakdown including customer derivatives approx. € 0.5 billion
⁴⁾ Emerging markets in accordance with the IMF definition

There has been a slight change in the distribution of the portfolio according to property type as of 30 June 2011 compared with the end of 2010. The reduction of €1.8 billion in the property type “Office buildings” to €8.8 billion EaD is worthy of note (35%; 31 December 2010: 40%). The percentage of financing for residential properties (mostly portfolio transactions) has remained stable (22%; 31 December 2010: 22%). Around 10% (31 December 2010: 8%) of the portfolio are attributable to the property type “Logistics/inventories”. Financing for retail properties also account for a major part of the Real Estate Finance segment (27%; 31 December 2010: 25%).

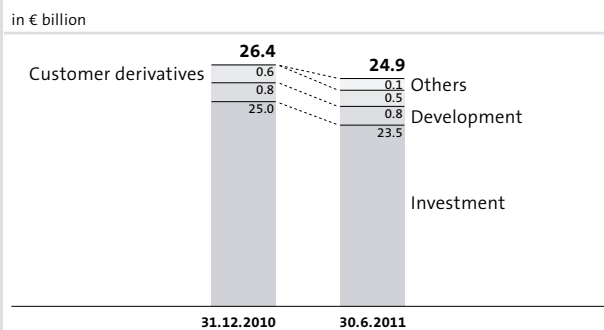
Real Estate Finance: EaD according to property types¹⁾



¹⁾ In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement.
²⁾ Breakdown including customer derivatives approx. € 0.6 billion
³⁾ Breakdown including customer derivatives approx. € 0.5 billion

At mid-year 2011 the portfolio was again dominated by investment financing to a greater extent (95.4%; 31 December 2010: 94.2%); higher risk construction projects in the building phase (building finance) account for only 2.5% of the EaD (31 December 2010: 3.4%). Real Estate Finance for which the capital is serviced mainly out of the current property cash flow is shown under investment financing.

Real Estate Finance: EaD according to loan types¹⁾



¹⁾ In the Real Estate Finance segment, there is no exposure to the counterparty FMS Wertmanagement.

Risk Parameters The expected loss (EL) for the Real Estate Finance portfolio amounted to €82.5 million as of 30 June 2011 using the parameters defined by Basel II. It has accordingly declined considerably compared with 31 December 2010 (€105.4 million); this is primarily attributable to an improvement in the PD and LGD parameters of some major clients.

Key Risk Aspects The developments on the real estate markets in the first half of 2011 are discussed in detail in the section “Sector-specific Situation” in the chapter “Business and Conditions“. Comments concerning possible future developments are set out in the Forecast Report of this Semi-annual Report.

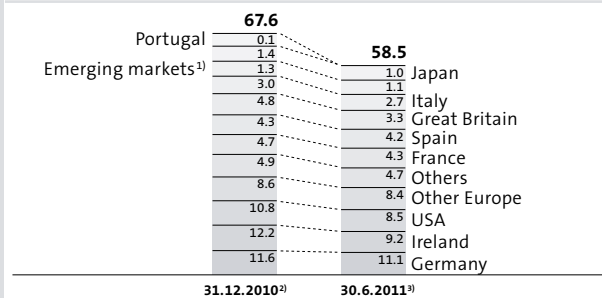
Value Portfolio: €58.5 Billion EaD Portfolio Development and Structure

The Value Portfolio comprises non-strategic portfolios of HRE Group as well as (at present) most of the transactions which exist with the counterparty FMS Wertmanagement. With regard to the non-strategic portfolios of HRE Group, the Value Portfolio comprises public finance business of the DEPFA sub-group as well as capital market business and a minor part of infrastructure financing operations. In the Value Portfolio, emphasis is placed on the reduction of existing assets in a manner which poses minimum strain on capital and which is designed to maintain value.

The decline of €9.1 billion in the exposure as of 30 June 2011 compared with 31 December 2010 is mainly attributable to the reduction of the exposure in the USA, Great Britain and Ireland. As of 30 June 2011, a regional emphasis is formed particularly by Germany, the USA, Ireland as well as various countries of Western Europe. The Irish content (which is high at €9.2 billion or 16 %) contains €8.6 billion EaD resulting from refinancing transactions with the Irish central bank.

Value Portfolio: EaD according to regions

in € billion



¹⁾ Emerging markets in accordance with IMF definition

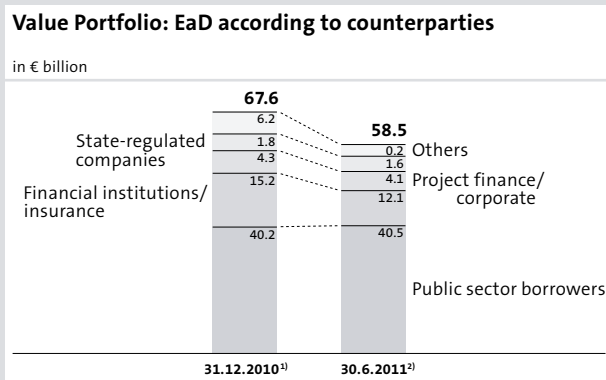
²⁾ In addition, €39.6 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions of €6.1 billion. The content without guarantees is fully attributable to Germany. The guaranteed positions are mainly broken down over Italy (65.1%), Great Britain (21.3%), Canada (6.7%) and France (3.6%).

³⁾ In addition, €26.1 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions of €5.2 billion. The content without guarantees is fully attributable to Germany. The guaranteed positions are mainly broken down over Germany (94%) and Italy (6%).

The counterparty structure in the Value Portfolio was revised in 2010 as part of the process of creating new segments, and the allocation to counterparties was standardised throughout the Group.

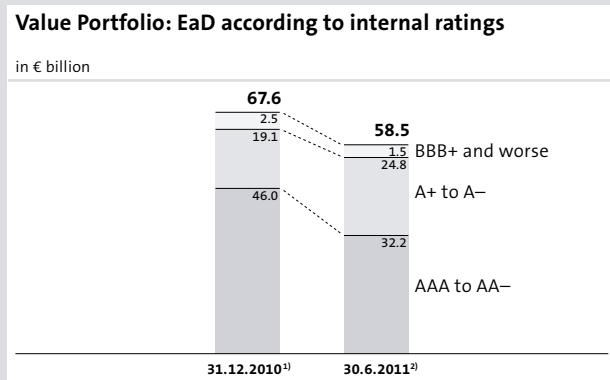
The heading “Public sector borrowers” includes 33 % exposure to countries, 50 % exposure to public sector companies and 17 % exposure to municipalities.

In the Value Portfolio, there has been an absolute as well as relative decline in exposure in the ratings AAA to AA– with a simultaneous increase in the ratings A+ to A–. The exposure in the ratings BBB+ and worse has declined by €1 billion compared with the end of the previous year, namely to €1.5 billion as of 30 June 2011. In consequence, with the exception of a minor percentage, the entire remaining Value Portfolio of HRE Group is rated “investment grade”.



¹⁾ In addition, € 39.6 billion EaD with regard to the counterparty FMS Wertmanagement, including guaranteed positions of € 6.1 billion

²⁾ In addition, € 26.1 billion EaD with regard to the counterparty FMS Wertmanagement, including guaranteed positions of € 5.2 billion



¹⁾ In addition, € 39.6 billion EaD to the counterparty FMS Wertmanagement, including guaranteed positions of € 6.1 billion. The amount excluding guaranteed positions is fully attributable to the rating class AAA. The guaranteed positions are broken down as follows: Rating classes AAA to AA– (94.5 %), rating classes A+ to A– (1.3 %) and rating classes BBB+ and worse (4.2 %).

²⁾ In addition, € 26.1 billion EaD with regard to the counterparty FMS Wertmanagement, including guaranteed positions of € 5.2 billion. More than 99 % of the EaD is attributable to the ratings AAA to AA–.

Risk Parameters The expected loss for the Value Portfolio amounted to €21.6 million as of 30 June 2011 using the parameters defined by Basel II. It has accordingly declined appreciably compared with 31 December 2010 (€69.7 million). One of the main drivers behind the reduction in the EL is a financing arrangement in the public sector (EL of €–54 million), for which an individual allowance was created in the first quarter of 2011.

Structured Products

In accordance with the recommendations of the Financial Stability Board (FSB, formerly FSF) as well as the Senior Supervisory Group (SSG) for “Leading Practice for Selected Exposures”, HRE Group discloses further information regarding the following sub-portfolios:

- **Structured products**
 1. State- and bank-guaranteed products; structured products with state backing
 2. Structured products in the banking book and consolidated special-purpose vehicles
- **Special-purpose vehicles inside and outside the group of consolidated companies** (section “Special-purpose Vehicles in HRE Group”)

1. State- and Bank-guaranteed Products; Structured Products with State Backing in the Value Portfolio (Excluding Additionally Credit-insured Securities) Due to considerations of transparency, the figures relate to all operating segments; by far the majority is attributable to the Value Portfolio.

Structured securities in € billion	30.6.2011		31.12.2010	
	Nominal value	Internal fair value	Nominal value	Internal fair value
Fully guaranteed structured products				
CDO (securitised, state-guaranteed European (mostly Spain) financing for small enterprises) ³⁾	1.9	1.7	2.0	1.8
ABS (securitised mortgage loans guaranteed by the Netherlands)	0.2	0.2	0.2	0.2
ABS (reverse mortgage; guarantee provided by US Federal Home Administration)	—	—	—	—
State-backed structured products				
ABS (housing finance: securitised subsidised mortgage loans)	0.5	0.5	0.5	0.5
ABS (stranded costs: securitised mortgage loans of buildings in the public interest; interest payment and repayment of principal by charges imposed by the public sector)	1.0	1.0	1.1	1.1
Structured products with state-guaranteed underlyings (including CM & AM)				
FFELB student loans (securitised student loans with a US state guarantee of at least 97%)	3.8	3.5	4.1	3.8
Bank-guaranteed structured products				
CDO – TRS with Suisse bank	0.6	0.6	0.6	0.6
CDO – TRS almost exclusively with US investment banks	—	—	—	—

³⁾ Of this figure, € 0.56 billion is attributable to the Public Sector Finance portfolio as of 30 June 2011.

Increased levels of risk can occur in relation to structured securities without an explicit guarantee (nominal €1.5 billion with state backing). However, because the securitised loans finance investments “in the public interest”, it can be assumed that state support will be provided in the event of payment difficulties.

FFELB Student Loans The decline of €0.3 billion, compared with 31 December 2010, in the nominal holdings of FFELB student loans which are completely attributed to the Value Portfolio is exclusively due to the strengthening of the euro against the US dollar.

2. Structured Products in the Bank Book and Consolidated Special-purpose Vehicles The nominal holdings of structured securities, which HRE Group breaks down into real-estate linked investments such as commercial mortgage-backed securities (CMBS), residential mortgage-backed securities (RMBS) and credit-linked investments, e.g. collateralised debt obligations (CDO, in the narrower sense of the term) and collateralised loan obligations (CLO), have been largely stable (€0.42 billion; 31 December 2010: €0.45 billion).

The internally calculated fair value of these securities which evidence credit risks is unchanged compared with 31 December 2010, namely €11 million.

Special-purpose Vehicles in HRE Group

Special-purpose vehicles are generally used for largely ring-fencing assets from operating companies in a manner in which they are protected from insolvency and also to enable these assets, which are frequently used as collateral, to be disposed of more readily if necessary. Within the framework of its business activities, HRE Group mainly uses special-purpose vehicles for reducing risk.

The following table summarises the special-purpose vehicles which have been included in the Annual Financial Statements of HRE Group as of 30 June 2011 or as of 31 December 2010 in accordance with IFRS. The assets underlying the consolidation are classified exclusively as loans and receivables (LaR).

Consolidated special-purpose vehicles according to categories		
Nominal value in € billion	30.6.2011	31.12.2010
Refinancing of the Group	0.06	0.06
Investments in ABS structures	0.59	0.64
Total	0.65	0.70

The consolidation of the special-purpose vehicles has resulted in particular in a balance sheet extension of €0.4 billion (31 December 2010: €0.5 billion) from securitisation special-purpose vehicles within the framework of investments in ABS structures in which HRE Group holds first loss tranches which have already been fully written down. From the risk point of view, this means that the volume exposed to risk has not changed. Accordingly, the volume exposed to risk has declined by €0.4 billion (31 December 2010: €0.5 billion).

As was the case at the end of 2010, there was no further nominal transaction volume for the remaining non-consolidated special-purpose vehicles.

Watchlist and Non-performing Loans: € 1.5 Billion¹⁾

Early Warning System The early warning system of HRE Group has defined triggers (= criteria) for including loans in the watchlist and for being classified as workout loans (e.g. past due payments, failure to meet covenants – such as LTV, ISC). The system constantly monitors whether a trigger has been set off. In the event of any problems being identified, the counterparty is analysed and, where appropriate, promptly transferred to watchlist, restructuring and workout loans.

Watchlist and non-performing loans (restructuring and workout loans) are defined as follows:

- **Watchlist Loans** Payments past due by more than 60 days or another early warning signal is triggered.
- **Restructuring Loans** Payments past due by more than 90 days or another defined early warning signal is triggered.
- **Workout Loans** There are no indications that the loan can be restructured. Enforcement measures have been/ will be introduced, individual allowances have been recognised.

Non-performing loan processing is also responsible for carrying out an impairment test in line with the relevant accounting regulations of the Group.

Development of Watchlist and Non-performing Loans Break-down of watchlist and non-performing loans as of 31 December 2010 and 30 June 2011:

Watchlist and non-performing loans	30.6.2011				31.12.2010				Change
	EaD in million	PSF	REF	VP	Total	PSF	REF	VP	
Workout loans	—	15	33	48	—	16	67	83	–35
Restructuring loans	36	1,162	86	1,284	38	1,141	91	1,270	14
Non-performing loans	36	1,177	119	1,332	38	1,157	158	1,353	–21
Watchlist loans	—	141	—	141	—	319	135	454	–313
Total	36	1,318	119	1,473	38	1,476	293	1,807	–334

¹⁾ Reporting has been changed over to EaD.

The non-performing and watchlist loans have stabilised. They declined by €0.3 billion to €1.5 billion as a result of repayments and successful restructuring.

Impairments and Provisions

Individual Allowances and Portfolio-based Allowances All financial assets which are not evaluated at fair value through profit or loss are subject to a regular impairment test. An assessment is first made to determine whether there is an objective indication of an impairment. The extent of any such impairment is then calculated as the difference between the carrying amount, at AfS assets plus AfS reserve, and the present value of the cash flows expected in future. Objective indications of an impairment as well as the measurement of the extent of impairments are described in detail in the Notes to the Consolidated Financial Statements 2010 or in the Risk Report section.

Portfolio-based allowances are calculated using risk parameters which are compliant with Basel II, such as probability of default (PD) and loss-given default (LGD). The resultant expected loss in relation to a time horizon of one year is scaled using an IFRS-compliant conversion factor to the period which on average is required for identifying the impairment event.

If differences are identified between long-term average values for the parameters PD and LGD on the one hand and the current figures on the other as a result of the market environment in some portfolios of the operating segments, these are taken into consideration accordingly.

The impairments are approved in the Risk Provisioning Committee in which the CROs of all subsidiary institutions are represented.

Risk Provisioning An overview of the development in provisions for losses on loans and advances and provisions is set out in the notes.

The decline of €59 million reported there (to €418 million) as of 30 June 2011 is mainly attributable to consumption.

The portfolio-based allowances amounted to €155 million as of 30 June 2011 (31 December 2010: €184 million). The main drivers behind the reduction in the portfolio-based allowances are improvements in the PD and LGD parameters at some major clients.

Cover Provided for Non-performing Loans As of 30 June 2011, there was 33.5 % cover for the non-performing loans in Real Estate Finance (REF; 31 December 2010: 33.7 %).

There is 40.2 % cover for the non-performing loans in the Value Portfolio and Public Sector Finance (31 December 2010: 37.5 %).

In relation to the total nominal value, there was 97.5 % cover for the structured products in the banking book and the consolidated special-purpose vehicles which are attributed to the Value Portfolio (31 December 2010: 97.4 %).

The provisions for contingent liabilities and other obligations mainly comprise provisions for guarantee risks, letters of credit and irrevocable loan commitments in lending business. They amounted to €34 million as of 30 June 2011 (€34 million as of 31 December 2010).

Market Risk

Definition, Market Risk Strategy, Structure Organisation and Reporting

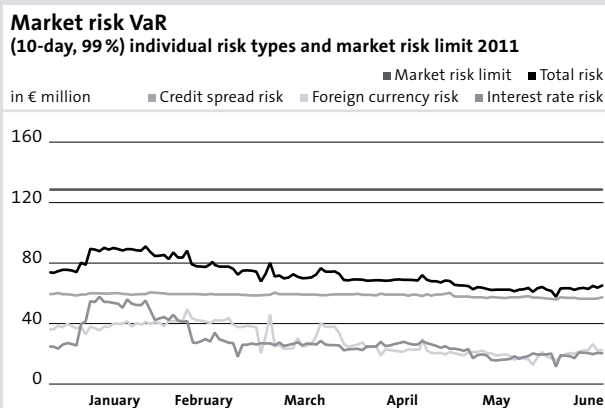
With regard to the points mentioned above, please refer to the details in the market risk part of the risk report in the Annual Report 2010.

Measurement and Limiting of Market Risk

With regard to the methods and assumptions of VaR measurement, please refer to the comments in the market risk part of the risk report in the Annual Report 2010.

The market risk VaR of HRE Group amounted to €63.5 million as of 30 June 2011; it is thus lower than the corresponding previous year-end figure of €74.1 million.

Whereas the market risk VaR in the first quarter of 2011 was subject to major fluctuations as a result of amendment entries in connection with the transfer of assets and liabilities to the FMS Wertmanagement, it remained at a comparatively constant level in the second quarter.



The VaR assessment is complemented by further instruments such as sensitivity analyses as well as stress testing and backtesting.

Backtesting Seven outliers were observed for the trading books during the past twelve months; most of these were attributable to the market movements of credit spreads and interest rates.

Stress Testing Hypothetical and historical stress scenarios which are uniform throughout the Group are calculated on a monthly basis for all main risk drivers for all positions. For instance, a parallel shift of 200 basis points in the interest rate curve would result in a change of €83.7 million in market value. The comparison figure at the end of 2010 was €197.9 million.

Economic Market Risk Capital For calculating the economic market risk capital, which is taken into consideration for the risk-bearing capacity analysis, the market risk VaR is scaled to a period of one year and also to a higher confidence level (from 99% to 99.95%). The economic capital for market risk, disregarding diversification effects for other risk types, amounted to €425 million as of 30 June 2011 (31 December 2010: €550 million). For further details concerning the calculation we refer to the chapter "Result of Risk-bearing Capacity Analysis".

Market Risk Management and Monitoring

With regard to the points mentioned above, please refer to the details in the market risk part of the risk report in the Annual Report 2010.

Liquidity Risk

General information in connection with the measurement and management of liquidity risk in HRE Group (including risk strategy, risk limitation) can be found in the Annual Report 2010 of HRE Group.

Development of the Risk Position of HRE Group

The liquidity reserve calculated as part of the liquidity risk measurement as of 30 June 2011 (after taking account of limits) was €8.4 billion for a twelve-month horizon. Operations are refinanced exclusively via money and capital markets and no external liquidity aid is utilised.

The liquidity ratio in accordance with the Liquidity Ordinance amounted to 1.18 at Deutsche Pfandbriefbank AG as of 30 June 2011; it is thus higher than the statutory minimum of 1.0. The liquidity requirements of the Irish regulator for DEPFA Bank plc were also satisfied. Accordingly, the liquidity ratio for the range of 0 to 8 days was 1.12 (the minimum figure required by the regulator in this respect is 1.0), and the ratio for the range between eight days and one month was 1.53 (the minimum required by the regulator in this respect is 0.9).

For refinancing, covered and uncovered issues are available as the main financing instruments to HRE Group. Pfandbriefe are the main refinancing instrument. Because of their high quality and acceptance on international capital markets, Pfandbriefe are comparatively less affected by market fluctuations than many other sources of refinancing.

The refinancing markets in the first half of 2011 were still affected by the crisis affecting European state finance. The German bond market proved to be a “safe haven”, and long-term interest rates remained at an all-time low despite rising inflation and subsequent rate hikes of the ECB.

Ahead of the EU decision regarding HRE Group, Deutsche Pfandbriefbank AG had only minor operations on the refinancing market, and placed approx. €0.5 billion (long-term) on the market in the first half of 2011.

Forecast Liquidity Requirement

From the point of view of HRE Group, the current liquidity can be classified as comfortable.

However, in addition to the forecast liquidity requirement for new business activities, the actual extent of the future liquidity requirement depends on numerous external factors:

- The future development of haircuts for securities for repo refinancing on the market and with the central banks
- Possible additional collateral demands as a result of changing market parameters (such as interest rates and foreign currency rates)
- The development in requirements for hedges
- Changed requirements of the rating agencies regarding the necessary surplus cover in the cover funds

Following the transfer of assets to FMS Wertmanagement, the risk for the liquidity of HRE Group which might be caused by turmoil on the financial markets has declined appreciably.

Operational Risk

Definition

HRE Group defines operational risk as “the risk of losses caused by processes which are not satisfactory or which have not even been implemented, human error, technology failure or external events”. The definition includes legal risks, but excludes strategic and reputation risks.

Strategy for Operational Risks

The overriding aims of HRE Group are the early recognition, recording, assessment as well as monitoring, prevention and limiting of operational risks as well as an early and meaningful report to the management. HRE Group does not attempt to completely preclude the possibility of risk; instead, it aims to minimise potential losses by way of specific early recognition measures. The provision of information is the basis for decisions regarding the limitation of risk.

Organisation of Operational Risk Management

In the field of Risk Management & Control, the Group Operational Risk department is responsible for uniform Group-wide processes, instruments and methods for recording, assessing, monitoring and reporting operational risks in HRE Group.

Risk Reports, Monitoring and Management of Operational Risks

Operational risks are monitored by means of a network of controls, procedures, reports and responsibilities. Within the Group, each individual unit takes on responsibility for its own operational risks, and provides appropriate resources and processes for limiting such risks. The focus is primarily on the early recognition, reduction and management of risks as well as the measurement and monitoring of risks.

The collected information is used in order to determine the operational risk profile of HRE Group and the necessary measures to reduce risks.

Regular reports are prepared for the CRO and the Risk Committee. The monthly Group risk report contains operational claims and losses as well as major risk-relevant issues with an effect on HRE Group. In addition, a quarterly risk report regarding major risk indicators notifies the Management Board of potential risk sources. The results of the annual risk self-assessments in the specialist units are also reported to the Risk Committee after the assessment process has been completed. When a detailed risk analysis has been completed, the relevant member of the Management Board receives a final report.

Risk Measurement

The economic capital for operational risks is €157 million as of 30 June 2011 (31 December 2010: €154 million). Details of the calculation are set out in the chapter “Result of Risk-bearing Capacity Analysis”.

Major Operational Risks of HRE Group

Major operational risks result from the continuing enhancements of HRE Group. This also comprises the process of rendering services for FMS Wertmanagement as well as ongoing changes in the IT environment. Operational risks are attributable in particular to the high number of manually recorded transactions as well as the high number of different processing and monitoring systems in HRE Group. Until the current consolidation process has been completed, there will be an increased level of susceptibility to faults with regard to the manual processes and controls which are carried out for ensuring data consistency.

There is also a significant reliance on know-how of key personnel for dealing with the continuing enhancements on the one hand and for operating daily business on the other. This is particularly important in view of the existing system landscape as well as manual processes and controls.

HRE Group suffered losses of €159,183 in total from operational risks in the first half of 2011. The losses were mainly attributable to the incorrect recognition of interest rate data of loans. Process and control improvements have been implemented in order to remedy the underlying causes of the losses which have occurred.

Result of Risk-bearing Capacity Analysis

Economic capital according to risk types without diversification effects in € million	30.6.2011	31.12.2010	Change
Credit risk	1,835	1,881	-46
Market risk	425	550	-125
Operational risk	157	154	+3
Business risk	—	62	-62
Total before diversification effects	2,417	2,647	-230
Total after diversification effects	2,218	2,413	-195
Available financial resources	8,604	8,654	-50
Cover buffer	+6,386	+6,241	+145

Excluding the diversification effects between the individual risk types, the economic capital of HRE is approx. €2.4 billion (31 December 2010: €2.6 billion). If these effects are taken into consideration, the economic capital falls to around €2.2 billion (31 December 2010: €2.4 billion).

As a result of new regulatory requirements, the risk cover funds can no longer be used to show the previously included result forecast for the next twelve months. The resultant decline more than compensates for the increase in IFRS shareholders' equity as a result of the positive interim results of the Group, leading overall to a slight decline of €50 million in the risk cover funds to €8.6 billion.

According to the ICAAP model which is a regulatory requirement and which determines the economic risk-bearing capacity of the company, there is an economic capital buffer of around €6.4 billion for a one-year observation period as of 30 June 2011 (31 December 2010: €6.2 billion).

The main risk type based on the ICAAP (measured in terms of economic capital and without explicitly taking account of the liquidity risk) is the credit risk which accounts for 76% of the undiversified economic capital.

Measured in terms of economic capital, HRE Group was adequately capitalised throughout the entire first half of 2011. The Group accordingly met all the requirements of risk-bearing capacity in full and at all times.

On 5 July 2011, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) published a draft of the regulatory appraisal of internal risk-bearing capacity concepts of the credit institutions. This might result in changes to future calculations of the Group.

Method Used for the Individual Risk Types

The economic capital of each risk type is determined using a quantitative approach, and aggregated to form the overall bank risk, taking account of specific correlations. In line with the common market standard, the risk types are calculated for a period of one year and a confidence level derived from the target rating (in this case: 99.95 %).

The method of calculating the economic capital for the individual risk types is explained in the following.

Credit Risk For calculating credit risk at the portfolio level, HRE Group uses a Group-wide credit portfolio model which follows the approach of a so-called asset-value model. The main underlying idea of this approach is that by repeated simulations of correlated rating migrations and borrower defaults, as well as a calculation of resulting value changes of the portfolio, probability statements can be made with regard to potential losses from lending business. The loss distribution calculated in this way can then be used to calculate the economic credit risk capital as a value at risk figure. This defines the maximum unex-

pected loss calculated for a confidence level of 99.95 % which will result within one year due to rating migrations and defaults in lending business. In addition to the loss distribution of the credit portfolio, a significant result is the risk-adjusted allocation of the credit risk capital measured in this way to the individual borrower units using the so-called expected shortfall principle. This ensures proper allocation to the borrowers, and thus constitutes a major module in the risk-oriented management of the credit portfolio.

For a confidence level of 99.95 % and a time horizon of one year the economic capital for credit risk calculated using the credit portfolio model, disregarding diversification effects to other risk types, is €1.8 billion (31 December 2010: €1.9 billion).

Market Risk The calculation of economic capital for market risk comprises the VaR used for market risk management extended by the VaR figures for the capital investment books. The market risk VaR is scaled accordingly in order to take account of the higher confidence level and the one-year period of the capital adequacy assessment process.

The economic capital for market risk over a one-year horizon was €425 million as of 30 June 2011, excluding diversification effects to other risk types (31 December 2010: €550 million).

Operational Risk The calculation of economic capital for operational risk includes the result of the calculation using the standard approach in accordance with Basel II. For the purpose of the capital adequacy assessment process, the capital requirement specified by the regulator is scaled to reflect the higher confidence level (from 99.9 % to 99.95 %). Economic minimum capital for operational risk is also maintained in certain areas of the Group. This buffer compensates for potential model-related weaknesses of the standard approach.

The economic capital for operational risk amounted to €157 million as of 30 June 2011 (31 December 2010: €154 million).

Business Risk The calculation of the economic capital for the business risk includes an assumed increase in financing costs as a result of an increased financing require-

ment with a simultaneous increase in the unsecured refinancing rate. As part of the liquidity risk measurement process, the stress scenario “Further decline” simulates every month the increased financing requirement if certain market events were to occur. Because this scenario has a positive liquidity cushion for the entire period of one year, there is no increased financing requirement even if this stress case were to occur. The economic capital for business risks is thus €0 as of 30 June 2011.

The previous year figure of €62 million consisted exclusively of the scenario of no new business, resulting in no forecast figures for net interest income and net commission income for the next four quarters. Because the risk cover funds do not include any forecast profits for regulatory purposes, the inclusion of this component in the business risk has become redundant.

Liquidity Risk Capitalising for liquidity risk in the narrower sense is not standard practise in the sector. Liquidity risk in the broader sense of an increase in funding costs is recognised in the economic capital for the business risk.

Stress Tests

Stress tests in relation to the economic capital are used in order to obtain a better understanding of the sensitivity of the results to changes in the risk parameters underlying the model. HRE Group carries out stress tests as an instrument of adequate economic capital management for the relevant individual risk types, and also for two integrated stress tests covering all risk. Further information and specifications regarding the stress tests are set out in the risk report of the Annual Report 2010.

Macro-economic Forecast

When comparing countries internationally, forecasts for growth for the whole of 2011 are more mixed than is normally the case. Accordingly, growth of 3.4 % is predicted for Germany, roughly in line with the figure for 2010. This would mean that the level of value creation seen before the crisis would be exceeded. With the approved raising of the debt ceiling in the USA together with significant reductions in spending, the prospects for growth in the USA are limited and a relapse into recession is considered possible. Growth in economic performance in the European Union is forecast to be 1.8 % (as is the case in the Euro zone). The crisis in Greece will probably again become somewhat more serious, with Greek gross domestic product probably declining by 4.5 % compared with 2010.

As has been the case in the past, caution has to be observed with regard to the risks on the financial markets. This is particularly applicable for the government finance situations in some European countries and the USA described in the macro-economic situation.

The fears of inflation which were still quite pronounced in 2010 should at least not become more serious in the near future. Accordingly, inflation in the Euro zone is currently expected to be 2.6 % for the whole of 2011 (Germany: 2.4 %) – with the trend likely to fall next year. However, it has to be borne in mind that capacities in some sectors and countries are now well utilised, which means that scope might be used for raising prices. At 2.5 %, consumer price inflation in the USA is considered to be at a similar level for the year 2011 – despite the fact that monetary and financial policy are very expansionary.

Sector-specific Situation

Development of the Bank Sector

Despite the existing uncertainty, the economic upturn in many European countries is still intact. Positive mention has to be made of Germany and France in particular in this respect. However, if the current debt crisis were to expand into a currency crisis, this would result in increased market uncertainty. This means that the second half of the year will also be characterised by uncertainty for the bank sector. Accordingly, the sector will place emphasis on higher liquidity and low-risk investments.

Public Sector Financing

Since the beginning of the government debt crisis in 2010, financial markets have become more sensitive with regard to financial policy risks. The financial markets evaluated the specific budget figures of the individual economies, thus focusing on the financial policy risks of the countries. This increased level of attention, particularly in Europe, has meant that all economies – and not only the countries which have attracted attention as a result of a high state deficit – have defined and communicated budget consolidation measures.

Special attention is devoted to Spain because of the size of its economy. The Spanish government has announced additional consolidation measures and has initiated a labour market reform. France and Great Britain have also decided to adopt budget consolidation measures. The British emergency budget was in general welcomed. France has also imposed appropriate measures in order to stop an increase in the debt ratio and accordingly to avoid any risk to its AAA rating. As is the case with Spain, the rating agencies and financial markets view Italy very critically, as a result a significant savings package has been approved for improvement in the budget.

Three of the economies which have been hardest hit in this respect can now only obtain funding at much higher interest rates, and are reliant on multilateral financing (International Monetary Fund, finance commitments of the EU) in order to secure liquidity and creditworthiness. The effects of the additional rescue packages involving

private investors for other countries which are the focus of attention cannot be foreseen at present.

The fact that markets continue to be affected by uncertainty has again meant that, in the first half of 2011, customers in countries of strategic core markets of Deutsche Pfandbriefbank AG are already attempting to cover their financing requirement for the full year, and are therefore tapping the market more quickly and with larger amounts. This means that demand for public investment finance and related financing will more than ever be determined by a mixture of financial policy measures and the respective regional economic development. The emphasis will be on stabilising the budget situations by cutting costs and adjusting taxes in order to maintain and expand economic efficiency.

Real Estate Financing

The economic climate in the strategic core markets of Deutsche Pfandbriefbank has improved compared with the years of crisis, and this situation is likely to continue. For this year, the players in Europe expect to see a further increase in real estate investment. A transaction volume of up to €130 billion in Europe is being forecast. This will entail an appropriate financing requirement. Investment demand for real estate let on a long-term basis will continue to be very high in the second half of the year. The limited supply in prime locations will probably result in a successive increase in the volume of investment in secondary locations.

The main real estate markets from the point of view of investors will again be Germany, Great Britain and France in the second half of 2011. Significant growth in volumes will probably be seen in Scandinavia and in Central and Eastern European countries such as Poland and the Czech Republic.

The vacancy rates affecting commercial real estate in Europe are still at a high level. It will not yet be possible to completely reduce the surplus supply which built up as a result of the new construction boom before the crisis. Because the supply of core properties is limited, investors

will look for investment opportunities in sub-prime and secondary locations as the year progresses. The vacancy rates on the office market will probably continue to decline slightly during 2011. Growth in employment as a result of the good economic situation is having a direct impact on demand for premises. However, older office properties in particular outside prime locations will be affected by a high vacancy rate risk. Overall, we are reasonably positive with regard to the development of the commercial real estate market in Germany. For Great Britain and France, we have identified further development opportunities particularly, for the metropolitan regions of London and Paris. In Spain, there are still no signs of any turnaround on the markets, and instead there has been a negative development in the volume of investment. Nor is there likely to be any turnaround in the second half of 2011. For the residential sector, we consider that, particularly in Germany, property prices will continue to rise in the second half of 2011, especially in the major cities.

The second half of 2011 will continue to be characterised by relatively conservative financing structures. Borrowers will have to provide much more capital for properties with an inadequate tenant structure. It will be difficult to obtain finance for speculative properties in the foreseeable future.

Refinancing Markets

In the second half of the year, the refinancing markets will continue to be affected by the government debt crisis, which will lead to continuing investor uncertainty. This means that the trend towards covered bonds will continue. In future, uncovered issues will presumably be viewed in a more critical light as a result of discussions concerning the shared liability of private investors and the new regulations.

Banks which previously have not issued covered bonds will increasingly appear as new issuers. We also see a considerable development for covered bonds at banks which are based in countries without any special legislation (for example Australia, USA).

The Pfandbrief will therefore continue to be the main refinancing instrument of specialist banks in future. The significance of covered financing will continue to be very high.

Company-specific Conditions

The forecasts regarding the future development of the Deutsche Pfandbriefbank Group constitute estimates which have been taken on the basis of the information available at present. If the assumptions underlying the forecasts fail to materialise, or if risks (such as those addressed in the Risk Report) occur to an extent which has not been calculated, the actual results may differ appreciably from the currently expected results.

Going Concern

On 18 July 2011, the European Commission approved the aid measures granted by Germany to HRE. With its positive decision, the European Commission has also accepted the viability of the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate finance and public sector investment finance. The decision is not legally binding.

Future development in assets, financial position and earnings

HRE has reported a profit for the first half of 2011. However, the extent of the profit has benefited from one-off effects such as the profits from the redemption of receivables. From its current point of view, the Management Board expects to be profitable and that a positive result will be generated for 2011. As a requirement in line with the “burden sharing” specified by the EU, profits will be retained at the Deutsche Pfandbriefbank sub-group until reprivatisation, and will be used for repaying the silent participation of the Federal Republic of Germany. From the time at which the payment requirement of € 1.59 billion is completely settled up to the time of privatisation, the DEPPFA sub-group will have to pay a further amount to the Federal Republic of Germany in line with the principle of burden-sharing; the precise form of this payment still has to be agreed in contractual form between the affected companies of the DEPPFA sub-group and the Federal Republic of Germany.

The volume of new business in the first half of 2011 was in line with expectations. HRE is assuming that it will be able to write new business of up to € 8 billion in 2011.

Total assets in the first half of 2011 declined appreciably due to the diminishing opposite effects of the transfer of positions to FMS Wertmanagement. The volume of opposite effects will in future probably continue to decline. For example, changes of debtor (novations) will be carried out in the case of other instruments. In addition, FMS Wertmanagement will refinance its operations on a stand-alone basis to an even greater extent and will thus no longer require HRE to pass on funds. The further extent of the reduction in total assets is still uncertain, and is not entirely within the control of the Deutsche Pfandbriefbank Group. In addition, market-related factors such as changes in exchange rates and market interest rates can also have an impact on total assets.

Opportunities

The developments in net assets, financial position and earnings which have occurred since the transfer of assets to FMS Wertmanagement, and also the expected developments, illustrate the potential of HRE. The conclusion of the approval process is a further milestone for the restructuring and refocusing of HRE. This results in the following opportunities for HRE:

- The conclusion of the EU aid proceedings will increase the level of reliability for customers and lenders. This means that HRE will tend to be able to conclude transactions more easily.
- In addition, HRE will be able to focus on its core areas of activity following the extensive completion of the successful conclusion of projects such as the EU aid proceedings. The focus will be on asset-based public sector finance and commercial real estate finance in selected target markets.
- HRE has considerable experience in the Pfandbrief market, which can be used to a greater extent following the completion of the EU aid proceedings. HRE will be able to take advantage of existing customer relations. Because of their high quality and stable maturity profile, Pfandbriefe are relatively unaffected by market turmoil. HRE thus uses an instrument which continues to be in demand on the capital market. Because situations involving unmatched maturities in refinancing have essentially been eliminated, liquidity shortages have become much less likely.
- The market environment of HRE improved in the first half of 2011. Although market uncertainty is still high, for instance due to the high level of debt of some countries, the development of the markets is considered to be positive. For instance, it is assumed that the volume of transactions will continue to increase in real estate finance. At the same time, some competitors will be compelled to withdraw from the market or to concentrate on individual regions. In this context and also in view of its considerable knowledge of the market and products as well as its existing customer relations, there will be opportunities for HRE to write new business in conjunction with attractive margins.
- At present, a project is being carried out to unbundle the Deutsche Pfandbriefbank Group and the DEPFA Group. As a result of unbundling, it will be easier for

the two sub-groups to be separated, and it will be possible for them to be perceived as more independent entities on the market, thus improving the chances of reprivatization.

Risks

However, it is also possible that the net assets, financial position and results of operations might have to contend with problems. The extent of these potential problems is influenced particularly by the occurrence or non-occurrence of the following risks, or the extent to which such risks might materialise:

- FMSA reserves the right, due to considerations of competition neutrality, to impose a payment condition for the stabilisation measure; this must not exceed €1.59 billion. The European Commission has imposed in the aid proceeding that the payment condition has to be fixed in the full amount by FMSA. The payment condition might have a considerably negative impact on the financial position of HRE, but will not pose a threat to the continued existence of HRE as a going concern.
- Although there has been a certain improvement, the situation on some markets continues to be difficult and the macro-economic situation is uncertain. In consequence, it is possible that significant impairments may have to be recognised in relation to loans. These might affect real estate financing depending on the specific properties. In addition, high fiscal deficits mean that some countries might experience considerable refinancing problems, or might require external aid to obtain refinancing. It is possible that some countries might not be able to service their interest and repayment obligations. In such a case, also as a result of the consequent economic turmoil, it may be necessary to recognise considerable impairments in relation to securities or loans.
- The image of HRE has suffered in recent years. Even if success has now been achieved in returning to markets, it is still possible that there might be negative consequences for future business and customer relations. This means that HRE might not meet its new business targets with regard to lending and refinancing, and this in turn would have a negative impact on the development in assets, financial position and earnings.

- Litigation which is currently pending and litigation which might become pending in future might have a considerably negative impact on the results of HRE.
- HRE has initiated projects for optimising processes and its IT infrastructure. The corresponding costs will have an impact on general administrative expenses. Despite the projects, HRE is exposed to operational risks resulting from its restructuring, such as its reliance on key positions, technology risks due to the large number of accounting systems and a higher level of staff fluctuation. The risks might also become relevant for the service obligations assumed by HRE for the on going operation FMS Wertmanagement. These risks may result in considerable losses.
- In order to avoid future financial market crises, legislative authorities have also decided to impose additional charges and taxes. The measures which have already been adopted and any further tightening of such measures might result in problems for development in earnings.
- The further development of national and international regulatory requirements can have an effect on the structure of assets and liabilities and can therefore affect the development of income. For example, arising from the introduction of changed requirements from the Basel Committee on Banking Supervision (Basel III) the profitability could be negatively affected by higher liquidity or capital demands. In addition, regulatory and economic ratios which are already mandatory today can be affected. By this, for example, a higher capitalisation can be necessary.
- According to the EU rating act as per September 2009, external ratings for the purposes of the calculation of capital requirements can only be used in banks in the future if the respective rating agencies are registered in accordance with the EU rating act and are supervised by the responsible supervisors. If agencies prepare ratings outside of the EU the regulation in the third country must meet European standards. The registration process of the rating agencies Fitch Ratings, Moody's and Standard & Poor's as well as the check of the regulatory standards of several third countries are still ongoing. Negative effects on the financial situation of HRE can arise from a refusal of the registration or the absence of the approval of third-country regulations as a higher regulatory capital requirement could arise on certain positions.

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Consolidated Interim Financial Statements

Income Statement

Income/expenses	Note · Page	1.1.–30.6.2011	1.1.–30.6.2010	Change	
				in € million	in %
in € million					
Operating revenues		437	–15	452	>100.0
Net interest income and similar income	7 · 72	359	478	–119	–24.9
Interest income and similar income		2,816	4,672	–1,856	–39.7
Interest expenses and similar expenses		2,457	4,194	–1,737	–41.4
Net commission income	8 · 72	8	–198	206	>100.0
Commission income		23	56	–33	–58.9
Commission expenses		15	254	–239	–94.1
Net trading income	9 · 72	5	–278	283	>100.0
Net income from financial investments	10 · 72	–35	59	–94	<–100.0
Net income from hedge relationships	11 · 73	–21	–64	43	67.2
Balance of other operating income/expenses	12 · 73	121	–12	133	>100.0
Provisions for losses on loans and advances	13 · 73	–20	454	–474	<–100.0
General administrative expenses	14 · 73	242	252	–10	–4.0
Balance of other income/expenses	15 · 74	1	2	–1	–50.0
Pre-tax profit/loss		216	–719	935	>100.0
Taxes on income	16 · 74	53	–19	72	>100.0
Net income/loss		163	–700	863	>100.0

Statement of comprehensive income in € million	1.1.–30.6.2011			1.1.–30.6.2010		
	Before tax	Tax	Net of tax	Before tax	Tax	Net of tax
Net income/loss	216	53	163	-719	-19	-700
Additional paid-in capital	—	—	—	—	—	—
Retained earnings	2	—	2	8	—	8
Foreign currency reserve	-2	—	-2	2	—	2
AfS reserve	-16	-10	-6	-2,278	141	-2,419
Cash flow hedge reserve	-124	-28	-96	416	112	304
Total other income	-140	-38	-102	-1,852	253	-2,105
Total	76	15	61	-2,571	234	-2,805
attributable to:						
Equity holders (consolidated profit/loss from the parent company)	76	15	61	-2,571	234	-2,805
Non-controlling interest	—	—	—	—	—	—

Disclosure of components of comprehensive income in € million	1.1.–30.6.2011		1.1.–30.6.2010	
Net income/loss		163		-700
Additional paid-in capital		—		—
Unrealised gains/losses		—		—
Reclassification adjustments for gains/losses included in profit or loss		—		—
Retained earnings		2		8
Unrealised gains/losses		2		8
Reclassification adjustments for gains/losses included in profit or loss		—		—
Foreign currency reserve		-2		2
Unrealised gains/losses		-2		2
Reclassification adjustments for gains/losses included in profit or loss		—		—
AfS reserve		-6		-2,419
Unrealised gains/losses		-6		-2,420
Reclassification adjustments for gains/losses included in profit or loss		—		1
Cash flow hedge reserve		-96		304
Unrealised gains/losses		-96		304
Reclassification adjustments for gains/losses included in profit or loss		—		—
Total other income		-102		-2,105
Total		61		-2,805

Statement of Financial Position

Assets						
in € million	Note - Page	30.6.2011	31.12.2010	Change		31.12.2009
				in € million	in %	
Cash reserve		537	2,507	-1,970	-78.6	1,824
Trading assets	18 · 75	22,504	39,114	-16,610	-42.5	10,749
Loans and advances to other banks	19 · 75	20,435	32,614	-12,179	-37.3	23,731
Loans and advances to customers	20 · 75	121,273	175,724	-54,451	-31.0	127,354
Allowances for losses on loans and advances	22 · 76	-573	-661	88	13.3	-3,898
Financial investments	23 · 76	60,692	66,819	-6,127	-9.2	179,588
Property, plant and equipment		5	6	-1	-16.7	15
Intangible assets		45	49	-4	-8.2	44
Other assets	24 · 78	7,253	10,244	-2,991	-29.2	15,399
Income tax assets	25 · 78	1,662	1,703	-41	-2.4	4,870
Current tax assets		72	76	-4	-5.3	146
Deferred tax assets		1,590	1,627	-37	-2.3	4,724
Total assets		233,833	328,119	-94,286	-28.7	359,676

Equity and liabilities						
in € million	Note - Page	30.6.2011	31.12.2010	Change		31.12.2009
				in € million	in %	
Liabilities to other banks	26 · 79	55,404	101,382	-45,978	-45.4	137,349
Liabilities to customers	27 · 79	31,241	43,216	-11,975	-27.7	13,259
Liabilities evidenced by certificates	28 · 79	94,350	107,898	-13,548	-12.6	156,376
Trading liabilities	29 · 79	21,789	39,109	-17,320	-44.3	11,391
Provisions	30 · 79	313	313	—	—	249
Other liabilities	31 · 81	18,010	23,226	-5,216	-22.5	29,250
Income tax liabilities	32 · 81	1,673	1,714	-41	-2.4	3,976
Current tax liabilities		153	129	24	18.6	113
Deferred tax liabilities		1,520	1,585	-65	-4.1	3,863
Subordinated capital	33 · 81	3,239	3,508	-269	-7.7	3,217
Liabilities		266,019	320,366	-94,347	-29.4	355,067
Equity attributable to equity holders		5,678	5,617	61	1.1	2,567
Subscribed capital		2,668	2,668	—	—	3,649
Additional paid-in capital		8,091	8,091	—	—	8,351
Retained earnings		-5,168	-4,260	-908	-21.3	-4,339
Foreign currency reserve		-46	-44	-2	-4.5	-29
Revaluation reserve		-30	72	-102	<-100.0	-2,829
AfS reserve		-427	-421	-6	-1.4	-2,267
Cash flow hedge reserve		397	493	-96	-19.5	-562
Consolidated loss 1.1.–31.12.		—	-910	910	100.0	-2,236
Consolidated profit 1.1.–30.6.2011		163	—	163	>100.0	—
Non-controlling interest in equity		2,136	2,136	—	—	2,042
Hybrid capital instruments		1,137	1,137	—	—	1,043
Silent participation		999	999	—	—	999
Equity		7,814	7,753	61	0.8	4,609
Total equity and liabilities		233,833	328,119	-94,286	-28.7	359,676

Statement of changes in equity (condensed)	Equity attributable to equity holders										Non-controlling interest	Equity
	Subscribed capital	Additional paid-in capital	Retained earnings (incl. unappropriated net income)	Foreign currency reserve	Revaluation reserve			Consolidated profit/loss	Hybrid capital instruments	Silent participation	Amounts relating to disposal group	
					Afs reserve	Cash flow hedge reserve						
in € million												
Equity at 1.1.2010	3,649	8,351	-4,339	-29	-2,267	-562	-2,236	1,043	999	—	—	4,609
Capital increase	—	1,400	—	—	—	—	—	—	—	—	—	1,400
Transaction costs of capital measures	—	—	—	—	—	—	—	—	—	—	—	—
Capital decrease/ withdrawal	—	—	—	—	—	—	—	—	—	—	—	—
Treasury shares	—	—	—	—	—	—	—	—	—	—	—	—
Distribution	—	—	—	—	—	—	—	—	—	—	—	—
Total comprehensive income for the year	—	—	8	2	-2,419	304	-700	—	—	—	—	-2,805
Transfer to retained earnings	—	—	-2,236	—	—	—	2,236	—	—	—	—	—
Reclassification of hybrid capital instruments	—	—	—	—	3,874	206	—	—	—	-4,080	—	—
Equity at 30.6.2010	3,649	9,751	-6,567	-27	-812	-52	-700	1,043	999	-4,080	—	3,204
Equity at 1.1.2011	2,668	8,091	-4,260	-44	-421	493	-910	1,137	999	—	—	7,753
Capital increase	—	—	—	—	—	—	—	—	—	—	—	—
Transaction costs of capital measures	—	—	—	—	—	—	—	—	—	—	—	—
Capital decrease/ withdrawal	—	—	—	—	—	—	—	—	—	—	—	—
Treasury shares	—	—	—	—	—	—	—	—	—	—	—	—
Distribution	—	—	—	—	—	—	—	—	—	—	—	—
Total comprehensive income for the year	—	—	2	-2	-6	-96	163	—	—	—	—	61
Transfer to retained earnings	—	—	-910	—	—	—	910	—	—	—	—	—
Equity at 30.6.2011	2,668	8,091	-5,168	-46	-427	397	163	1,137	999	—	—	7,814

Statement of Cash Flows (condensed)

Statement of cash flows (condensed)		
in € million	2011	2010
Cash and cash equivalents at 1.1.	2.507	1,824
+/- Cash flow from operating activities	-7.605	-6,521
+/- Cash flow from investing activities	5.925	4,052
+/- Cash flow from financing activities	-273	1,206
+/- Effects of exchange rate changes and non-cash valuation changes	-17	-26
Cash and cash equivalents at 30.6.	537	535

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1 Principles

HRE Holding has prepared its consolidated interim financial statements for the period ended 30 June 2011 in line with EC ordinance No. 1606/2002 of the European Parliament and Council of 19 July 2002 in accordance with International Financial Reporting Standards (IFRS). These consolidated interim financial statements are based on the IFRS rules, which have been adopted in European Law by the European commission as part of the endorsement process; it is also based on the regulations of commercial law which are applicable in accordance with section 315 a (1) HGB (German Commercial Code). Due consideration has in particular been given to the requirements of IAS 34. With the exception of specific regulations relating to fair value hedge accounting for a portfolio hedge of interest risks in IAS 39 all mandatory IFRS rules have been completely endorsed by the EU. HRE does not apply this type of hedge accounting.

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

On 18 July 2011, the European Commission approved the governmental aid for HRE. This decision is described in detail in the section Events after 30 June 2011. With its positive decision, the European Commission has also accepted the viability of the business model of Deutsche Pfandbriefbank AG as a specialist bank for real estate finance and public sector investment finance. Hence, HRE is still preparing its consolidated financial statements under the going concern assumption.

The companies of the DEPFA sub-group will not conduct any new business until they are reprivatised. This is not applicable for measures carried out as part of bank, risk and refinancing management which is necessary for regulatory purposes and which has the aim of maintaining value and also within the framework of managing the cover funds. The complete reprivatisation of the DEPFA sub-group is a medium-term objective. Measures have already been initiated to sever the links between the entities of the DEPFA sub-group and the other companies of HRE.

Apart from the change explained in the following, the accounting policies applied in the first half of 2011 were the same as those applied in the consolidated financial statements for the period ending 31 December 2010. In accordance with IAS 8.14 (b), there has been a change in the way of recognising the bonds which were allocated to the IAS 39 measurement category loans and receivables. In the past, some of these bonds which were recognised as loans and receivables (LaR) were disclosed as loans and

advances to other banks and loans and advances to customers. In future, these holdings will be disclosed completely as financial assets. In accordance with IAS 8.19 (b), the change has been carried out retrospectively, which means that the previous year figures have been adjusted accordingly. Financial assets have increased by € 37.7 billion as of 31 December 2010 (31 December 2009: € 84.8 billion); loans and advances to other banks have declined by € 5.8 billion (31 December 2009: € 13.8 billion) and loans and advances to customers have declined by € 31.9 billion (31 December 2009: € 71.0 billion).

HRE shows profits or losses from the sale of receivables in net interest income. On the other hand, effects from the sale of financial assets are shown in the net income from financial investments. As a result of the LaR bonds being reclassified under financial assets (whereas they had previously been shown under receivables), it is also necessary to adjust the way in which profits and losses from the sale of such positions are reported. These effects are therefore no longer shown in net interest income, and have to be shown in net income from financial investments.

The sale of LaR bonds in 2010 resulted in net income of € 75 million shown in net interest income; of this figure, € 61 million was generated in the first half of 2010. The net income from financial investments for 2010 has thus improved by € 61 million to the detriment of net interest income. HRE has retrospectively adjusted the figures in accordance with IAS 8.14 (b).

IFRS and interpretations applied for the first time The following standards and interpretations, respectively their amendments, have to be adopted for this consolidated interim financial statement:

- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments
- Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues
- Amendment to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters
- Amendment to IFRIC 14 Prepayments of a Minimum Funding Requirements
- Annual Improvements to IFRSs 2010

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments clarifies the accounting when an entity issues shares or other equity instruments to extinguish all or parts of a financial liability. There have not been any impacts on HRE from this.

The Amendment to IAS 32 Financial Instruments: Presentation on Classification of Rights Issues addresses the issuer's accounting for rights, options and warrants to acquire a fixed number of own equity instruments that are denominated in a currency other than the functional currency of the issuer. As HRE has not issued any such rights, at the moment the amendment will not have any impact on the Group.

Amendment to IFRS 1 Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters clarifies comparative disclosures relating financial instruments for IFRS first-time adopters. Because HRE is not a first-time adopter of IFRS there were no impacts.

Amendment to IFRIC 14 Prepayments of Minimum Funding Requirements concerns accounting requirements of pension plans. The amendment is applicable if an entity supplies prepayments to meet the minimum funding requirements regarding its pension plan. Because this is not the case for the pension plans of HRE, there will not be any impacts on the Group.

In the course of the project Business Combination Phase II the following standards and interpretations were amended and were combined in Annual Improvements to IFRSs 2010:

- IFRS 3 (revised) Business Combinations
- IAS 27 (revised) Consolidated and Separate Financial Statements
- IAS 21 The Effects of Changes in Foreign Exchange Rates
- IAS 28 Investment in Associates
- IAS 31 Interests in Joint Ventures

Additionally, Annual Improvements to IFRSs 2010 comprises the amendments of the following standards and interpretations:

- IFRS 1 First-time Adoption of International Financial Reporting Standards
- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Presentation of Financial Statements
- IAS 34 Interim Financial Reporting
- IFRIC 13 Customer Loyalty Programmes

The majority of the amendments are applicable for financial years beginning on or after 1 January 2011. Annual Improvements to IFRSs 2010 do not have material impacts in HRE. The amendment to IAS 34 Interim Financial Reporting is an exemption which will result in extended financial instruments disclosures in the consolidated interim financial statements of HRE.

Published but not mandatory applicable standards and interpretations In May 2011 IASB published the following new standards, which are not mandatory applicable:

- IFRS 10 Consolidated Financial Statements
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosure of Interests in Other Entities, and amended the following standards:
 - IAS 27 Separate Financial Statements
 - IAS 28 Investments in Associates

IFRS 10 Consolidated Financial Statements supersedes the guidance regarding control and consolidation included IAS 27 Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities. IAS 27 is renamed in Separate Financial Statements and includes solely the guidance regarding separate financial statements. In IFRS 10 the determination of control is enhanced by a broad guidance which demonstrates multiple forms of how a reporting entity can control another entity. The new standard has to be applied for financial years beginning on or after 1 January 2013. Material changes due to applying IFRS 10 are not expected for the accounting of HRE in its current group structure.

The standard IFRS 11 Joint Arrangement defines joint operations and joint ventures as joint arrangements. The previous option to apply proportional consolidation method for entities under joint control is abolished. A joint venturer of a joint venture has to apply mandatory the equity method in accordance with the amended IAS 28. The new standard has to be applied for financial years beginning on or after 1 January 2013. Currently, HRE does not have material joint arrangements. Impacts on HRE will depend on joint arrangements in the future.

IFRS 12 Disclosure of Interests in Other Entities expands the disclosure requirements concerning the nature, risks and financial implications of an entity's investment in subsidiaries, associates, joint arrangements and non-consolidated special purpose entities. The new standard has to be applied for financial years beginning on or after 1 January 2013. Due to the requirements of IFRS 12, HRE will probably extend disclosures regarding its interests in other entities.

Furthermore, the IASB published in May 2011 IFRS 13 Fair Value Measurement. Material requirements of IFRS 13 concern the definition of fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent market participants (exit price). In consequence, the fair value of a liability would represent the default risk, i.e. the own credit risk. For measuring financial instruments applying bid price, respectively asking price, if these prices represent the fair value in the best way. IFRS 13 expands the disclosure requirements regarding the fair value hierarchy. These additional disclosures are similar to the disclosures of IFRS 7 Financial Instruments: Disclosures, but they are required not only for financial instruments but also for all assets and liabilities. IFRS 13 is applicable to financial years beginning on or after 1 January 2013. The stand-

ard is applicable prospectively. In particular, the amendments of the currently applicable fair value measurement methods, for example considering the bid price, respectively the asking price, and including the own credit risk, may result in material impacts on HRE.

In June 2011 the IASB published the Amendment to IAS 1: Presentation of Financial Statements and the Amendment to IAS 19: Employee Benefits.

Pursuant to the Amendment to IAS 1, positions of other comprehensive income have to be grouped whether or not they could be recycled into the income statement – including subtotals for both groups. Amendment to IAS 1 is applicable for periods beginning on or after 1 July 2012. HRE will adjust its disclosures accordingly.

The prohibition of the corridor approach of recognising actuarial gains or losses is a material amendment to IAS 19. Such effects have to be recognised directly in equity. Past service costs have to be recognised in the period of the plan changes instead of allocating the expenses over the period until the benefits become vested. The interest rate for discounting the defined benefit obligation is also used for the expected return on plan assets. In addition, sensitivity analysis of pension plans and the average duration of the defined benefit obligation have to be disclosed in the notes. Furthermore, the treatment of settlements in connection with post-employment benefits is amended by IAS 19. The amendments to IAS 19 will generally have impacts on employee benefits accounting and disclosure of HRE. In particular, the cancellation of the corridor approach will increase equity volatility and will change the measurement of plan asset income. Besides, the disclosures in the notes will have to be extended. The amendments to IAS 19 are applicable for periods beginning on or after 1 January 2013.

2 Consolidation

The Annual Report 2010 contains a list of all consolidated and non-consolidated holdings of HRE disclosed on pages 162 to 164.

There were no changes in the group of consolidated companies compared to the Annual Report 2010.

3 Transfer of Positions to FMS Wertmanagement

With economical effect from 1 October 2010, HRE transferred positions to FMS Wertmanagement, which was established on 8 July 2010. The positions had been transferred at the respective carrying amount of the transferred company in line with the accounting regulations which were applicable for the separate financial statements of the respective company. The amount of the compensation claims which HRE received from FMS Wertmanagement was calculated as the difference between the carrying amount of the assets transferred by the respective companies and the transferred liabilities.

The transfer has resulted in the derecognition of non-derivative assets with an IFRS value of €173.2 billion, provisions for losses on loans and advances of €3.0 billion, derivatives of €11.6 billion and (previously HRE-internal) refinancing of €76.1 billion. The effects which reduced total assets were partially compensated for by opposite effects. These amounted to €217.5 billion as of 30 September 2010, €173.9 billion as of 31 December 2010 and €93.1 billion as of 30 June 2011. The opposite effects are attributable to synthetically transferred positions, for instance in the form of back-to-back derivatives, or the performance of refinancing functions for FMS Wertmanagement, for instance in the form of reverse repos.

4 Notes to Segment Reporting by Operating Segment

HRE operates in the three operating segments Public Sector Finance, Real Estate Finance and Value Portfolio, which are used as the basis for managing the Group.

The presentation of the segments of HRE is based on internal reporting which is prepared in accordance with IFRS. Income and expenses are allocated to the segments in line with the principle of causation. The external net interest income of the Group is allocated to the segments.

Public Sector Finance (PSF) The operating segment Public Sector Finance comprises the financing arrangements for the public sector which are eligible as cover funds in accordance with German law. New business will focus on the primary markets, i.e. direct financing of public sector corporations with a conservative refinancing strategy, concentrating on public investment finance. The target group of these activities are profitable customer segments with a commensurate risk level: regions, cities and municipalities as well as state guaranteed public corporations and guaranteed public private partnerships.

Real Estate Finance (REF) The operating segment Real Estate Finance comprises all commercial real estate financing arrangements of the Group. New business focuses on financing existing properties with a conservative refinancing strategy for professional investors. Adequate batch sizes and loan-to-values commensurate for the level of risk involved are essential for independent operations. Strategic partnerships are agreed with other institutions with the aim of permitting higher loan-to-values and larger volumes for customers by means of syndications and syndicate financing arrangements.

Value Portfolio (VP) The operating segment Value Portfolio comprises non-strategic portfolios of HRE. It comprises all assets and liabilities of the DEPFA sub-group. In addition, the segment mainly comprises positions in connection with the transfer of positions to FMS Wertmanagement and the income and expenses attributable to the servicing of FMS Wertmanagement.

The **Consolidation & Adjustments** column is used to reconcile the total segment results with the consolidated results. In addition to consolidations, this item comprises certain expenses and income which cannot be allocated to the respective operating segments.

The cost-income ratio is the ratio between general administrative expenses and operating revenues, consisting of net interest income and similar income, net commission income, net trading income, net income from financial investments, net income from hedge relationships and the balance of other operating income/expenses.

5 Income Statement and Balance-sheet-related Measures, Broken Down by Operating Segment

In the first half of 2011 the composition of the segments was adjusted. The adjustment mainly resulted from issues which arose or ceased due to the newly implemented steering after the transfer of positions to FMS Wertmanagement. According to IFRS 8.30 the disclosure is made on the basis of the former and the new segment composition.

Income/expenses						
in € million		PSF	REF	VP	Consolidation & Adjustments	HRE
Operating revenues	1.1.–30.6.2011	44	144	254	-5	437
	1.1.–30.6.2011 ³⁾	35	146	274	-18	437
	1.1.–30.6.2010	44	258	-257	-60	-15
Net interest income and similar income	1.1.–30.6.2011	57	121	155	26	359
	1.1.–30.6.2011 ³⁾	40	127	166	26	359
	1.1.–30.6.2010	50	303	133	-8	478
Net commission income	1.1.–30.6.2011	-2	22	-12	-	8
	1.1.–30.6.2011 ³⁾	-2	22	-12	-	8
	1.1.–30.6.2010	-3	42	-237	-	-198
Net trading income	1.1.–30.6.2011	3	1	10	-9	5
	1.1.–30.6.2011 ³⁾	-8	-1	19	-5	5
	1.1.–30.6.2010	8	-79	-207	-	-278
Net income from financial investments	1.1.–30.6.2011	3	-	-38	-	-35
	1.1.–30.6.2011 ³⁾	3	-	-38	-	-35
	1.1.–30.6.2010	-11	-4	74	-	59
Net income from hedge relationships	1.1.–30.6.2011	-25	-2	7	-1	-21
	1.1.–30.6.2011 ³⁾	-	-	7	-28	-21
	1.1.–30.6.2010	-	-	-29	-35	-64
Balance of other operating income/expenses	1.1.–30.6.2011	8	2	132	-21	121
	1.1.–30.6.2011 ³⁾	2	-2	132	-11	121
	1.1.–30.6.2010	-	-4	9	-17	-12
Provisions for losses on loans and advances	1.1.–30.6.2011	-	11	-31	-	-20
	1.1.–30.6.2011 ³⁾	-	11	-31	-	-20
	1.1.–30.6.2010	5	395	54	-	454
General administrative expenses	1.1.–30.6.2011	33	72	128	9	242
	1.1.–30.6.2011 ³⁾	39	73	121	9	242
	1.1.–30.6.2010	29	94	82	47	252
Balance of other income/expenses	1.1.–30.6.2011	-	-	1	-	1
	1.1.–30.6.2011 ³⁾	-	-	1	-	1
	1.1.–30.6.2010	-	-	1	1	2
Pre-tax profit	1.1.–30.6.2011	11	61	158	-14	216
	1.1.–30.6.2011 ³⁾	-4	62	185	-27	216
	1.1.–30.6.2010	10	-231	-392	-106	-719

³⁾ Former segment structure

Key ratio						
in %		PSF	REF	VP	HRE	
Cost-income ratio	1.1.–30.6.2011	75.0	50.0	50.4	55.3	
	1.1.–30.6.2010	65.9	36.4	> 100.0	> 100.0	

The Management Board controls balance-sheet-related measures by operating segments based on risk-weighted assets and on financing volumes. Financing volumes are the notional amounts of the drawn parts of granted loans and parts of the securities portfolio.

Balance-sheet-related measures, broken down by operating segments						
in € billion		PSF	REF	VP	Consolidation & Adjustments	HRE
Equity ¹⁾	30.6.2011	0.3	1.2	0.7	5.6	7.8
	31.12.2010	0.3	1.3	0.8	5.3	7.7
Risk-weighted assets ²⁾	30.6.2011	3.1	9.9	5.1	—	18.1
	31.12.2010	2.6	11.9	5.9	—	20.4
Finance volume	30.6.2011	48.2	25.6	52.5	—	126.3
	31.12.2010	52.3	26.7	57.5	—	136.5

¹⁾ Excluding revaluation reserve

²⁾ Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; according to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach; pro forma as per prepared annual financial statements and after result distribution

6 Breakdown of Operating Revenues

Operating revenues by products		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Public sector financings	44	– 83
Real estate financings	144	258
Other products	249	– 190
Total	437	– 15

Notes to the Income Statement

7 Net Interest Income and Similar Income

Net interest income and similar income broken down by categories of income/ expenses		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Interest income and similar income	2,816	4,672
Lending and money-market business	2,208	3,242
Fixed-income securities and government-inscribed debt	608	1,430
Interest expenses and similar expenses	2,457	4,194
Deposits	998	1,105
Liabilities evidenced by certificates	1,761	2,423
Subordinated capital	70	75
Current result from swap transactions (balance of interest income and interest expenses)	-372	591
Total	359	478

Total interest income for financial assets that are not at fair value through profit or loss amount to €2.8 billion (1.1.–30.6.2010: €4.7 billion). Total interest expenses for financial liabilities that are not at fair value through profit or loss amount to €2.8 billion (1.1.–30.6.2010: €3.6 billion).

Net interest income and similar income includes income of €6 million (1.1.–30.6.2010: €54 million) due to the increase in the present value of the adjusted allowances resulting over a period of time and an expense of €-8 million (1.1.–30.6.2010: €-8 million) due to the increase in the present value of the adjusted liabilities over a period of time.

Furthermore, the position contains a positive effect attributable to profits of €158 million from liabilities which were redeemed before maturity as a result of customer wishes and for market management purposes (1.1.–30.6.2010: €2 million).

8 Net Commission Income

Net commission income		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Securities and custodial services	-2	-5
Lending operations and other service operations	10	-193
thereof: Expenses of the liquidity support	-	-239
Total	8	-198

Net commission income is attributable exclusively to financial assets and financial liabilities which are not designated at fair value through profit or loss.

9 Net Trading Income

Net trading income		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
From interest rate instruments and related derivatives	8	-178
From credit risk instruments and related derivatives	-5	-82
From foreign exchange trading interest	2	-18
Total	5	-278

10 Net Income from Financial Investments

Net income from financial investments		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Income from financial investments	29	118
Expenses from financial investments	64	59
Total	-35	59

Based on valuation categories, net income from financial investments is broken down as follows:

Net income from financial investments by IAS 39 categories		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Held-to-maturity financial investments	-	-
Available-for-sale financial investments	-34	-1
Loans-and-receivables financial investments	-1	60
Total	-35	59

11 Net Income from Hedge Relationships

Net income from hedge relationships		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Result from fair value hedge accounting	—	–10
Result from hedged items	573	5,810
Result from hedging instruments	–573	–5,820
Result from dFVTPL investments and related derivatives	–21	–52
Result from dFVTPL investments	–95	105
Result from derivatives related to dFVTPL investments	74	–157
Ineffectiveness from cash flow hedge accounting affecting income	—	–2
Total	–21	–64

12 Balance of Other Operating Income/Expenses

Balance of other operating income/expenses		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Other operating income	150	9
Other operating expenses	29	21
Balance of other operating income/expenses	121	–12

Other operating income comprises mainly an income from services for the ongoing operations of FMS Wertmanagement of €107 million (1.1.–30.6.2010: €0 million). This income has compensated the correspond increase in general administrative expenses. Currency translation (in particular US dollar) also resulted in income of €18 million (1.1.–30.6.2010: €–11 million). The largest individual amounts of other operating expenses are expenses for compensation of claims regarding derivatives with FMS Wertmanagement amounting to €–6 million (1.1.–30.6.2010: €0 million).

13 Provisions for Losses on Loans and Advances

Provisions for losses on loans and advances		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Provisions for losses on loans and advances	–19	455
Additions	40	568
Releases	–59	–113
Provisions for contingent liabilities and other commitments	—	—
Additions	—	—
Releases	—	—
Recoveries from write-offs of loans and advances	–1	–1
Total	20	454

The development of individual allowances on loans and advances as well as portfolio-based allowances is shown in the note allowances for losses on loans and advances.

14 General Administrative Expenses

General administrative expenses		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Personnel expenses	98	81
Wages and salaries	78	57
Social security costs	12	15
Pension expenses and related employee benefit costs	8	9
Other general administrative expenses	135	160
Consulting expenses	29	48
IT expenses	60	72
Office and operating expenses	11	14
Other administrative expenses	35	26
Depreciation/amortisation	9	11
on software and other intangible assets excluding goodwill	8	8
on property, plant and equipment	1	3
Total	242	252

Cost-income ratio		
in %	1.1.–30.6.2011	1.1.–30.6.2010
Cost-income ratio	55.3	>100.0

15 Balance of Other Income/Expenses

Balance of other income/expenses		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Other income	2	13
thereof:		
Releases of restructuring provisions	2	13
Other expenses	1	11
thereof:		
Additions to restructuring provisions	1	11
Balance of other income/expenses	1	2

16 Taxes on Income

Breakdown		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Current taxes	46	7
Deferred taxes	7	-26
thereof:		
Deferred taxes on capitalised losses carried forward	-21	—
Total	53	-19

17 Net Gains/Net Losses

The income statement contains the following income-statement-related net gains/net losses according to IFRS 7.20 (a):

Net gains/net losses		
in € million	1.1.–30.6.2011	1.1.–30.6.2010
Loans and receivables	21	-389
Held to maturity	—	—
Available for sale	-34	-1
Held for trading	5	-278
Designated at fair value through P&L	-21	-52
Financial liabilities at amortised cost	158	2

Notes to the Balance Sheet (Assets)

18 Trading Assets

Trading assets	30.6.2011	31.12.2010
in € million		
Debt securities and other fixed-income securities	33	40
Positive fair values from derivative financial instruments	425	772
Stand-alone derivatives (bank book)	22,046	38,302
Total	22,504	39,114

20 Loans and Advances to Customers

Loans and advances to customers, broken down by type of business	30.6.2011	31.12.2010
in € million		
Loans and advances	72,743	78,322
Public sector loans	37,981	40,107
Real estate loans	32,688	35,942
Other loans and advances	2,074	2,273
Investments	48,530	97,402
Total	121,273	175,724

19 Loans and Advances to Other Banks

Loans and advances to other banks, broken down by type of business	30.6.2011	31.12.2010
in € million		
Loans and advances	18,728	29,499
Public sector loans	6,560	9,550
Real estate loans	17	29
Other loans and advances	12,151	19,920
Investments	1,707	3,115
Total	20,435	32,614

Loans and advances to customers, broken down by maturities	30.6.2011	31.12.2010
in € million		
Unspecified terms	21	—
With agreed maturities	121,252	175,724
Up to 3 months	49,260	98,577
From 3 months to 1 year	6,218	5,052
From 1 year to 5 years	29,151	33,528
From 5 years and over	36,623	38,567
Total	121,273	175,724

Loans and advances to other banks, broken down by maturities	30.6.2011	31.12.2010
in € million		
Repayable on demand	8,499	17,408
With agreed maturities	11,936	15,206
Up to 3 months	6,185	3,821
From 3 months to 1 year	652	963
From 1 year to 5 years	3,265	4,074
From 5 years and over	1,834	6,348
Total	20,435	32,614

21 Volume of Lending

Volume of lending	30.6.2011	31.12.2010
in € million		
Loans and advances to other banks	18,728	29,499
Loans and advances to customers	72,743	78,322
Contingent liabilities	124	196
Total	91,595	108,017

22 Allowances for Losses on Loans and Advances

Development			
in € million	Individual allowances on loans and advances	Portfolio-based allowances	Total
Balance at 1.1.2010	3,072	826	3,898
Changes affecting income	420	-73	347
Gross additions	762	79	841
Releases	-263	-151	-414
Increase of the present value due to passage of time (unwinding)	-79	—	-79
Release model reserve	—	-1	-1
Changes not affecting income	-3,015	-569	-3,584
Use of existing loan-loss allowances	-705	-1	-706
Effects of currency translations and other changes not affecting income	123	-2	121
Change due to transfer to FMS Wertmanagement	-2,433	-566	-2,999
Balance at 31.12.2010	477	184	661
Balance at 1.1.2011	477	184	661
Changes affecting income	-9	-16	-25
Gross additions	25	15	40
Releases	-28	-31	-59
Increase of the present value due to passage of time (unwinding)	-6	—	-6
Release model reserve	—	—	—
Changes not affecting income	-50	-13	-63
Use of existing loan-loss allowances	-59	-13	-72
Effects of currency translations and other changes not affecting income	9	—	9
Change due to transfer to FMS Wertmanagement	—	—	—
Balance at 30.6.2011	418	155	573

The allowances for losses on loans and advances were exclusively created for the measurement category loans and receivables.

23 Financial Investments

Breakdown		
in € million	30.6.2011	31.12.2010
AfS financial investments	2,932	2,403
Shares in non-consolidated subsidiaries	2	2
Participating interests	1	1
Debt securities and other fixed-income securities	2,926	2,397
Equity securities and other variable-yield securities	3	3
dFVTPL financial investments	3,478	3,722
Debt securities and other fixed-income securities	3,478	3,722
LaR financial investments	54,282	60,694
Debt securities and other fixed-income securities	54,282	60,694
Total	60,692	66,819

The carrying amounts of the LaR financial investments were reduced by portfolio-based allowances amounting to €6 million (31 December 2010: €5 million).

The dFVTPL financial investments comprise securities issued by the Republic of Portugal with a carrying amount of €69 million and a nominal value of €105 million.

Financial investments, broken down by maturities		
in € million	30.6.2011	31.12.2010
Unspecified terms	1,425	6
With agreed maturities	59,267	66,813
Up to 3 months	1,889	5,944
From 3 months to 1 year	4,289	6,963
From 1 year to 5 years	18,939	16,007
From 5 years and over	34,150	37,899
Total	60,692	66,819

HRE has made use of the IASB amendments to IAS 39 and IFRS 7, published on 13 October 2008, and reclassified financial assets. The Group identified assets, eligible under the amendments, for which at the reclassification date it had a clear change of intent to hold for the foreseeable future rather than to exit or trade in the short term and which had met the definition of loans and receivables according to IAS 39 (amongst others not quoted in an active market). The reclassified portfolios are disclosed under financial investments.

On 30 September 2008, HRE reclassified retrospectively as of 1 July 2008 trading assets out of the category held-for-trading amounting to €3.5 billion and financial investments out of the category available-for-sale of €76.1 billion. In addition, trading assets of €0.7 billion were reclassified prospectively into financial investments of the category loans and receivables on 1 October 2008.

At the date of reclassification the effective interest rate for the trading assets was between 1.3 % and 21.9 %. For AfS assets the interest rate was between 0.25 % and 34.4 %.

Since the date of reclassification, financial assets with a (reclassified) carrying amount of around €14.5 billion became due. Thereof €12.7 billion are reclassified AfS financial investments and €1.7 billion are reclassified trading assets.

In the first half of 2011 securities with a reclassified carrying amount of €0.5 billion (2010: €1.0 billion) were sold due to the decided reduction of portfolios. Thereby a net gain of €5 million (2010: net gain of €2 million) was realised.

Interest income for reclassified trading instruments is now shown under net interest income; before reclassification interest income was shown in net trading income. In the first half of 2011, net interest income contains €7 million (2010: €87 million) of interest income for reclassified trading instruments. The reclassification of AfS assets did not cause a disclosure change of current interest income as it is still shown under net interest income.

The following table summarises the carrying amounts and fair values as of 30 June 2011 as well as fair value gains and losses that would have been recognised in the first half of 2011 if the financial assets had not been reclassified.

Reclassifications 2011	into: Financial investment loans and receivables (LaR)			Effect in reporting period if no assets would have been reclassified (1.1.–30.6.2011)	
	30.6.2011			Income statement in € million	AfS reserve (after taxes) in € million
	Date	Carrying amount in € billion	Fair value in € billion		
out of:	1.7.2008	—	—	—	
Trading assets held for trading (HfT)	1.10.2008	0.2	0.2	–3	
out of:					
Financial investments available for sale (AFS)	1.7.2008	20.7	20.0	—	658
Total		20.9	20.2		

Reclassifications 2010	into: Financial investment loans and receivables (LaR)			Effect in reporting period if no assets would have been reclassified (1.1.–31.12.2010)	
	31.12.2010			Income statement in € million	AfS reserve (after taxes) in € million
	Date	Carrying amount in € billion	Fair value in € billion		
out of:	1.7.2008	—	—	—	
Trading assets held for trading (HfT)	1.10.2008	0.3	0.3	–6	
out of:					
Financial investments available for sale (AFS)	1.7.2008	22.0	21.3	–16	–26
Total		22.3	21.6		

24 Other Assets

Other assets	30.6.2011	31.12.2010
in € million		
Positive fair values from derivative financial instruments	6,837	8,904
Hedging derivatives	6,612	8,633
Micro fair value hedge	5,963	7,656
Cash flow hedge	649	977
Derivatives hedging dFVTPL financial instruments	225	271
Salvage acquisitions	83	85
Other assets	278	1,203
Deferred charges and prepaid expenses	55	52
Total	7,253	10,244

25 Income Tax Assets

Income tax assets	30.6.2011	31.12.2010
in € million		
Current tax assets	72	76
Deferred tax assets	1,590	1,627
Total	1,662	1,703

Notes to the Balance Sheet (Equity and Liabilities)

26 Liabilities to Other Banks

Liabilities to other banks by maturities		
in € million	30.6.2011	31.12.2010
Repayable on demand	631	377
With agreed maturities	54,773	101,005
Up to 3 months	49,998	95,240
From 3 months to 1 year	2,631	1,400
From 1 year to 5 years	1,215	2,916
From 5 years and over	929	1,449
Total	55,404	101,382

29 Trading Liabilities

Trading liabilities		
in € million	30.6.2011	31.12.2010
Negative fair values from derivative financial instruments	398	763
Interest-based and foreign-currency-based transactions	352	634
Credit-related transactions	46	129
Other trading liabilities	124	230
Stand-alone derivatives (bank book)	21,267	38,116
Total	21,789	39,109

27 Liabilities to Customers

Liabilities to customers by maturities		
in € million	30.6.2011	31.12.2010
Repayable on demand	9,923	3,464
With agreed maturities	21,318	39,752
Up to 3 months	582	1,525
From 3 months to 1 year	979	1,594
From 1 year to 5 years	4,515	4,914
From 5 years and over	15,242	31,719
Total	31,241	43,216

30 Provisions

Breakdown		
in € million	30.6.2011	31.12.2010
Provisions for pensions and similar obligations	3	3
Restructuring provisions	150	161
Provisions for contingent liabilities and other commitments	34	34
Other provisions	126	115
thereof:		
Long-term liabilities to employees	3	3
Total	313	313

28 Liabilities Evidenced by Certificates

Liabilities evidenced by certificates, broken down by maturities		
in € million	30.6.2011	31.12.2010
With agreed maturities		
Up to 3 months	5,315	5,188
From 3 months to 1 year	10,612	11,954
From 1 year to 5 years	34,181	42,608
From 5 years and over	44,242	48,148
Total	94,350	107,898

As of 1 January 2005, HRE took out reinsurance which is classified as a “qualifying insurance policy” under IAS 19 to protect itself against parts of the risks arising from the defined-benefit pension commitments. The expected return of the plan assets has been calculated by employing the long-term risk-free interest rate in accordance with the investment strategy of the plan assets.

Legal and Arbitration Proceedings As a result of the nature and global scope of its activities, HRE is involved in court, arbitration and regulatory proceedings in numerous countries. For the uncertain liabilities arising from these proceedings, HRE creates provisions if the potential outflow of resources is sufficiently likely and if it is possible for the extent of the obligation to be estimated. The probability of the outflow of resources depends to a considerable extent on the outcome of the proceedings, which, however, normally cannot be estimated with any certainty. The assessment of probability and the quantification of the uncertain liability essentially depend on estimates. The actual liability may differ considerably from this estimate. With regard to the accounting treatment of the individual cases, the Group relies on its own expertise, appraisals prepared by external advisors, in particular legal advisors, developments in the individual proceedings as well as developments in equivalent proceedings, experience within the Group and also the experience of third parties in equivalent cases, depending on the importance and difficulty of the specific case.

The investigations of the public prosecutor against former members of the Management Board have not yet been completed. It is possible that fines will be imposed against HRE Holding in this respect.

Claims are being enforced on the grounds of alleged misinformation particularly in connection with the CDO impairment requirement and the ad hoc release of 15 January 2008 on the one hand as well as the liquidity situation of DEPPFA Bank plc on the other. Overall, 231 legal actions with a total value in dispute of around €945 million are pending against HRE Holding as of the reporting date. The 105 conciliation proceedings which have so far been initiated, with a total value in dispute of around €29 million, will probably also be converted into legal proceedings. Overall, this results in a value in dispute of around €974 million as of the reporting date. So far, there has been a judgement of the first instance only in one case, in which the plaintiff was awarded around 40% of the original claim. An appeal has been lodged against this verdict. The Landgericht München I has since issued a court order to the OLG München for initiating an investor test case.

Three legal actions are currently pending in connection with the termination of the service agreements of former members of the Management Board. Frank Lamby and Dr. Markus Fell have taken legal action with regard to their compensation for January 2009, and Georg Funke has taken legal action for his compensation for the months of January and February 2009. Georg Funke and Dr. Markus Fell have each taken legal action to establish that the immediate termination of their employment agreement was ineffective. Georg Funke has also taken legal action to establish that the revocation of his retirement pension commitment is ineffective. By way of a reserved judgement, the Landgericht München I ordered the Company to pay the compensation for January and February 2009 (Georg Funke) or January 2009 (Dr. Markus Fell).

With its adjudication of 27 January 2011, the court ordered the preparation of an expert appraisal in order to determine whether any obligations had been violated.

Six actions for annulment have been initiated against the resolutions adopted at the extraordinary general meeting of 2 June 2009. Based on the progress of the process so far, the Company is assuming that the legal action will be rejected in the first instance.

Thirty-nine former minority shareholders originally initiated legal action against the squeeze-out of minority shareholders adopted at the extraordinary general meeting of 5 October 2009. With its judgement of 20 January 2011, the court rejected the actions of all plaintiffs as unfounded. Appeals were lodged by six plaintiffs. The Court of Appeal will probably reject the appeals.

In March 2009, a credit broker who previously had been acting for Deutsche Pfandbriefbank in France initiated legal action against Deutsche Pfandbriefbank at the Landgericht Stuttgart, claiming damages of at least €20 million due to the suspension of the cooperation contract.

On 26 February 2010, Kommunale Wasserwerke Leipzig GmbH (KWL) initiated legal action against DEPPFA Bank plc at the Landgericht Leipzig. The legal action aims to establish that credit-default-swap transactions with KWL from 2007 are null and void. It is alleged that the former managing directors of KWL exceeded their powers in concluding the transactions. The alleged damages are specified as approx. €116 million in the legal action.

HRE Holding as the legal successor of DIA GmbH following the merger of DIA GmbH (transferring entity) into HRE Holding (absorbing entity) on 10 March 2004, is the defendant in judicial appraisal proceedings (Spruchverfahren) filed regarding the squeeze-out of minority shareholders of Hypo Real Estate Bank AG, which was entered into the commercial register in Munich on 3 September 2003. A new assessment ordered by the court leads to an increase of the cash compensation of €4.41 per share.

The decision of the Management Board not to pay any discretionary variable compensation for the year 2008 has since resulted in several labour court proceedings with staff in Germany which are either pending or which have been threatened. Legal verdicts of the labour courts and the State Labour Courts in Munich and Baden-Württemberg are not consistent, which means that legal action in relation to bonus payments for 2008 has in certain cases been completely rejected, although in certain cases such action has been partially allowed.

31 Other Liabilities

Other liabilities	30.6.2011	31.12.2010
in € million		
Negative fair values from derivative financial instruments	7,375	8,504
Hedging derivatives	7,279	8,444
Micro fair value hedge	6,790	7,729
Cash flow hedge	489	715
Derivatives hedging dFVTPL financial instruments	96	60
Other liabilities	10,584	14,668
Deferred income	51	54
Total	18,010	23,226

32 Income Tax Liabilities

Income tax liabilities	30.6.2011	31.12.2010
in € million		
Current tax liabilities	153	129
Deferred tax liabilities	1,520	1,585
Total	1,673	1,714

33 Subordinated Capital

Breakdown	30.6.2011	31.12.2010
in € million		
Subordinated liabilities	2,945	3,222
Participating certificates outstanding	16	15
Hybrid capital instruments	278	271
Total	3,239	3,508

Subordinated capital, broken down by maturities	30.6.2011	31.12.2010
in € million		
With agreed maturities		
Up to 3 months	53	204
From 3 months to 1 year	43	113
From 1 year to 5 years	2,174	1,701
From 5 years and over	969	1,490
Total	3,239	3,508

Notes to the Financial Instruments

34 Fair Values of Financial Instruments

The recognised fair values of financial instruments according to IFRS 7 correspond to the amounts at which, in the opinion of HRE, an asset could be exchanged on the balance sheet date between willing, competent business partners or the amount at which a liability could be settled between such business partners.

HRE classifies all assets and liabilities measured at fair value in the three levels of the fair value hierarchy. This three-level hierarchy is based on the observability of the measurement parameters:

- Level 1 – market prices (unadjusted) listed in active markets for identical assets or liabilities
- Level 2 – measurement procedures using directly or indirectly observable market-based parameters which, however, are not considered to be listed prices of level 1
- Level 3 – measurement procedures which are not based on observable market data (non-observable parameters)

In the first half of 2011, a minor volume of financial instruments has been reclassified between the levels of the fair value hierarchy. Major reclassifications of financial instruments (€47 million) took place in the previous year from level 1 to level 2. In addition, financial assets of €2,576 million and financial liabilities of €253 million were reclassified from other levels to level 3. The previous year only saw major reclassifications from level 3 in the case of financial liabilities of €28 million.

In the first half of 2011, there was an initial increase in the level of medium- to long-term interest rates on the market, but they fell back somewhat in the second quarter of 2011. Credit spreads have been mixed. Whereas credit spreads for countries which are the focus of attention have widened further, the credit spreads of some European core countries have narrowed slightly. These factors have had the following impact on the fair values of HRE:

Fair values of financial instruments	30.6.2011		31.12.2010	
	Carrying amounts	Fair value	Carrying amounts	Fair value
in € million				
Assets	231,705	227,773	325,021	320,639
Cash reserve	537	537	2,507	2,507
Trading assets (HfT)	22,504	22,504	39,114	39,114
Loans and advances to other banks ¹⁾	20,404	20,329	32,578	32,504
Category LaR	20,404	20,329	32,578	32,504
Loans and advances to customers ¹⁾	120,731	119,421	175,099	173,880
Category LaR	120,731	119,421	175,099	173,880
Financial investments	60,692	58,145	66,819	63,730
Category AfS	2,932	2,932	2,403	2,403
Category dFVTPL	3,478	3,478	3,722	3,722
Category LaR	54,282	51,735	60,694	57,605
Other assets	6,837	6,837	8,904	8,904
thereof:				
Hedging derivatives	6,612	6,612	8,633	8,633
Derivatives hedging dFVTPL financial instruments	225	225	271	271
Liabilities	223,573	218,171	317,922	312,036
Liabilities to other banks	55,404	55,350	101,382	101,341
Liabilities to customers	31,241	31,378	43,216	43,316
Liabilities evidenced by certificates	94,350	89,227	107,898	102,386
Trading liabilities (HfT)	21,789	21,789	39,109	39,109
Other liabilities	17,550	17,569	22,809	22,812
thereof:				
Hedging derivatives	7,279	7,279	8,444	8,444
Derivatives hedging dFVTPL financial instruments	96	96	60	60
Liabilities in relation to coverpool assets which were synthetically transferred to FMS Wertmanagement	9,185	9,204	10,925	10,928
Subordinated capital	3,239	2,858	3,508	3,072
Other items	1,255	1,194	1,310	1,255
Contingent liabilities	124	124	196	196
Irrevocable loan commitments	1,131	1,070	1,114	1,059
Liquidity facility	—	—	—	—

¹⁾ Reduced by allowances for losses on loans and advances

In the case of certain positions which, as of the balance sheet date, had not been transferred physically and instead had been transferred synthetically by means of financial guarantees to FMS Wertmanagement, the hidden reserves or hidden charges are as follows:

The above table takes account of the financial guarantees for calculating the fair values (economic view). If these were not taken into consideration, the fair value of loans and advances to customers would have been €842 million lower; on the other hand, it would have been necessary to show a contingent receivable from the financial guarantee from €842 million. This is also applicable for the position “Irrevocable loan commitments”, the value of which would decline by €29 million if a financial guarantee is not taken into consideration.

35 Assets and Liabilities According to Measurement Categories and Classes

Assets and liabilities according to measurement categories and classes in € million	30.6.2011	31.12.2010
Assets	231,705	325,021
Loans-and-receivables (LaR)	195,417	268,371
Held-to-maturity (HtM)	—	—
Available-for-sale (AFS)	2,932	2,403
Held-for-trading (HfT)	22,504	39,114
dFVTPL-assets (dFVTPL)	3,478	3,722
Cash reserve	537	2,507
Positive fair values from hedging derivatives	6,837	8,904
Liabilities	223,573	317,922
Held-for-trading (HfT)	21,789	39,109
Financial liabilities at amortised cost	194,409	270,309
Negative fair values from hedging derivatives	7,375	8,504

36 Exposure to Selected European Countries

The following table provides an overview of the direct exposure to public counterparties of selected European countries:

Exposure to selected European countries as of 30.6.2011								Book value	Notional value	Fair value
in € million	Counterparty (direct exposure)	IAS 39 measurement category	Repayable on demand	up to 3 months	from 3 months to 1 year	from 1 year to 5 years	from 5 years and over	Total		
Portugal	Sovereign	LaR	—	—	—	43	—	43	34	37
		AFS	—	—	—	—	102	102	165	102
		dFVTPL	—	—	—	18	50	68	105	68
	Sub-sovereign	LaR	—	—	—	100	94	194	194	136
	State guaranteed	LaR	—	—	50	453	726	1,229	1,223	902
Ireland	Sovereign	LaR	—	327	25	—	—	352	352	352
	Sub-sovereign	LaR	—	105	108	15	—	228	226	175
	State guaranteed	LaR	—	—	—	—	83	83	83	83
Italy	Sovereign	LaR	—	—	721	2,709	349	3,778	3,347	3,644
		AFS	—	—	—	—	1,194	1,194	1,060	1,194
	Sub-sovereign	LaR	—	—	43	300	2,526	2,869	2,751	2,606
	State guaranteed	LaR	—	—	—	67	23	90	87	88
Spain	Sovereign	LaR	—	—	—	—	356	356	360	289
	Sub-sovereign	LaR	—	75	39	1,613	4,279	6,006	5,802	5,099
	State guaranteed	LaR	—	—	—	252	269	521	523	471

As of 30 June 2011 no direct exposure existed to Greek public counterparties.

For the total portfolio as of 30 June 2011 and as of 31 December 2010 the exposure at default according to regions is disclosed in the Risk Report.

For financial assets which are measured at fair value affecting income changes in value are directly included in the book value. HRE tests financial assets which are not measured at fair value affecting income for impairments. Allowances for loans and advances or impairments for securities are created if there is objective evidence that it will not be possible for the entire amount which is due in accordance with the original contractual conditions to be recovered. As per 30 June 2011 there is no such objective evidence.

37 Past Due but Not Impaired Assets

LaR Assets

LaR assets: past due but not impaired (total investment)	30.6.2011	30.12.2010
in € million		
Up to 3 months	384	134
From 3 months to 6 months	54	18
From 6 months to 1 year	53	4
From 1 year and over	76	7
Total	567	163

Carrying amounts LaR assets	30.6.2011	30.12.2010
in € billion		
Carrying amount of LaR assets that are neither impaired nor past due	194.8	268.2
Carrying amount of LaR assets that are past due but not impaired (total investment)	0.6	0.2
Carrying amount of individually assessed impaired LaR assets (net)	0.4	0.4
Balance of portfolio-based allowances	0.2	0.2
Total	196.0	269.0
thereof:		
Loans and advances to other banks (including investments)	20.4	32.6
Loans and advances to customers (including investments)	121.3	175.7
Financial investments (gross)	54.3	60.7

Other Notes

38 Contingent Liabilities and Other Commitments

Contingent liabilities and other commitments in € million	30.6.2011	31.12.2010
Contingent liabilities	124	196
Guarantees and indemnity agreements	124	196
Loan guarantees	12	14
Performance guarantees and indemnities	112	182
Other commitments	1,131	1,145
Irrevocable loan commitments	1,131	1,114
Book credits	95	84
Guarantees	56	57
Mortgage and public sector loans	980	973
Liquidity facilities	—	—
Other commitments	—	31
Total	1,255	1,341

Positions have been transferred to FMS Wertmanagement primarily by way of the granting of sub-participations, trust agreements or risk transfers (guarantees). The Framework Agreement specifies that FMS Wertmanagement can demand a review of the complete real transfer. Specifically, FMS Wertmanagement can demand the transfer if the transferring party does not suffer any economic disadvantage or if it provides compensation for such a disadvantage. The direct costs of the transfer are not considered to be a disadvantage for the purposes of this regulation. If an economic disadvantage were to arise, the Finanzmarktstabilisierungsanstalt would make a binding decision as to whether a transfer is nevertheless to take place. The costs of the transfer are borne by the transferring legal entity.

The above passages therefore comprise the following possible cost components:

1. Costs of the audit
2. Costs of the transfer
3. Compensation for economic disadvantages

In addition, the European Commission has imposed a payment condition in relation to the aid proceedings, namely the complete fulfilment of the payment of €1.59 billion to avoid distortions of competition in connection with the utilisation of the deconsolidated environment. In consequence, this payment condition has resulted in a subsequent purchase price adjustment in the companies of HRE which have transferred assets to FMS Wertmanagement. The payment condition will probably mainly affect the DEPFA sub-group. The payment condition is recognised in equity, and has accordingly no impact on the income statement.

Deutsche Pfandbriefbank AG also has to retain its profits in order to be able to repay the silent participation of the federal government. The entities of the DEPFA sub-group will pay a fee to the federal government which is not related to profit or loss of these entities. The exact form still will have to be regulated by contract.

In accordance with the framework agreement for transferring risk positions and non-strategic operations to a deconsolidated environment constituted under federal law in accordance with Section 8 a of the Financial Market Stabilisation Act, HRE assumes joint and several liability for all payment obligations of its subsidiaries resulting from the transaction agreements which have been transferred as part of the process of transferring assets to FMS Wertmanagement.

The Restructuring Fonds Act, which envisages the imposition of a bank levy in Germany, came into force in Germany in December 2010. Within HRE this obligation affects Deutsche Pfandbriefbank AG. Details concerning the bank levy are disclosed in the Ordinance of Raising of Contributions to the Restructuring Fund for Credit Institutions (Restructuring Fund Ordinance). On 20 July 2011, the Federal Cabinet adopted the Restructuring Fund Ordinance with the modifications adopted by the Bundesrat (Upper House). The ordinance came into force on 26 July. The relevant liabilities and derivatives disclosed in the separate financial statements of 2010 constitute the basis for calculating the bank levy to be paid in 2011. On this basis, a figure of €41 million has been calculated for 2011. However, because Deutsche Pfandbriefbank AG reported a loss in its separate financial statements for 2010, only a minimum payment of €2 million will be imposed in 2011; a provision of €1 million was set aside for this purpose in the first half of 2011. The Restructuring Fund Ordinance specifies a subsequent payment for years in which the most recently adopted annual financial statements report a net loss for the year or in which the limits of reasonableness are exceeded. Because of the link to future annual payments, there is a possibility of avoidance in accordance with IAS 37.19, which means that a provision does not have to be created for the subsequent payment. The omitted levy that could be payable in the years 2012 and 2013 amounts to €39 million.

39 Key Regulatory Capital Ratios (Based on German Commercial Code)

The Management Board of HRE Holding manages regulatory capital on the basis of the German Solvency Regulation (SolvV) in connection with Section 10 German Banking Act (KWG). According to these standards the total equity capital ratio (equity capital/risk-weighted assets) may not go below 8.0%. In addition, the core capital (Tier I) must consist of at least 50% of equity capital (core capital and supplementary capital), so that the core capital ratio may not be lower than 4.0%. At the same time, the own funds ratio, which is calculated by dividing the own funds by the total risk-weighted assets, must not be lower than 8.0%. The total risk-weighted assets are determined by multiplying the capital requirements for market risk positions and operational risks by 12.5 and adding the resulting figures to the sum of risk-weighted assets for credit risk.

For HRE the capital for regulatory purposes (according to German Solvency Regulation [SolvV]) is as follows:

Own funds ¹⁾	30.6.2011	31.12.2010
in € million		
Core capital (Tier I)	7,041	7,074
Supplementary capital (Tier II)	2,513	2,647
Equity capital	9,554	9,721
Tier III capital	—	—
Total	9,554	9,721

¹⁾ Consolidated pursuant to Section 10 a German Banking Act [KWG]; pro forma as per prepared annual financial statements and after result distribution

The risk-weighted assets, the operational risks and market risk positions were as follows:

Risk-weighted assets ¹⁾	30.6.2011	31.12.2010
in € billion		
Risk-weighted assets	18.1	20.4

¹⁾ Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5; according to Basel II advanced IRB approach for authorised portfolios, otherwise Basel II standardised approach

Operational risks	30.6.2011	31.12.2010
in € million		
Total	31	104

Market risk positions	30.6.2011	31.12.2010
in € million		
Currency risks	7	25
Interest rate risks	20	22
Total	27	47

The regulatory capital ratios were calculated on the basis of the definition for regulatory capital according to SolvV and risk-weighted assets according to Basel II. The resulting capital ratios as of 30 June 2011 and as of 31 December 2010 were thus as follows:

Key capital ratios ¹⁾	30.6.2011	31.12.2010
in %		
Core capital ratio ²⁾	38.9	34.7
Equity capital ratio ³⁾	53.8	49.1
Own funds ratio (overall indicator) ²⁾	52.8	47.7

¹⁾ Pro forma as per prepared annual financial statements and after result distribution

²⁾ Including risk-weighted credit risk positions as well as the capital requirements for market risk positions and operational risks scaled with the factor 12.5

³⁾ Including risk-weighted credit risk positions as well as the capital requirements for operational risks scaled with the factor 12.5

40 Relationship with Related Parties

Because HRE is controlled by SoFFin, a special fund of the federal government in accordance with Section 2 (2) FMStFG, HRE is a government-controlled entity and a related party of other companies which are subject to the control, joint management or significant influence of the Federal Republic of Germany (so-called government-related entities). FMS Wertmanagement is also subject to the control of the Federal Republic of Germany and is thus a related party of HRE. Business relations with government-related entities are conducted on an arm's-length basis. Major income and expenses in accordance with IAS 24 are attributable to services of HRE provided to FMS Wertmanagement for the latter's ongoing operation. The income of €107 million from servicing FMS Wertmanagement (1.1.–30.6.2010: €0 million) compensate for the costs of HRE incurred in connection with servicing.

41 Employees

Average number of employees	1.1.–30.6.2011	2010
Employees (excluding apprentices)	1,377	1,385
Apprentices	—	2
Total	1,377	1,387

42 Summary of Quarterly Financial Data

HRE		2010			2011	
		2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
Operating performance						
Operating revenues	in € million	-66	-244	348	260	177
Net interest income and similar income	in € million	235	197	90	218	141
Net commission income	in € million	-98	-125	4	8	-
Net trading income	in € million	-173	-153	67	-7	12
Net income from financial investments	in € million	22	18	12	-20	-15
Net income from hedge relationships	in € million	-44	1	7	-4	-17
Balance of other operating income/expenses	in € million	-8	-182	168	65	56
Provisions for losses on loans and advances	in € million	194	-2	-7	-9	-11
General administrative expenses	in € million	137	167	97	106	136
Balance of other income/expenses	in € million	2	1	10	-	1
Pre-tax profit	in € million	-395	-408	268	163	53
Net income/loss	in € million	-413	-445	235	136	27
Key indicators						
Total volume of lending	in € billion	248.7	237.1	145.7	96.6	91.6
Employees		1,374	1,392	1,366	1,375	1,396

Public Sector Finance		2010			2011	
		2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
in € million						
Operating performance						
Operating revenues		25	4	23	17	27
Net interest income and similar income		29	16	20	27	30
Net commission income		-1	-1	-1	-1	-1
Net trading income		5	-3	-4	-2	5
Net income from financial investments		-8	-5	7	3	-
Net income from hedge relationships		-	-	-	-11	-14
Balance of other operating income/expenses		-	-3	1	1	7
Provisions for losses on loans and advances		5	-3	-2	-	-
General administrative expenses		19	13	3	13	20
Balance of other income/expenses		-	-	-	-	-
Pre-tax profit		1	-6	22	4	7

Real Estate Finance		2010			2011	
		2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
in € million						
Operating performance						
Operating revenues		125	209	94	73	71
Net interest income and similar income		147	168	69	64	57
Net commission income		23	17	13	15	7
Net trading income		-43	47	29	-1	2
Net income from financial investments		1	-	2	-	-
Net income from hedge relationships		-	-	-	-4	2
Balance of other operating income/expenses		-3	-23	-19	-1	3
Provisions for losses on loans and advances		173	-6	33	9	2
General administrative expenses		55	47	6	30	42
Balance of other income/expenses		-	-	-	-	-
Pre-tax profit		-103	168	55	34	27

Value Portfolio	2010			2011	
	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
in € million					
Operating performance					
Operating revenues	-187	-335	125	174	80
Net interest income and similar income	64	29	-8	120	35
Net commission income	-120	-141	-8	-6	-6
Net trading income	-142	-213	45	1	9
Net income from financial investments	29	23	3	-23	-15
Net income from hedge relationships	-28	10	8	13	-6
Balance of other operating income/expenses	10	-43	85	69	63
Provisions for losses on loans and advances	19	7	-38	-18	-13
General administrative expenses	31	57	69	62	66
Balance of other income/expenses	1	-	3	-	1
Pre-tax profit	-236	-399	97	130	28

Consolidation & Adjustments	2010			2011	
	2nd quarter	3rd quarter	4th quarter	1st quarter	2nd quarter
in € million					
Operating performance					
Operating revenues	-29	-122	106	-4	-1
Net interest income and similar income	-5	-16	9	7	19
Net commission income	-	-	-	-	-
Net trading income	7	16	-3	-5	-4
Net income from financial investments	-	-	-	-	-
Net income from hedge relationships	-16	-9	-1	-2	1
Balance of other operating income/expenses	-15	-113	101	-4	-17
Provisions for losses on loans and advances	-3	-	-	-	-
General administrative expenses	32	50	19	1	8
Balance of other income/expenses	1	1	7	-	-
Pre-tax profit	-57	-171	94	-5	-9

Munich, 5 August 2011

Hypo Real Estate Holding Aktiengesellschaft
 The Management Board



Manuela Better



Wolfgang Groth



Dr. Bernhard Scholz



Alexander von Uslar

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Financial Calendar Addresses

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Addresses

Hypo Real Estate Holding AG
 Freisinger Straße 5
 85716 Unterschleißheim
 Germany
 Telephone +49(0)89 2880-0
 Fax +49(0)89 2880-10319
 info@hyporealestate.com
 www.hyporealestate.com

Deutsche Pfandbriefbank AG
 Freisinger Straße 5
 85716 Unterschleißheim
 Germany
 Telephone +49(0)89 2880-0
 Fax +49(0)89 2880-10319
 info@pfandbriefbank.com
 www.pfandbriefbank.com

DEPFA Bank plc
 1 Commons Street
 Dublin 1
 Ireland
 Telephone +353 1 7922222
 Fax +353 1 7922211
 info@depfa.com
 www.depfa.com

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Concept, Design and Realisation

KMS TEAM GmbH, Munich

Hypo Real Estate Holding AG
Freisinger Straße 5
85716 Unterschleißheim
Germany
Telephone +49(0)89 2880-0
Fax +49(0)89 2880-10319
www.hyporealestate.com