InvestitionsBank des Landes Brandenburg

Annual Report for 2008

The General Economic Situation

The year 2008 marks the end of a long upswing in the world economy. After a good first quarter in 2008 the consequences of the weaker trend in the world economy and the crisis in the financial markets also became apparent in the **German economy**. The economic trend slackened markedly.

According to calculations by the Federal Statistical Office price adjusted gross domestic product (GDP) was 1.3 percent higher than in 2007. The stimulus to growth in 2008 came exclusively from the domestic economy. State consumption increased by 2.2 percent in real terms, while private consumer spending stagnated.

Foreign trade and payments were a brake on the economic development in 2008. This was due to the relatively slight rise in exports of only 3.9 percent (2007: +7.5 percent). The economic output came from 40.4 million persons employed on average in 2008, 582,000 more (+1.5 percent) than a year before. The average unemployment rate for the year in 2008 was 7.8 percent. According to calculations by the Federal Statistical Office the public budget deficit was EUR 3.3 billion in 2008 (a deficit ratio of -0.1 percent).

The global crisis had a moderate effect on the economic development in **Brandenburg** in 2008. The gross domestic product rose by 0.8 percent in real terms from 2007, putting Brandenburg slightly below the average of 0.9 percent for east Germany (without Berlin).

The development in manufacturing was positive on the whole in 2008. Around 434 Brandenburg industrial firms employing 50 persons or more achieved an increase of 5.2 percent in turnover compared with 2007. The inflow of orders to Brandenburg industrial firms rose by 11.0 percent in 2008 over 2007; the increase was due more to orders from abroad (+22.2 percent) than to domestic orders (+4.4 percent).

The number of persons in Brandenburg in jobs on which social insurance is payable rose by 1.1 percent. Altogether 1,046,200 persons were in employment in Brandenburg. The unemployment rate was 13.0 percent on average for 2008, compared with 14.9 percent in 2007.

Brandenburg ended the 2008 fiscal year with a surplus expected to be EUR 180 million. Total revenue in 2008 amounted to around EUR 10.5 billion, while investment expenditure was around EUR 1.6 billion, an investment ratio of 16.2 percent.

The Bank's Earnings, Financial and Assets Situation

ILB again achieved a good result for the year with a slight increase in the balance sheet total.

The Earnings Situation

The net income for the year is EUR 5.5 million.

Interest income showed a very gratifying development, rising by EUR 4.9 million from the 2007 figure to reach EUR 43.8 million. The rise was achieved particularly by growth in the Treasury result following the positive development in interest rates for the Bank. The interest income also reflects the balance of interest received and interest expenditure on ILB's interest-bearing promotional business, which was on the previous year's level.

Net commissions earned is mainly fees for handling promotional programmes. It consists of contributions to the administrative costs of lending from trust funds, handling grants programmes and administering guarantees.

Altogether net commissions amounted to EUR 31.8 million, a rise over the 2007 figure (EUR 27.9 million). The growth of EUR 3.9 million is due to the increase in the volume of business handled.

The **other income from operations** consists mainly of rent received for renting out parts of the Bank's building and earnings on services for subsidiaries and other enterprises. At EUR 1.8 million this item is slightly below the previous year's level of EUR 2.0 million.

Expenditure on personnel rose by EUR 0.7 million to EUR 26.2 million. Beside the adjustment of wages and salaries under the collective wage agreement for the banking sector, this was due to the appointment of former apprentices.

The **other administrative expenditure, including depreciation and value adjustments on intangible assets and fixed assets** fell by EUR 0.2 million to EUR 12.6 million. No major investments in operating and office equipment were made in 2008, so at EUR 1.1 million an amount close to the previous year's level of EUR 1.2 million is shown for depreciation on fixed assets. Expenditure on fixed assets was EUR 11.5 million, which was slightly below the previous year's figure of EUR 11.6 million.

The sale of our holding in ib-bank-systems GmbH realised an amount above the book value.

ILB achieved a good result for 2008 at EUR 40.1 million before risk provision and allocations to the reserves.

Account has been taken of all recognisable risks in the lending business with appropriate valuations and risk measures. Individual value adjustments were made, taking into account existing securities for risks on loans and advances identified and quantified during the financial year. The trend is declining. The positive development chiefly reflects the success of our loan risk management. In keeping with the development of the latent loan risk an appropriate allocation was made to the global value adjustments in accordance with the principles of commercial law.

The securities treated as fixed assets were valued according to the lower of cost or market (modified). Owing to the high quality of ILB's securities portfolio and the worldwide actions to stabilise the financial markets lasting reductions in value are not expected.

Securities issued by Lehman Brothers Holding Inc. to the nominal value of EUR 10 million were valued according to the strict lower of cost or market principle and entirely written off.

As in previous years, EUR 2.0 million was allocated to the Fund for General Bank Risks.

In addition, further provision for general bank risks was made in 2008 by allocating an EUR two-figure amount to the prudential reserves.

ILB allocated an amount of EUR 7.5 million to the **ILB Promotional Fund** in 2008. As a result, 50% more of the bank's own funds will be available in 2009 for interest rate reductions for the ILB product family, the Brandenburg loan.

The expenditure and earnings are steered through the yearly planning process with fixed budget figures. The planning data is brought up to date during the year and checked against targets. The targets for 2008 were met, and in most cases exceeded. Hence the overall result achieved is higher than the planned result.

The Financial Position

Most of the short-term borrowing during the 2008 financial year was in the form of open market transactions with the Bundesbank and securities purchases against repurchase agreement, mainly with German banks.

The borrowed funds were mainly in the form of loans against borrower's notes from domestic banks and global loans from the European Investment Bank, the KfW Banking Group, the Landwirtschaftliche Rentenbank and the Council of Europe Development Bank. Borrowing from banks rose by EUR 287.3 million above the previous year's figure, so that this now accounts for 98.9 percent of all borrowed funds, excluding liabilities on a trust basis.

The bank's funding is secured by the state guarantee (the "Anstaltslast" and "Gewährträgerhaftung"), which is laid down in law, as well as the guarantee from the State of Brandenburg. It is therefore obtainable at particularly favourable conditions.

The remaining borrowed funds are exclusively liabilities to customers, chiefly in connection with the promotional business on behalf of the State of Brandenburg. 63.7 percent of these funds are at call or with forward contracts of up to one year.

The bank's liquidity was always assured. The supervisory figure for liquidity was between 2.31 as minimum and 3.91 as maximum in 2008.

During the past financial year ILB increased its equity capital as shown in the balance sheet by EUR 5.5 million over the previous year, bringing it to EUR 194.8 million. The Fund for General Bank Risks in accordance with § 340 g of the Commercial Code was increased to EUR 31.0 million.

The prudential reserves for general bank risks were also increased.

The published capital and reserves now amount to EUR 225.8 million. The increase of EUR 7.5 million results from ILB's net income for the year 2008 and the allocation to the Fund for General Bank Risks in accordance with § 340 g of the

Commercial Code. As no decision has yet been taken on the use of the profits for the years 2005 to 2007 these funds are shown as earnings brought forward. An allocation of EUR 0.3 million to the statutory reserves was made in 2008 as well.

The bank always fulfilled the requirements on equity capital in the Solvency Regulation.

ILB’s equity capital ratio, or the overall figure under the Solvency Regulation, was between 15.9 and 17.0 percent in 2008.

Assets

ILB’s balance sheet total rose by EUR 80.4 million to EUR 11,269.2 million in the 2008 financial year.

The volume of business, which consists of balance sheet business and contingent liabilities, administrative loans and administrative guarantees, had risen at the end of the 2008 financial year to EUR 11.8 billion.

The reduction of over 20 percent in loans and advances to banks to EUR 869.4 million is due to the fall in interbank business.

Although fewer EU, Federal and State funds were available for promotional purposes in the State of Brandenburg the bank’s loans and advances to customers rose by EUR 308.6 million to EUR 4,307.1 million. The rise was mainly due to the Brandenburg loan and lending business with the State of Brandenburg. Loans on a trust basis - which form part of the assets on a trust basis - are shown at EUR 3,639.1 million. This is a fall of EUR 158.9 million, due to increased redemptions with at the same time less new business.

The portfolio of bonds and other fixed interest securities totals EUR 2,320.2 million, a slight rise of EUR 166.2 million.

ILB is not a commercial bank, and it has always pursued the strategy of holding securities to maturity. When the liquidity regulation came into force, replacing Principle II, ILB was no longer required to hold securities as liquidity. In view of this the bank has since 2008 assigned all its securities to Assets, except for those issued by Lehman Brothers Holding Inc. mentioned above, which have been totally written off.

An increase of EUR 12.0 million in Other Assets, bringing this item to EUR 12.1 million, is due to the difference shown in the balance sheet on 31 December 2008 on foreign currency conversions for loans taken up in US dollars (USD) , which were fully secured with active interest swaps in USD. At the same time Other Liabilities were reduced by EUR 58.5 million due to the difference in foreign currency conversions.

Funds borrowed from banks total EUR 7,189.6 million, a rise of EUR 287.3 million, mainly due to taking up long-term funding loans.

The bank had also concluded interest swaps and foreign currency interest swaps, forward interest swaps and forward rate agreements (FRAs) to steer the risk of changes in interest rates through macro and micro hedging to a total of EUR 6,542.3 million on balance sheet date.

On balance sheet date the volume of FRAs purchased was EUR 50.0 million.

As the targets were achieved in the balance sheet and the income and expenditure account the bank's earnings, financial and assets situation can be regarded as satisfactory and stable in the 2008 financial year.

Memo Item

No events of particular significance for the Annual Report occurred after the end of the 2008 financial year.

Risk Report

The Risk Situation

ILB is a specialised bank and it does not operate in every area of the banking business. Its risk structure results from the commission to engage in the promotional and structural policy of the State of Brandenburg. Risks are only incurred in these operations to a very limited extent. Account has been taken of all recognisable risks with the appropriate valuations and provisions.

Risk Management

The bank's risk supervisory system is directed to the current risks of default, market prices, liquidity and operations.

The separation of functions into risk supervision and risk acceptance is carried through all the bank's levels of organisation. The identification, assessment, control and steering of the risks for the bank as a whole are performed by our Controlling Department or the Loan Secretariat, while the specialist departments steer risks on operational level.

The risk controlling covers the regular supervision of the limits set by the Board of Managing Directors, and reports on the risk content and the supervisory requirements.

The Board of Managing Directors bears overall responsibility for the bank's risks. In accordance with the Minimum Requirements for Risk Management (MaRisk) the Board of Managing Directors informs the Risk Committee, a committee of the Board of Supervisory Directors, every quarter in writing of the bank's risk situation. ILB's risk situation is also explained to the Board of Supervisory Directors, as the controlling organ of management, at the regular board meetings.

Risk Assessment Methods

The main guideline is the risk strategy, which is derived from the business strategy. On principle ILB pursues a conservative risk policy, aiming for diversification of the various types of risk, while knowingly accepting risks and avoiding them in areas where the bank does not have core competences. The principles on the attitude to risks laid down in the risk strategy are thus the general framework for the bank's business operations.

As well as laying down the risk management process and responsibilities the basic range of instruments to assess and steer risks are also documented. The aim is to secure the bank's business position and its future success with efficient risk management. Against that background the risks are limited, depending on ILB's inclination to risk and its ability to take risks.

To calculate the bank's ability to take risks the capital available to meet risks (risk cover capital) is set against the risk capital involved in the various kinds of risk. Beside the liable equity capital, the risk cover capital also consists of the expected net income for the year after risk provision in the current year. The envisaged allocations to the other reserves from earnings and the allocations to the published and hidden reserves in accordance with §§ 340 f and g of the Commercial Code are also included in the calculation of the risk cover capital. An upper limit is set for losses to limit the overall risk for ILB, and this was fixed in accordance with the risk policy. To limit the risk potential this upper limit for loss is divided among the main types of risk to ILB. A risk inventory was carried out and the following types of risk were identified: default, performance, market prices, liquidity and operations. No limit to count towards the upper limit for loss was set for the performance and liquidity risks. A limit system by products/areas is used to steer risks within the above types.

To control risks the current exposure to the individual types of risk is compared with the corresponding limits. As well as the supervision of the individual limits per type of risk, the overall risk situation is appraised in relation to the utilisation of the overall bank limit, and so the bank's ability to take risks. As a guide for steering during the year the periodical annual result is also calculated, and it must not fall below a minimum target figure. Quarterly reports by the Controlling Department provide the Board of Managing Directors with information on the risk situation for the entire bank, enabling them to exercise control. The supervision of the bank's ability to bear risk is supplemented by studies of the effect of crises on the markets, and for this purpose scenarios are evolved to simulate the effects of unusual but plausible events on the risk situation of the bank as a whole. The aim is to identify possible events or future changes that would have a negative effect on the bank's risk situation, and ensure the bank's ability to bear risks in extreme situations as well. The analysis of the scenarios helps to ensure the stability of the bank beyond the regular course of business.

The Different Types of Risk

The Risk of Default

The risk of default is the danger that borrowers on whom the bank has claims may become insolvent and consequently cannot fulfil their contractual obligations. The risk of default covers the risks on lending and the country, counterparty and shareholder risks.

The bank's ability to bear risk of default is assessed by calculating the equity capital tied, using the offsetting procedure laid down in supervisory law in the Solvency Regulation (loan risk standard approach), and comparing this with the limit set for default risk.

The steering of default risk is oriented to the MaRisk. A limit system has been set up for individual product groups (securities, derivatives, short term interbank claims, customers' banks), and to limit the risks on these types of business volume limits have been established on borrower level (partly on the basis of loan equivalence amounts). There are also qualitative and quantitative requirements for products and specialised departments, based on ILB's default risk strategy. The limit system is supplemented by the supervisory requirements on the limits for large loans.

The upper limit for default risks was always observed during the year under review.

The Loan Risk

ILB's core business is the promotion of public and private investment projects, mainly using funds from the budget of the State of Brandenburg or in the low-risk procedure through customers' banks. Hence the loan risk is of only minor significance in ILB's promotional business. The bank incurs no loan risks on the assets administered on a trust basis for the State, like the State Housing Construction Fund (LWV). This is a tied State special fund which ILB handles on behalf of the Ministry of Infrastructure and Regional Planning on the basis of approved business plans and principles.

The loan risks are mainly in lending for housing construction and the commercial lending/syndicate business. While in the housing construction loan business the demographic development and the consequently high proportion of empty housing are still causing liquidity and profitability problems for some borrowers, the risks on the commercial lending business result from the general economic development. To limit these risks precisely defined minimum criteria are set for the syndicate business, especially on the standing of the borrower and the maximum amount of the loan. Sufficient provision was made for the known risks with individual value adjustments in the annual financial statements.

The strategy for dealing with risk of default, which is brought up to date each year, forms the basis of our lending business. On part-loan portfolio level it contains both the qualitative and the quantitative requirements for the lending business.

A risk report is drawn up quarterly in accordance with the requirements in the MaRisk, and this provides the information for the Board of Managing Directors and the bank's Risk Committee. As well as the account of the loan portfolio this risk report also contains an assessment of the risk of default and, if necessary, recommendations on action to steer risks.

In keeping with ILB's conservative risk policy the risk structure of the loan portfolio can be regarded as low risk. The entire loan portfolio at ILB's own risk amounted to EUR 8,580.6 million on 31 December 2008. Of this 89.9 percent has loan rating 1, which means that these commitments are of first-class standing or have full security (generally a government guarantee or material collateral).

To steer the risk of default ILB has introduced an internal risk classification procedure for all the main groups of customers and products. It includes a simplified procedure for municipal loans, banks and borrowers of less than EUR 250,000. As well as rating borrowers to reflect the likelihood of default, loans are also rated. Beside the standing of the borrower the loan rating process also includes an analysis of the location and the property for rented housing construction and the value of the security. This will in future enable the overall risk assessment to include not only the likelihood of default but also the ratio of loss should default occur.

ILB pursues a conservative investment policy. Only bonds of first-class issuers were acquired. Investment decisions are made after an independent risk analysis. A condition for purchase is a minimum "A" rating by an external rating agency (Moody's, Standard & Poor's or Fitch). The risks were widely spread. The securities portfolio consists mainly of bonds issued by German and European banks. Around half is mortgage bonds, state-guaranteed bonds and government bonds (around EUR 1 billion).

Our Risk Controlling Department checks the standing of the paper or the issuer for changes daily in publications. In addition to these measures the development of the yields on certain securities that are entered in a watch list is observed and compared with risk-free investments to utilise the market valuation as an early indicator of any change in risk. Owing to the high quality of our securities portfolio no losses are at present expected when the securities are redeemed at maturity.

As well as limiting the purchase of securities, short-term interbank business and derivatives from individual institutes, upper limits are set per bank for loans channelled through customers' banks. The limits are set for each bank individually, based on an evaluation of its financial position, its external rating and other qualitative data. If the standing and/or external rating change the limit is adjusted accordingly. The limits are reappraised each year.

The regular supervision of observance of the limits is performed by our Risk Controlling Department and our Department for Customers Banks Limits.

The Counterparty Risk

The counterparty risk is the danger of incurring loss if a party to a contract defaults when claims are due to be settled (fulfilment risk) or fails to meet a payment deadline (performance risk). ILB counters this risk by on principle only transacting commercial business with selected market partners who have a minimum "A" rating.

The Country Risk

The country risk is the transfer risk on cross-frontier payments caused by a country's refusal to pay (the political risk), and its inability to pay (commercial risk).

In accordance with its promotional task ILB's business is almost entirely in Germany and here it is concentrated in the State of Brandenburg. Our foreign engagements are chiefly investments in securities, and most of these are with countries in the Eurozone. On principle only selected issuers are accepted, in keeping with ILB's default risk strategy. Issuers outside Germany should not account for more than 50%. Hence the country risk is only of minor significance for the bank.

The Shareholder Risk

The shareholder risk is the danger that losses may be incurred on the provision of equity capital for third parties.

In the performance of its statutory obligations ILB only holds strategic shareholdings. It acquires shareholdings principally to realise important interests of the bank or to perform structural policy tasks resulting from state policy. Essential conditions are that no other business solution is possible, the contribution is limited, appropriate influence on the company's management can be assured and the State has given its approval. ILB has shareholdings in three areas:

- Equity investment companies - providing equity capital for companies in the State of Brandenburg
- Property companies - developing real estate projects in the State of Brandenburg
- Others - supporting other ILB activities.

On 31 December 2008 ILB held shares in twelve companies to a book value of EUR 29.0 million. Large parts of its equity investments are secured against risk with guarantees or grants from the State of Brandenburg, so that ILB is not exposed to any potential risk on these commitments. Sufficient risk provision has been made for the risks attached to the remaining shareholdings.

The Market Risk

The market risks are the danger of negative developments for the bank on a market. As well as the risk of changes in interest rates, they include the market price risk, currency risk, share price risk and other price risks.

The market risks are steered as part of our risk management, in accordance with the principles laid down in the MaRisk. ILB is classified as a non-commercial bank.

The Risk of Changes in Interest Rates

There are risks of changes in interest rates where rates are fixed for different periods in the lending and borrowing business.

ILB steers the risk of interest rate changes through the payments flows on all transactions where interest rate changes are relevant. The maximum risk of interest rate changes that may be accepted is fixed using the value at risk (VaR) system based on the modern historical simulation. The historical simulation is based on about 5,200 past interest curves from 1 January 1988. As parameter the bank has set a confidence level of 99% for rates held for three months. To enable the effects of extraordinary market changes on the risk of interest rate changes to be estimated additional extreme or worst case scenarios are also simulated.

To measure the quality of the forecast provided by the risk assessment model used ILB carries out back testing, in which the forecast value at risk (VaR) is compared with the losses actually incurred. On all the sample days tested the changes in cash value established were below the VaR. The results of the back testing show that ILB's risk model does take sufficient account of the market risks.

As well as limiting the risk of changes in interest rates the efficiency of the open positions entered into through matching maturities is measured and steered by comparison with a benchmark. The aim is to optimise ILB's opportunities/risk ratio in accordance with that benchmark.

The risk of changes in interest rates is supervised by our Risk Controlling Department. The Board of Managing Directors receives a monthly risk report on the risks of interest rate changes to which the bank is exposed. Decisions on how to position the bank in regard to risks of interest rate changes are then taken in the Management Board meetings on the basis of these reports. Possible measures are discussed and their effect on the risk of interest changes and the efficiency of the cash flow examined.

The limits laid down by the Board of Managing Directors to restrict the risk of changes in interest rates were always observed in the 2008 financial year.

The Market Price Risk

On principle ILB buys securities with the intention of holding them to maturity (long-term portfolio). So if it is certain that the full value will be redeemed fluctuations in market prices do not cause lasting loss. Hence the market price risk is not a significant risk for ILB.

The Currency Risk

Transactions in foreign currencies are fully secured immediately after completion using foreign currency interest swaps, so that ILB incurs no currency risks on these transactions.

The Risk on Shares / Other Price Risks

During the period under review ILB held no shares. Hence the bank incurred no risks of changes in share prices or other price risks.

The Liquidity Risk

In general the liquidity risk means the risk that the bank may not be able to meet payment obligations in full when they become due.

ILB's Treasury Department steers the bank's liquidity through its daily transactions. Funds are raised and invested on the basis of the expected inflows and outflows of payments to meet the bank's contractual obligations and in accordance with the reports by the specialised departments. By the nature of its operations ILB has a high share of payments flows that are fixed and can therefore be planned.

The liquidity risk is supervised by the Finance and Accounting Department. The Board of Managing Directors receives monthly statements showing that the liquidity principle has been observed. The liquidity risk is also assessed by comparing the bank's need for funds with its potential to raise funds (the liquidity reserve), with a one-year horizon for the forecast. Moreover, the effects of potential liquidity shortfalls are examined in various scenarios, taking into account internal and external factors that influence ILB's ability to meet its payments obligations. If fixed limits are exceeded appropriate measures, depending on the amount needed, are taken to improve the liquidity situation. The results are presented to the Board of Managing Directors monthly.

The Liquidity Risk in the Narrower Sense

To ensure that it can meet its payment obligations at all times ILB has money market lines available with commercial banks and a portfolio of securities, loans and advances that can be used in open market transactions for short-term funding through the European Central Bank. This gives ILB sufficient refinancing potential to generate adequate liquidity, even when it is facing heavy outflows, and largely independent of the general market situation. The shortage of funds on the money market caused by the financial markets crisis did not have negative effects on ILB's provision with liquidity. In the past financial year it was always able to provide itself with sufficient liquidity, both on the interbank market and through open market transactions. In addition, ILB has signed contracts with German and European promotional banks to secure long-term funding.

The Refinancing Risk

With the guarantee from the State of Brandenburg for the bank's liabilities ILB has very good standing. The financial markets crisis caused some considerable changes in interest conditions on the money market. However, ILB continued to be able to obtain liquid funds at a competitive price. Consequently it still classifies the risk of only being able to refinance at less favourable conditions as slight.

The Operational Risk

The operational risk is the risk of losses due to the unsuitability or failure of internal procedures, systems and people, or to external factors; strategic risks and risk to the bank's reputation are excluded.

ILB cannot exclude operational risks from its business activities. On principle major risks that would jeopardise the continued existence of the bank are avoided, or appropriate provision is made by passing on the risks (for example through insurance), or to reduce the risks (by damage prevention measures).

The procedure to manage operational risks is supported by tranparent communication and documentation throughout the bank. Information on risky events and potential risks is compiled in a risk data bank. The annual risk inventory enables potential risks to be recognised at an early stage, partly through risk indicators. The OpRisk experts are regularly exchanged and the staff and management personnel are continuously made aware of the risk potential. This has helped to ensure risk-oriented and constructive handling of the few cases of damage and risk reports. Avoiding risks was always the main concern.

The issue of fraud prevention was continuously advanced. The recommendations for action compiled with the help of external consultants are currently being implemented in crucial areas.

The Commercial Risk

Minor risks are accepted in consideration for profitability. ILB counters these commercial risks with an appropriate internal control system. Sufficient insurance has also been obtained to cover any damage that might be incurred. To supplement the existing emergency plan, which covers questions of deputising, data protection and fire precautions, a project was started at the end of 2008 to work out an extended emergency concept for ILB. The aim is to cover all the relevant operational processes and carry out a business impact analysis.

The Legal Risk

There are legal risks in the material validity of contracts, approvals, authorisations/powers of attorney and the observance of formal requirements, especially new laws and jurisdiction.

ILB counters these legal risks by using standardised documents that are approved by the bank's Legal Department and continuously brought up to date. It also involves the Legal Department at an early stage in decisions that can entail legal obligations or have a beneficial effect for the bank.

ILB's shareholders are the State of Brandenburg, NRW.BANK and Landesbank Berlin AG (LBB). In proceedings against the State of Brandenburg and ILB as co-debtors LBB has applied to the Administrative Court for payment of an amount in dispute (its shareholding) on the basis of the balance sheet price. The State of Brandenburg and ILB argue that there is no justification for this claim. Apart from this, the amount allegedly owed cannot be claimed from ILB owing to the terms of the contract and legal regulations.

However this legal dispute may be decided negative effects are not to be expected for ILB's current and future business.

Summary of the Risk Situation

On 31 December 2008 the distribution of the overall risk between the different types of risk accorded with their percentage of the overall risk to the bank, namely:

The risk of default constituted the major part at 82 percent.

The market price risk accounted for 11 percent of ILB's overall risk. This reflects the risks of changes in interest rates on matching maturities. The efficiency of the opportunity/risk ratio that results from matching maturities is optimised through benchmark steering.

The potential loss from operational risks calculated using the base indicator approach in Basel II accounts for 7 percent of the overall risk to ILB for the year 2008.

A comparison of the risks incurred with the total risk cover capital shows a risk coefficient of 43.7 percent at the end of 2008. This corresponds to the bank's readiness to take risk as laid down in its risk strategy, and it also reflects responsible handling of the risk cover capital. The conservative risk assessment methods deliberately chosen by ILB overstate the risk on overall bank level, and they do not take into account correlation effects between the various types of risk that can reduce risk. These factors, and the risk cover capital, which was not all made available for risks as the overall bank risk was limited, form an adequate buffer against risk that can deal with extraordinary situations as well.

The limit to ILB's risk position laid down in the maximum set for loss was always observed in the 2008 financial year. The risks entered into were thus always in accordance with ILB's approach to risk. The results of the scenario studies show that ILB's ability to bear risk is not in jeopardy, even should extraordinary events occur. The bank's ability to bear risk is assured.

Outlook

The Economic Situation

With its great dependency on exports the German economy is particularly affected by the falling demand in our trading partner countries and the crisis in the financial markets. For the year as a whole the Federal Government is expecting a decline in the gross domestic product (GDP) of 2.25 percent in real terms.

Foreign trade has been a driving force in growth in past years, but it will not make a contribution in 2009. After two-figure growth rates in some years, this year a fall of -8.9 percent is expected. Consequently a fall in imports of -5.0 percent is expected.

Private consumption can stabilise the development - not least owing to fiscal stimulus - but it will not fully compensate for the dampening influence of the world economy. Falling prices, higher wages and reductions in taxes and charges should cause consumer spending by private households to rise to 0.8 percent above the previous year's level in 2009.

As a result of the recession the Federal Government is expecting the number out of work to rise by 500,000 to 3.5 million by the end of the year. The unemployment rate for the total workforce is forecast to be 8.4 percent for 2009.

The Federal Government is expecting a deficit on the public budget again for 2009. Net new borrowing in Germany will be above EUR 36.8 billion, mainly due to supporting measures in the cyclical recovery packages. Despite this level of debt the Federal Government is not expecting Germany to exceed the EU threshold for the public budget deficit in 2009.

In Brandenburg as well a fall in GDP and employment is expected in 2009. However, the crisis is likely to be less severe here than in West Germany. The manufacturing sector has been the driving force of growth in East Germany as well for years, with corresponding effects on other sectors, but export dependency is less here, so that the decline in demand for export goods will not have as strong an effect as in the western areas of the Federal Republic.

The ifo Institute is expecting a fall in price-adjusted GDP of -1.9 percent for 2009 in East Germany.

Major Influences

Against the background of the financial markets crisis and the recession public financing instruments are playing an increasingly important role. The financial markets crisis has not had disadvantageous or negative effects on ILB's promotional business. The bank is meeting with growing demand for promotional loans from the savings banks and commercial banks for their customers in Brandenburg. That is particularly the case for the Brandenburg loan, where around EUR 255 million was committed in 2008. In its planning the bank is expecting high demand for the Brandenburg loan to continue. The funds for the necessary reductions in interest rates have already been made available in allocations to the ILB Promotional Fund. Hence there will be no risk to future earnings. The risk of a fall in the total volume of commitments in the promotional business is thus regarded as slight on the whole.

In the present view, the financial markets crisis will not result in additional risks to ILB on securities owing to the high quality of our portfolio. For the rest, ILB has not invested in financial markets derivatives that directly or indirectly entail subprime risks.

Apart from this it may be assumed that the financial markets crisis will also increasingly affect the real economy in Brandenburg. A possible increase in the number of defaults by borrowers from ILB has already been taken into account in planning our risk provision.

On ILB's liquidity situation it can be stated that the need for funding can in future be met, also taking into account current developments. No liquidity problems are evident in ILB owing to the bank's excellent funding possibilities. ILB has long-term funding contracts with German and European promotional banks; it also has the possibility of obtaining short-term liquidity at any time through the ECB/Deutsche Bundesbank.

The Development of the Earnings and Financial Position

The planning for the 2009 and 2010 financial years is optimistic. ILB is expecting the earnings and financial situation to remain stable as a whole for the next two years.

Interest income on the promotional business is regarded as stable in view of the special effects in 2008. The bank's stock of business and its new products will both contribute to this. During the financial markets crisis the banks' funding costs have risen, and ILB is also affected by this. However, as ILB's funding structure has largely congruent maturities negative effects on interest income are not expected. For the rest, interest income depends on the development on the money and capital markets.

Net commissions earned should remain on a high level. As a major services enterprise ILB will continue to conclude contracts to handle business for the State of Brandenburg. Possible effects of implementing the Federal Government's economic stimulus programmes on ILB's promotional business are being examined. Additional effects on ILB's business activity are not foreseeable at present.

Owing to the high quality of ILB's securities portfolio a re-evaluation is not at present indicated.

The net income for the year is planned to be on the level of the previous year.

ILB's result will be stable and satisfactory in future, too, and it will provide the basis for continued successful business operations to the benefit of the State of Brandenburg. Against this background ILB intends to make further allocations to the ILB Promotional Fund in order to offer loans at favourable terms, including the use of its own earnings. For the next few years an annual allocation to the ILB Promtional Fund of EUR 5.0 million is planned.

Potsdam, 25.03.09

Klaus-Dieter Licht Jacqueline Tag