ANNUAL REPORT 2017

L-BANK
Staatsbank für Baden-Württemberg

L-BANK IN FIGURES

OVERVIEW 2013–2017 in EUR millions

	2013	2014	2015	2016	2017
Total assets	70,682.10	70,190.09	73,294.92	75,075.39	70,669.98
Equity	2,616.91	2,714.68	2,765.31	2,814.64	2,865.23
Net interest income[1]	414.03	375.54	365.41	368.93	323.41
Net income	100.77	49.19	50.63	49.33	50.59

	2013	2014	2015	2016	2017
Tier 1 capital ratio[2]	15.68%	14.17%	16.38%	18.00%	18.67%
Tier 1 capital ratio fully phased-in[3]	12.11%	13.95%	16.38%	18.00%	18.67%
Total capital ratio	20.28%	16.87%	19.00%	20.29%	20.73%
Return on equity	11.65%	11.75%	10.28%	12.19%	5.44%
Cost-income ratio	32.24%	41.97%	42.82%	41.65%	52.39%

2017	Moody's	Standard & Poor's
Rating	Aaa	AAA

1 Based on business operations. 2 Basel II until 2013, Basel III CET1 ratio from 2014 onwards. 3 Basel III CET1 ratio.

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A LETTER TO OUR BUSINESS PARTNERS

Dear Business Partners,

Accommodation is a basic human need, and a home is more or less synonymous with protection from the vagaries of the weather and other dangers. In Germany, the well-known IKEA advertising slogan *'Are you just living, or are you living the life?'* picks up on this. It makes the point that today's homes are more than just a protective roof over our heads. They have become part of what identifies us as human. Good living standards and an unblemished environment directly impact each individual's quality of life, thereby influencing the social climate of society as a whole.

As the federal state's housing development resource, providing financial support for affordable housing is part of L-Bank's development funding DNA. The research project *'Creating com-*

munities by providing homes. State lending institutions in Württemberg and Baden 1924–1945', carried out at the University of Stuttgart under the guidance of Professor Pyta, shows that even then social housing assistance was already a development priority for both development banks in Baden and Württemberg. Since then, the two banks have become one – but the particular passion for supporting affordable housing continues unabated.

The road map for future social housing construction will be devised by reference to private investors and companies, as well as housing policies at federal, state and local government level. It must be drawn up in the near future, based on reliable, comprehensive data. The Prognos study to determine housing needs in Baden-Württemberg, commissioned by L-Bank as a member of Baden-Württemberg's Housing Alliance, is an important building block in this project. The study highlights those areas of the region where there are clear shortages – the widespread preconception that 'Germany has all the housing it needs' is in urgent need of correction!

In 2017, more than 19,600 residential units were funded across all housing development programmes, sending a strong signal to the housing market and those segments of the population in greatest need of housing. The reorganisation of Baden-Württemberg's social housing support is delivering further stimulus. The state development programme 'Wohnungsbau BW 2017' (Housing Construction BW 2017), launched last year, gives high priority to both affordable rental accommodation and home ownership. In recent years, the situation has become increasingly acute for families with children in particular – a social issue that clearly needs to be corrected. The 3,200 or so applications for residential units received since the federal state's housing assistance programme for social rental housing and home ownership was redesigned and show that our efforts to extend the programme and make it more flexible are already having an effect.

But housing development is not the only sector where the figures add up. Overall demand for our development loans has also grown; once again, we can look back on a good year for development finance. Our enterprise development activities have set new benchmarks in multiple sectors. More than 8,000 established small and medium-sized enterprises, as well as business start-ups and business transitions, have benefited from our support. We were also kept very busy handling the demand for our financial aid services; we processed more than 142,000 applications for family allowances alone.

In short, the Bank's overall performance was very respectable. And for this, I warmly thank our employees, who have shown so much commitment and dedication in so many different ways, both in our ordinary business activities and in our many special projects.

Dr. Axel Nawrath
Chief Executive Officer, L-Bank

GREETINGS FROM THE STATE PREMIER

Baden-Württemberg is doing well – in many respects, even excellently. At the start of 2018, we registered the lowest levels of unemployment for 25 years. We currently have more people in work than ever before, and we are the region with the strongest research record in Europe.

These are all factors that make our state attractive to both locals and the many new citizens who have moved here from Germany and abroad. Over the last few years, Baden-Württemberg has welcomed many new residents. But even among locals, the urban relocation trend has continued. This is changing population patterns and housing structures in our urban and rural districts.

Many local authorities are having difficulties providing all our new citizens with sufficient suitable accommodation. And this is true across large swathes of the federal state – in 27 of our 44 urban and rural districts the housing market situation has become strained. But suitable housing at reasonable prices is also becoming an increasingly significant aspect of our region's attractiveness as a business location. A good housing construction policy is thus a fundamental part of a forward-looking regional development policy.

There is a significant need for new living space, as evidenced by the Prognos AG study commissioned by L-Bank at the request of the Baden-Württemberg Housing Alliance. The study estimates that by 2020 the annual new housing requirement across the state as a whole will come to more than 60,000 residential units, including between 1,500 and 6,000 social housing units alone.

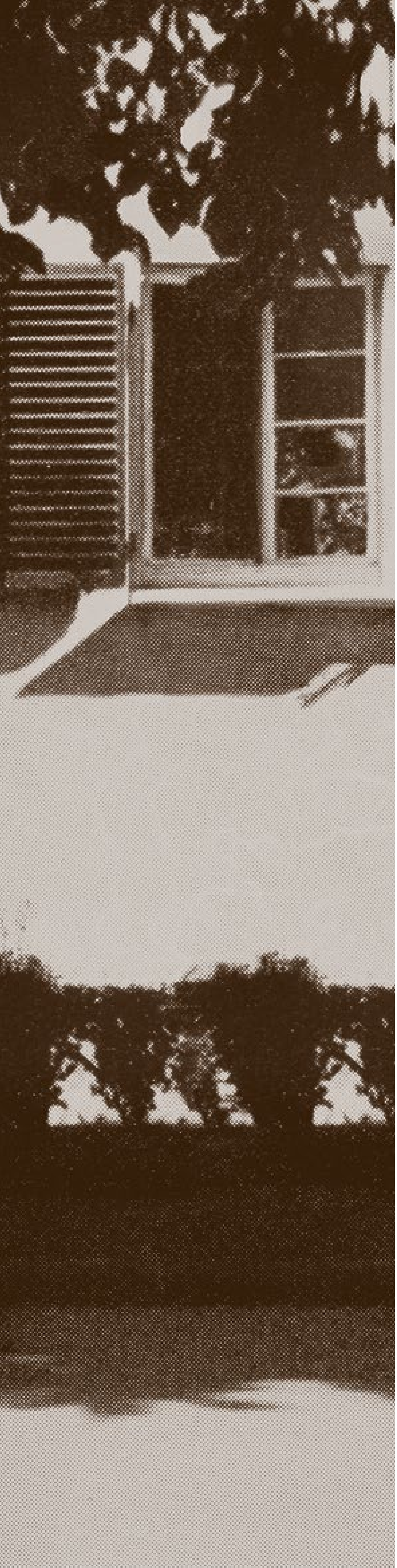
Consequently, the state government has accepted the recommendations made by the Housing Alliance and boosted social housing assistance with a new, broader and more efficient state development programme christened 'Housing Construction BW 2017'. For the first time in many years, L-Bank – which manages the programme as both development bank and funding approval authority – was able to draw on approved funding amounting to a quarter of a billion euros. This represents a fivefold increase compared to 2011. In addition, zoning for social rental housing development was extended to include the entire federal state.

Social housing development is not a recent top development priority for L-Bank. It would be more accurate to say that financial support for social housing represents the original core of L-Bank and its predecessor institutions, strongly influencing the Bank's history over many decades. With this major skill set at its disposal, the federal state government seeks to continue its housing construction efforts and consequently – despite a decline in federal funding – has once again made EUR 250 million available for each of programme years 2018 and 2019.

I would like to thank L-Bank and all L-Bank employees for their impressive efforts in this area and in each of the four other main development areas. Your efforts help to keep our federal state strong and attractive, and to develop it further as we look forward to a bright future!

Winfried Kretschmann

Winfried Kretschmann MdL
State Premier of the State of Baden-Württemberg



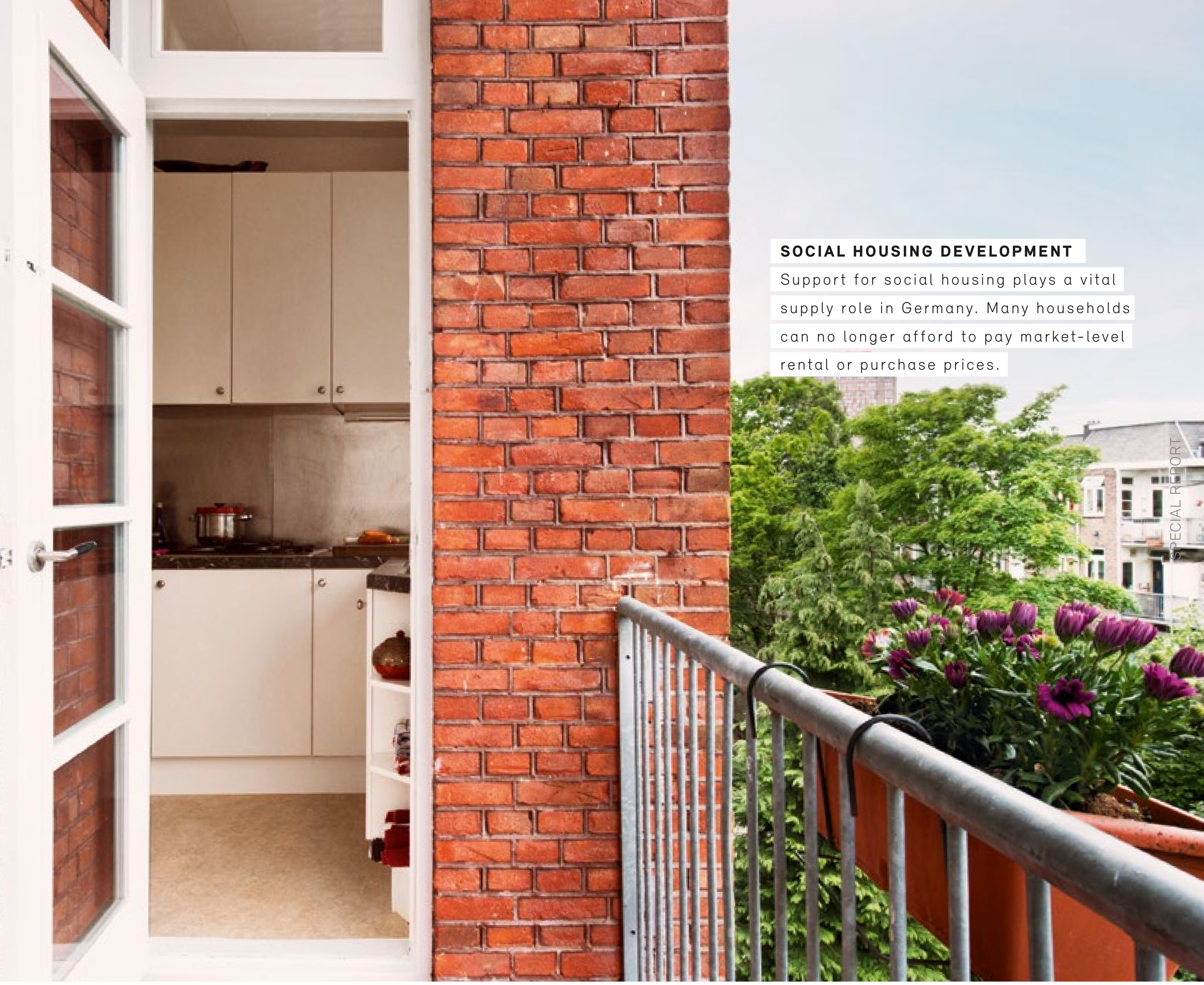
LIVING THE LIFE

AFTER THE FIRST WORLD WAR
there was a general housing shortage, and the construction of social housing became a key socio-political challenge. In response to this need, the Württembergische Landeskreditanstalt was established from 1922 onwards, followed by the Badische Landeskreditanstalt in 1934/1935; both have their origins in Baden's housing benefit funds. Over the next few decades, providing financial support for housing development remained the central remit of both institutions. In this sense, the early history of these L-Bank ancestors is largely a record of housing construction and housing development.

STUDY ON BEHALF OF
THE HOUSING ALLIANCE

HOUSING NEEDS IN BADEN-WÜRTTEMBERG

The results of the study make it clear that various development dynamics affecting housing supply and demand have caused the housing markets in Baden-Württemberg to diverge to the extent that they are now in a clear state of imbalance. Due to population growth, immigration from other parts of Germany and abroad, as well as the **trend towards smaller households** (households of just one or two people), housing demand in Baden-Württemberg has grown significantly in recent years. Whereas in the period from 2011 to 2015 the population increased by 370,000 residents (+3.6%), and thus grew well above average both at federal level (Germany: +2.3%) and compared to other large federal states (Bavaria: +3.2%), the number of economic households in Baden-Württemberg also increased above average (+5.1%), as did residential households (+4.6%). In recent years, demographic and housing market trends in Baden-Württemberg have developed in parallel with a significant surge in employment. In the period from 2011 to 2015, the number of employees liable to pay social security contributions increased by 335,000 statewide, from around 4 million to 4.35 million. As a result of this upsurge of around 8.9%, there was also a significant increase in job density (employees liable to pay social security contributions per 1,000 inhabitants) in Baden-Württemberg, rising from 381 in 2011 to 407 in 2015.



SOCIAL HOUSING DEVELOPMENT

Support for social housing plays a vital supply role in Germany. Many households can no longer afford to pay market-level rental or purchase prices.

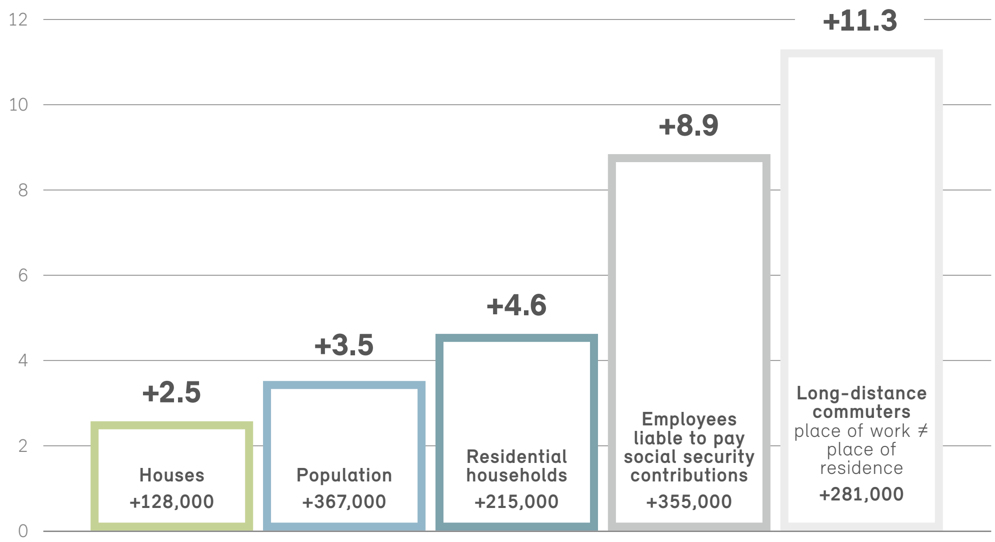
Whereas the number of residential households statewide rose by 215,000 units between 2011 and 2015 (+4.6%), the housing supply curve lagged significantly behind. Over the same period, 149,000 new houses were completed. At the same time, housing stock was reduced (due to demolition or repurposing) by some 21,000 units, meaning that in real terms the housing supply only increased by 128,000 houses. This is equivalent to an increase of roughly 2.5% relative to Baden-Württemberg's total housing stock of 5.19 million houses. The number of completed buildings in Baden-Württemberg rose from 22,000 in 2010 to around 33,000 in 2016. This increase was mainly accounted for by multifamily houses, with the number of building completions doubling over the period from 2010 to 2016 (from 9,300 to 18,500). Relative to the Free State of Bavaria, however, it is clear that the number of completed buildings in Baden-Württemberg is below average, at just 3.1 completed buildings per 1,000 inhabitants (Bavaria: 3.6).

URBAN AND RURAL LIVING SPACE

Affordable living space is not just in short supply in cities, conurbations and university towns; it has become a major issue throughout Baden-Württemberg.

Again, the Free State of Bavaria actually shows a slightly lower relative increase in housing demand (economic household trends 2011–2015: BW: +5.1%, BY: +5.0%). Compared in particular to the 215,000-unit increase in residential households over the 2011–2015 period, the growth of the housing supply in Baden-Württemberg fell there significantly behind, by 128,000 units. In mathematical terms, just 60% of the demand for new housing in Baden-Württemberg over this period was covered by expanding the federal state's housing supply. Thus the housing shortfall over this period came to 88,000, which could be described as the state's cumulative housing need.

Figure 1
COMPARISON OF SELECTED DEVELOPMENT INDICATORS FOR HOUSING SUPPLY AND DEMAND
in Baden-Württemberg 2011–2015 in %



Source: Own calculations based on figures from State Statistical Office of Baden-Württemberg and German Federal Employment Agency (2017).

As a result, this imbalance in Baden-Württemberg's housing market development is causing a significant increase in the density and/or shortage of housing in most of the state's regional markets. This is reflected in a decline in housing vacancies (to an exceptionally low historical level), the bundling and utilisation of housing by multiple economic households (especially in metropolitan areas and university towns) as well as sharp increases in rental prices, purchase prices and building-plot prices. Especially for new tenants and house-hunters entering Baden-Württemberg's regional housing markets as active new consumers, is it much more difficult to find living space, making the search for housing more time-consuming, and reducing the quality of the housing stock on offer.

The deterioration of the housing supply situation is clear from the following figures. Whereas in 2011 there were still 5.06 million houses available for the state's 4.9 million households (economic households), representing an average of 1,031 houses per 1,000 households, by 2015 this figure had fallen to 1,006 (Germany as a whole: 1,016). The decline in this ratio illustrates the deterioration in the quantity of housing supply in Baden-Württemberg.[1]

HOUSING NEEDS IN REGIONAL MARKETS

The regional differentiation of housing market development in Baden-Württemberg at the level of the 44 rural and urban districts, as well as the relevant primary and secondary hubs, highlights both the broad distribution of active housing demand and the specific shortages in the federal state's housing supply. While the nationwide study of municipality growth dynamics carried out by the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR) in 2006–2011 classified some 33% of the total of 460 municipalities and/or municipal associations in Baden-Württemberg as shrinking to strongly shrinking, this figure fell to just 4% over the 2010–2015 period. Between 2010 and 2015, 82% of Baden-Württemberg's municipalities/municipal associations were categorised as municipalities enjoying growth or above-average growth.

The spatial distribution of the cumulative 'housebuilding deficit' of 88,000 houses that arose at district level between 2011 and 2015 illustrates the intensity of housing demand in the state's regional markets. Stuttgart, the state capital, and its immediately surrounding districts (Esslingen, Böblingen, Ludwigsburg and Rems-Murr-Kreis) stand out in particular, accounting for around 28,400 of the 'missing' houses, or just under one-third of the statewide housebuilding deficit. Measured in terms of housing stock, the size of the housebuilding deficit is above average in the following university towns and cities in particular: Freiburg (4.9%), Stuttgart (4.2%), Pforzheim (4.2%), Karlsruhe (3.9%), Mannheim (3.3%) and Heidelberg (2.8%). In these towns and cities, the shortfall in the residential accommodation built between 2011 and 2015 compared to actual demand amounted to around 35,000 houses. But especially in primarily rural districts with areas of concentrated population (such as the districts of Constance, Tübingen, Ravensburg and Ostalbkreis), housing construction fell well short of the surging demand for housing. Because the federal state's economic strength is so broad-based, the lack of living space in Baden-Württemberg is very widespread and – in contrast to other large federal states in western Germany – the phenomenon is not confined to big cities and metropolitan areas, but also affects a large number of Baden-Württemberg's municipalities.

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1 Housing markets start to show strain as soon as the average housing supply falls below 1,025 to 1,030 houses per 1,000 households. This figure is considered the minimum value for vacant housing, representing 2.5–3% of the housing stock, at which stage a housing market can be described as 'clear', with sufficient reserve for moves, renovation work and refurbishment projects.

CLASSIFYING AND CHARACTERISING REGIONAL HOUSING MARKETS IN BADEN-WÜRTTEMBERG – HOUSING AS AN ECONOMIC DEVELOPMENT FACTOR

As a result of the increasingly acute housing shortage, housing is becoming an ever more important factor in making the federal state attractive to investors, given the continuing need for skilled labour. The harder it is to find a home, the more difficult tight housing markets make it for companies to attract skilled workers from outside the state. House-hunters must often resign themselves to spending more time searching, and to accepting financial or qualitative strictures on available housing. In the course of this study, five different types of housing market were identified in Baden-Württemberg, based on a differentiation of job density and housing supply in the region's housing markets. At the level of the 44 rural and urban districts, the classification subdivides the housing markets into groups with similar structural characteristics in terms of the interaction between labour and housing markets. This systematic classification resulted in five groups of housing markets, as described below:

TYPE A

Very stressed housing market (1,010 houses per 1,000 households) **with very strong labour market and/or above-average job density** (581 employees liable to pay social security contributions (ESCs) per 1,000 inhabitants). Type A includes the nine administratively independent cities in the state, which together account for around 37,500 houses or 43% of the housing deficit that accumulated from 2011 to 2015. Over the 2011–2015 period, Type A housing markets were characterised by a markedly above-average increase in housing demand (+6.2%).

TYPE B

In comparison with other rural districts, a **very stressed housing market** (1,058 homes per 1,000 households) **plus a very strong labour market and/or high job density** (394 ESCs per 1,000 inhabitants). Type B includes ten rural districts (such as Böblingen, Rastatt, Ravensburg) with around 25% of the cumulative housebuilding deficit (22,000 houses). Type B housing markets often consist of districts immediately surrounding metropolitan areas or large cities, as well as rural districts with population concentrations. Between 2011 and 2015, Type B housing markets were characterised by an above-average increase in housing demand (+4.7%) as well as above-average employment growth (+9.9%).

TYPE C

In comparison with other rural districts, a **very stressed housing market** (1,056 houses per 1,000 households) **with low job density** (320 ESCs per 1,000 inhabitants). Eight rural districts are classified as type C (including, for example, Constance, Rhein-Neckar-Kreis, Tübingen), accounting for 16,300 'missing' houses or 19% of the cumulative housing shortfall. Type C housing markets are characterised by a housing demand that is about average compared to other federal states (+4.3%), accompanied by above-average employment growth (+10.1%).

TYPE D

A relaxed housing market (1,086 houses per 1,000 households) **with above-average job density** (394 ESCs per 1,000 inhabitants). Nine districts are classified as Type D (including, for example, Biberach, Tuttlingen, Schwäbisch Hall). With a shortfall of around 4,200 houses, representing about 5%, this group's share of the state's housebuilding deficit accumulated between 2011 and 2015 is relatively manageable. In recent years, Type D districts have been characterised by below-average housing demand (+3.3%) and employment growth (+7.9%).

TYPE E

A relaxed housing market (1,080 houses per 1,000 households) **with below-average job density** (310 ESCs per 1,000 inhabitants). Eight rural districts are classified as Type E (including, for example, Waldshut, Sigmaringen, Enzkreis). With a shortfall of around 7,000 houses, representing about 8%, this group's share of the federal state's cumulative housebuilding deficit is relatively manageable. Like Type D districts, Type E districts have been characterised by below-average housing demand (+3.5%) and employment growth (+6.3%) in recent years.

Figure 2

CLASSIFICATION OF REGIONAL HOUSING MARKETS IN BADEN-WÜRTTEMBERG

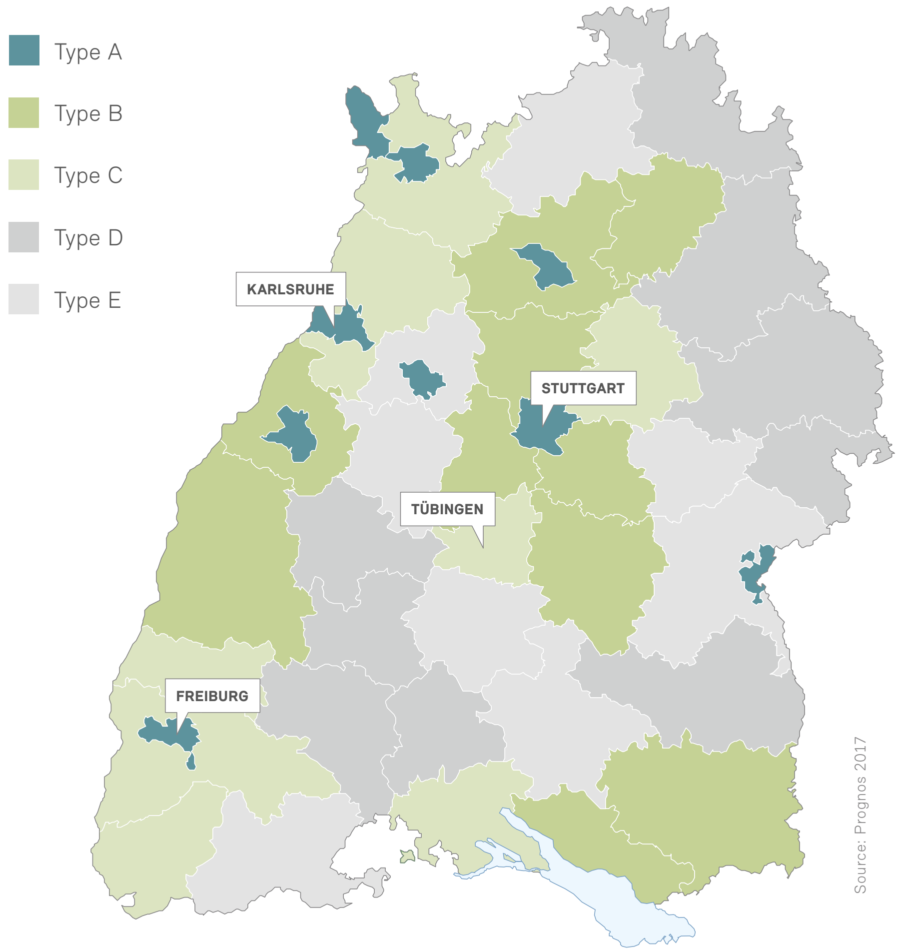
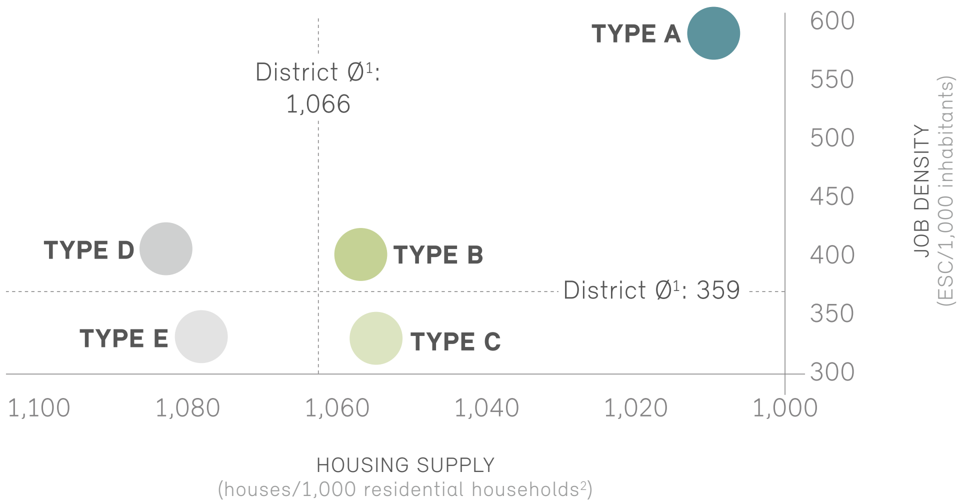


Figure 3

AVERAGE HOUSING SUPPLY AND JOB DENSITY by type



1 Average across rural and urban districts.
2 People living together in a single house or apartment are counted as one household (house/flat share = household).

Source: Prognos 2017

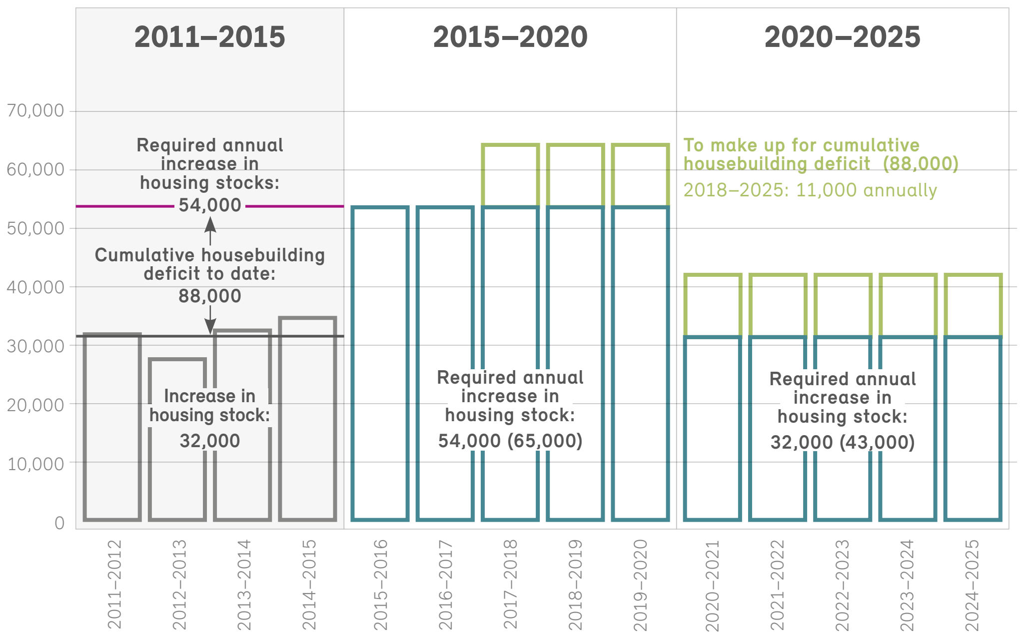
Figures 2 and 3 show the spatial distribution and classification of the five types of housing market in Baden-Württemberg at rural and urban district level, revealing the spatial patterns of and functional interrelationships between towns, cities and the surrounding countryside. The classification of Baden-Württemberg's housing markets makes it clear that towns and municipalities in Type A markets (9 urban districts), Type B markets (10 rural districts) and Type C markets (8 rural districts) in particular will experience significant challenges in expanding their housing supply in the future. This is evident from the combination of a constrained housing supply with lively housing demand and employment trends. There is a shortfall of around 76,000 houses (86% of the cumulative statewide housebuilding deficit) in the 27 rural and urban districts classified as Type A to Type C housing markets, which also account for around three-quarters of Baden-Württemberg's total population. Due to their immediate geographical proximity and commuter populations, towns and municipalities – as well as planning associations – in Type A and B housing markets (partly also Type C) are called upon to improve the intermunicipal and regional coordination of their urban development and housing policy activities and plans in the future, so they can respond more effectively to changes in urban-suburban dynamics. In addition to expanding residential areas, launching brownfield construction projects and providing targeted funding for housebuilding, the integration and expansion of the local public transit systems connecting these different types of housing markets will play an increasingly important role in the future.

FUTURE HOUSING NEEDS IN BADEN-WÜRTTEMBERG TO 2025

Given current and future housing needs, Baden-Württemberg and its regional housing markets face some major challenges. All signs indicate that there will be no easing in housing demand in the short to medium term; indeed, we should expect an ongoing intensification of housing demand due to immigration. Even in the longer term, there is no likelihood that the situation will ease, with three scenarios indicating that Baden-Württemberg's housing needs will continue to rise until 2040.

As part of the study, new scenarios for the long-term growth of Baden-Württemberg's population were drawn up using the Prognos Demography Model. Based on the latest population data (as at 31 December 2015), the scenarios were used to forecast demographic and household

Figure 4
REPRESENTATION OF HOUSING NEEDS BY TYPE
in Baden-Württemberg by 2025



Source: Own calculations based on State Statistical Office figures and Prognos Demography Model (primary variant) 2017. Simplified assumption: Cumulative housebuilding deficit will be made up over an eight-year period (2018–2025). Note: The annual figures presented in each case relate to developments between the reporting dates (31 December) of the years shown.

trends and hence predict long-term housing demand through to 2040.[2] At times when house-building requires lengthy planning and approval processes, it is especially important to identify anticipated demand trends as early and precisely as possible so that the necessary preparations can be made.

The scenarios, which explore long-term demographic trends in Baden-Württemberg based on immigration assumptions through to 2040, show that the state's population, households and housing demand are all likely to rise in the short, medium and long term. The **primary variant** suggests that by 2040, the number of households will increase by around 600,000 or 11.7%. While the increase in households and housing demand is likely to flatten over the very long term (starting in 2035), the short- to medium-term outlook over the next few years (until 2021 or 2025) is likely to be very significant for housing market developments in Baden-Württemberg. **Figure 4** illustrates the future annual new build requirement for Baden-Württemberg up to 2025 and compares this with the expansion of housing stock between 2011 and 2015.

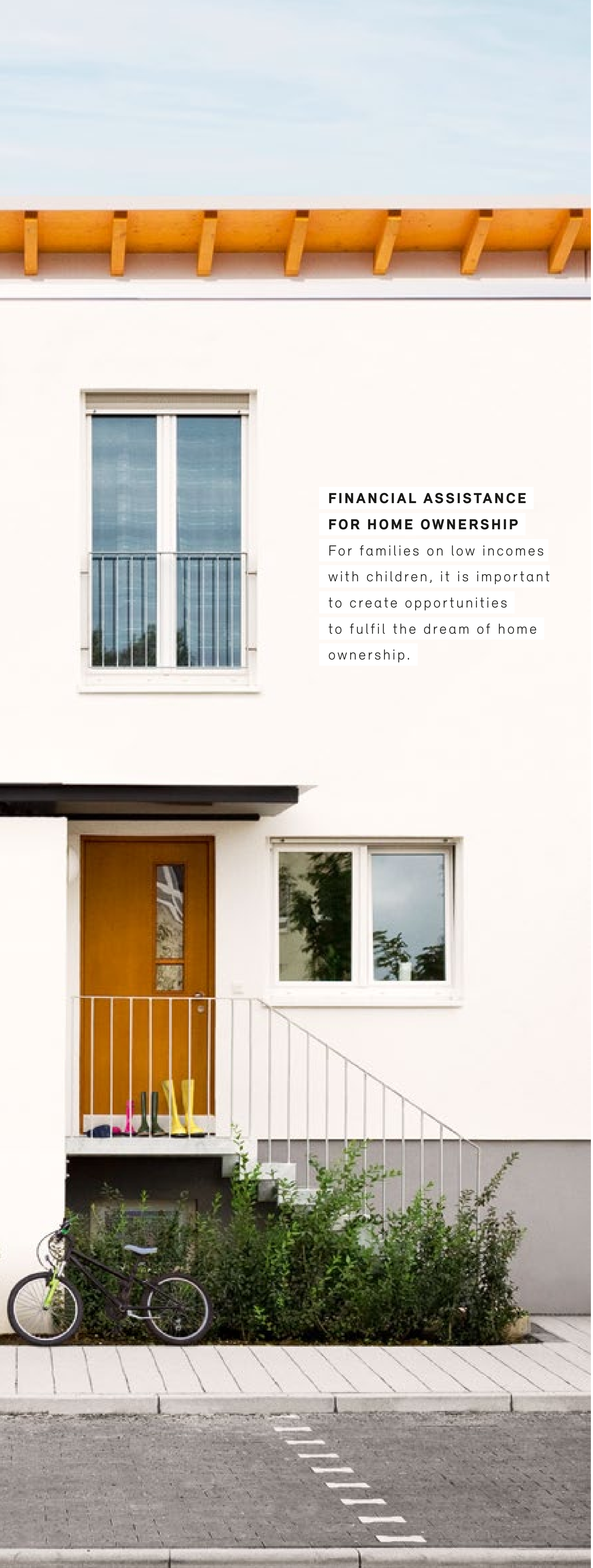
In the period from 2011 to 2015, the state's housing stock grew by an average of 32,000 houses. Relative to the growth in household numbers, a housebuilding deficit of 88,000 houses accumulated over this period. The predicted future increase in households means that there will be an urgent need for redevelopment and new builds. By 2025, the state's housing needs are likely to develop as follows:

- In the period from 2016 to 2020, the upsurge in the number of households will create an annual requirement for redevelopments or new builds of around 54,000 houses. This represents a total of 270,000 houses. In addition, the gradual elimination of the cumulative baseline requirement (88,000) over the period 2018–2020 is expected to create a need for another 33,000 houses (11,000 p.a.), so that the total housing requirement will rise to around 300,000 houses.[3]

- According to population projections in the primary variant, a slowdown in immigration and an increase in the number of households is expected over the period 2021–2025. The annual requirement for redevelopments and new builds will amount to 32,000 houses. If elimination of the cumulative housebuilding deficit is included, the total annual housing requirement amounts to 43,000 houses. Thus the total housing requirement for the period 2021–2025 is expected to amount to 215,000 houses.

2 This step became necessary because the last forecast by the State Statistical Office of Baden-Württemberg (in 2015) was based on figures from 31 December 2014; an updated population forecast for 31 December 2017 is only expected by the beginning of 2019.

3 For the sake of simplicity, we have assumed that eliminating the cumulative baseline requirement over the eight-year period 2018–2025 would require 11,000 houses per annum.



FINANCIAL ASSISTANCE FOR HOME OWNERSHIP
For families on low incomes with children, it is important to create opportunities to fulfil the dream of home ownership.

CONCLUSIONS AND KEY RECOMMENDATIONS FOR THE TARGETING OF HOUSING POLICY IN BADEN-WÜRTTEMBERG

As one of the strongest federal states in Germany economically, with a commensurately high demand for skilled labour, Baden-Württemberg is exceptionally dependent on the ongoing expansion of its housing supply for retaining its current strong reputation as an attractive business location in the future. One of the study's more important contributions is the presentation of a body of useful information, combined with a road map depicting emerging long-term trends and challenges in Baden-Württemberg's housing markets. This is a valuable tool for decision makers in Baden-Württemberg's political, administrative and housing organisations. Municipal policymakers in particular represent a vitally important target audience for bringing about the necessary change in the state's regional housing markets. As a result of rising immigration from 2011 onwards, the stagnating indeed, declining – trend prior to 2009 turned into rapid, dynamic growth in many submarkets. Thus, the process of predicting and reversing housing and living space policies has inevitably resulted in some major shortfalls as far as interpretation and objectives are concerned.

Combined with an exceptionally acute shortage of living space and a historically prolonged period of low interest rates, the business of identifying the real issues and then readjusting, refocusing and introducing new measures in the face of drawn-out planning and decision-making processes (including the involvement of political bodies) while simultaneously grappling with the uncertainty of future developments, has caused significant delays and deferrals in associated activities. The response of municipal building and planning departments to increasingly complex needs and a growing number of inquiries has often been to employ more staff.

Resolving and overcoming the challenges posed by housing demand in Baden-Württemberg requires a joint effort by decision makers at state and municipal level, in consultation with the housing industry. Comparisons with the experiences of other federal states and regions, as well as other historical periods (e.g. post-war reconstruction, the 1980s, reunification) show that it is entirely possible to tackle and find solutions for these tasks and challenges.

Construction and housing policy instruments in Germany and Baden-Württemberg have been continuously developed over the last few decades. The current housing policy debate should therefore focus less on developing and implementing entirely new instruments and approaches, and take a critical look at the existing instruments instead. The latter can then be adjusted as necessary,

RENTAL ACCOMMODATION DEVELOPMENT

Publicly supported social housing must become more attractive for housing companies, pension funds, insurance companies and fund providers. Financial assistance is required.

flexibly deployed in response to need, and promptly implemented to provide more affordable housing. The high baseline housing need (due to the cumulative housebuilding deficit) means that the timely implementation of initiatives and approaches that have already been planned should now take top priority. After all, there has been a housing shortfall in many of Baden-Württemberg's regional housing markets for some considerable time.

In the course of this study, we have identified the following general approaches to and requirements for action, as potential starting points and triggers for further strategic discussion within the Housing Alliance:

1. A needs-based expansion of the housing supply, a focus on the need for new builds and redevelopments by 2025 (around 485,000 houses), and the prompt provision of more affordable housing in Baden-Württemberg. In addition to the consolidation and exploitation of existing inner-city development potential, the activation of residential areas in suburbs and extra-urban districts by municipalities will also play a key role. To minimise the amount of land required, consideration should be given to bundling and integrating land development in central locations (such as schools, childcare facilities) and development hotspots (where high housing needs and surging demand coexist with high employment levels and an efficient transport infrastructure). And in response to bottlenecks in land availability, housing density should be increased by prioritising the apartment-block segment when expanding the housing supply – especially in urban areas.

HOMEOWNERS' ASSOCIATIONS

The modernisation of older residential buildings is a forward-looking activity that benefits the environment and mitigates energy costs.

2. The development of social housing stock in Baden-Württemberg is showing a sharp decline. The stock of regulated-rent houses fell from 137,000 houses in 2002 to around 60,000 in 2015. In the long term, i.e. by 2030, the expiry of occupancy rights is expected to result in the loss of around 22,000 regulated-rent houses, reducing the stock to a total of 39,000 houses. It is thus crucially important to strengthen and stabilise social housing development over a longer period of time. Stabilisation plays a very important role in housing and social policy, especially in urban housing markets that are already under strain. In addition to new builds, the purchase of occupancy rights with the aim of establishing regulated tenancies in the existing housing stock plays an important supporting role in stabilising and increasing housing supply in this segment. Here, municipalities should share their experience of rental thresholds, prerequisites and potential scopes of application while exploring how housing quotas based on specific areas and projects could be used flexibly and in response to demand. According to experts, the scale of social housing needs in Baden-Württemberg is defined as having an upper limit of 6,000 and a lower limit of 1,500 additional houses per annum. The lower limit of the scale (1,500 houses) would merely contribute to maintaining the status quo, with around 60,000 houses by 2030. Significant expansion and replenishment of the state's social housing stock as a whole depends, for example, on the structure of federal funding (from 2020 onwards), the stabilisation of the State of Baden-Württemberg's own financial resources, and – to an important extent – on the acquisition and activation of private funding.

3. The federal state's housing assistance programme remains a very important instrument in Baden-Württemberg's housing policy. The size and scope of the state's housing needs mean that assistance programmes for both rental social housing and owner-occupied housing are crucially important. In terms of the division of labour, the two funding approaches are complementary, contributing directly to the activation and provision of more affordable housing in urban centres, conurbations and more rural districts. As a strategy, simply providing more financial assistance – especially for rental housing – is reaching its limits in many regional housing markets, due to the enduring low-interest environment, rising housebuilding costs and a pronounced shortage of building plots. The instruments in the federal state's housing assistance programme could be supplemented and strengthened by acquiring more land, as well as by activating and utilising brownfield sites or making them available on the housebuilding market. The State of Baden-Württemberg, as well as individual cities and municipalities, should move to increase the use of earmarked allocations (specifically for social and low-cost housing; family support for low and middle-income earners in particular; definition of award criteria for property development and use concepts) when selling land or acquiring housing stock and land. Direct access to housing stock (especially social and low-cost housing) and the availability and targeted provision of residential building plots by the public sector (federal, state, local authorities), as well as allocation models for the socially responsible use of land for building, are all becoming increasingly important levers for shaping and developing housing markets in overstressed markets. The state government might wish to explore the feasibility of developing and introducing additional instruments such as a real-estate fund or state development corporation (LEG). Such an instrument would provide the state with direct access to real estate and housing stock, and could have a damping or structuring influence on housing markets, especially very stressed ones (at risk of market failure).

4. Against the backdrop of demographic change, the provision of age-appropriate housing is becoming an increasingly important issue. Even as things stand, a model-based calculation of existing housing stock versus the need for housing suitable for the elderly indicates that Baden-Württemberg still has a significant shortfall of around 220,000 houses optimised for senior citizens. Furthermore, the demand will continue to rise from 19.8% in 2015 to 27.4% in 2040, due to the larger proportion of over-65s in Baden-Württemberg's future population. The outlook for 2040 suggests that the demand for age-appropriate housing in Baden-Württemberg will climb to around 486,000 houses. Hence it is likely that the differential between existing stock and future need will continue to grow. In view of this demographic shift, housing markets in Baden-Württemberg must adapt to a significantly greater need for accommodation for senior citizens. This is why development programmes focusing on age-appropriate refurbishment (by KfW, L-Bank) are so important for supporting and developing housing suitable for the elderly, to build up housing stocks at an early stage and encourage private investment in this area (by homeowners, for example).

5. Building costs have risen continuously over the last 10 to 15 years. This is due to general price increases, but also to changes in the regulatory requirements for new builds (such as energy standards). In urban areas, this is exacerbated by disproportionately high increases in the price of building land. The effect is further amplified by taxes (including property tax and land transfer tax) and fees influenced by federal, state and local authorities. To increase the proportion of affordable housing in Baden-Württemberg, it is essential to lower or moderate building and property costs. In order to contain costs and prevent further disproportionate increases in building and manufacturing expenses, the State of Baden-Württemberg is required under federal and state coordination rules to examine, determine and implement potential relief, as well as simplification and acceleration procedures, in line with the legislation governing building codes and planning. In this respect, the adaptation and standardisation of State Building Regulations (LBO) lies within the remit of the federal state. In addition to costs, lengthy planning procedures at municipal level represent another obstacle to new building activity. Facilitating, accelerating and simplifying planning and approval procedures (including handouts, reduction of complexity, retrospective or additional requirements for building applications) could help speed up the provision of housing while also reducing costs.

6. Cities and municipalities are the main driving force and co-creators of the local housing supply through urban land-use planning and municipal real-estate policies. Their influence is further strengthened by municipal housing companies responsible for developing and managing property and housing stocks to which the municipalities have direct or extended access. But local authorities in many of Baden-Württemberg's regional housing markets are reaching their limits with respect to the prompt activation and redesignation of residential building land in their municipalities. In addition, they are incurring follow-up costs for the development of the requisite technical and social infrastructure (such as childcare, public transport, accessibility). These issues are throwing the limitations of a purely one-dimensional approach to planning and other activities into sharp relief. Furthermore, the growing geographical distance between homes and workplaces is also causing the volume of commuter and other traffic to increase at above-average speed, as people cover

HOUSING NEEDS
Home owners and housing policy makers must develop sustainable concepts for age-appropriate housing.

longer distances during the working day. Attractive housing markets, with an adequate supply of regional facilities as an added attraction, play a central role in securing a supply of skilled workers for all regions in Baden-Württemberg. In view of the growing pressure on land and traffic, improving the coordination of residential and commercial property policy with transport policy is a vital mission, especially in densely populated conurbations. Inter-municipal cooperation and city-suburb joint ventures covering housing policy – especially in areas with exceptionally high pressure on living space, high levels of functional interdependence beyond city limits, and/or limited space and development options – will become increasingly important as a way of expanding suitably targeted housing stocks in regional housing markets.

The strategic recommendations and courses of action outlined above represent guidelines for the demand-driven realignment of housing policy in Baden-Württemberg. As an overarching frame of reference, the suggested courses of action could help the Housing Alliance to examine, evaluate and fine-tune recommendations and policy requirements which have already been formulated. To develop regional housing markets so that they meet specific targets based on existing and emerging housing needs in Baden-Württemberg, the timely implementation and completion of practical measures and instruments in the years leading up to 2020 will be crucial. Important prerequisites for rapid implementation include jointly agreed objectives, close cooperation between the federal state and partners in Baden-Württemberg's housing industry, and ongoing dialogue.

Study on behalf of the Housing Alliance Stuttgart, 4 October 2017 **Commissioned by** L-Bank, Karlsruhe
Prognos AG www.prognos.com

'SHORTAGE OF LIVING SPACE IS A WIDESPREAD PHENOMENON.'

An adequate supply of affordable living space is an important issue for people in Baden-Württemberg, and also a high priority for policy makers. Commissioned by L-Bank, Tobias Koch and his colleagues from economic research institute Prognos analysed the current and future situation on the housing market in Germany's south-western region.

Prognos expert
Tobias Koch

Mr Koch, what are conditions basically like in the federal state? Our research shows that the housing demand in Baden-Württemberg rose significantly between 2011 and 2015. The main cause is the population increase resulting from immigration, combined with a trend towards smaller households. The expansion of the residential housing supply couldn't keep pace with the dramatic surge in demand.

According to your analysis, we're already starting with a deficit of 88,000 houses. So what needs should we be prepared to meet in the future? Based on our demographic forecast, we expect the housing demand to swell by an additional 600,000 households by 2040. Much of this demand will be relatively concentrated over the period up to 2025, so to cover the housing need and make up the existing housebuilding deficit, we should be bringing 65,000 new builds or modernised houses onto the market every year through to 2020, then 43,000 houses per year through to 2025.

Are there particular regions where the housing need is especially acute? Baden-Württemberg is something of a special case in Germany. We shouldn't make the mistake of concentrating exclusively on urban areas, as is more or less common practice in many other federal states. The shortage of living space is a widespread phenomenon; it even radiates out into rural regions with very successful economies. According to our classification of the state's housing markets, the need for action is especially acute in the nine urban districts and 18 (out of 35) rural districts which are currently experiencing an above-average rise in housing demand as a result of migration and new jobs.

Which pressure points could be tweaked to close the yawning gap between supply and demand in Baden-Württemberg's housing market as a whole? Providing enough housing is posing a complex challenge to members of Baden-Württemberg's Housing Alliance, which requires the use of existing instruments to meet both current need and future targets. The most important thing is to put the appropriate road map in place as soon as possible. Improving the way cities and municipalities network and cooperate on land development and urban land-use planning, curbing increases in building costs, speeding up approval procedures – these are just some of the key levers in the State of Baden-Württemberg's dialogue with its partners. Over the next few years, it will be essential to stimulate more investment across all segments of the housebuilding market (including, for example, social housing construction) in order to make up the housebuilding deficit as soon as possible.

You can download the Prognos study from
www.l-bank.de/studien

FOR A SUSTAINABLE STATE

We help Baden-Württemberg tackle its challenges.

ATTRACTIVE AND INNOVATIVE – WE HELP BUILD BADEN-WÜRTTEMBERG'S FUTURE

Baden-Württemberg is attractive – as an investment target, as a place to live and work, as a tourist destination and as an educational hub. Southwestern Germany is one of Europe's leading technology regions with a high concentration of research and education facilities and a large proportion of employees in high-tech and cutting-edge industries.

First-rate job opportunities are not confined to the Rhine-Neckar area or the Greater Stuttgart and Karlsruhe areas. Throughout the state, companies small and large offer interesting career prospects. Dynamic rural areas are a salient feature of Baden-Württemberg. Many world market leaders and SMEs with plentiful apprenticeships and full-time jobs have made their home here. At the same time, the federal state is one of the most popular in the country because of the high quality of its leisure facilities and lifestyle.

MAJOR DEVELOPMENT BOOST FOR BADEN-WÜRTTEMBERG

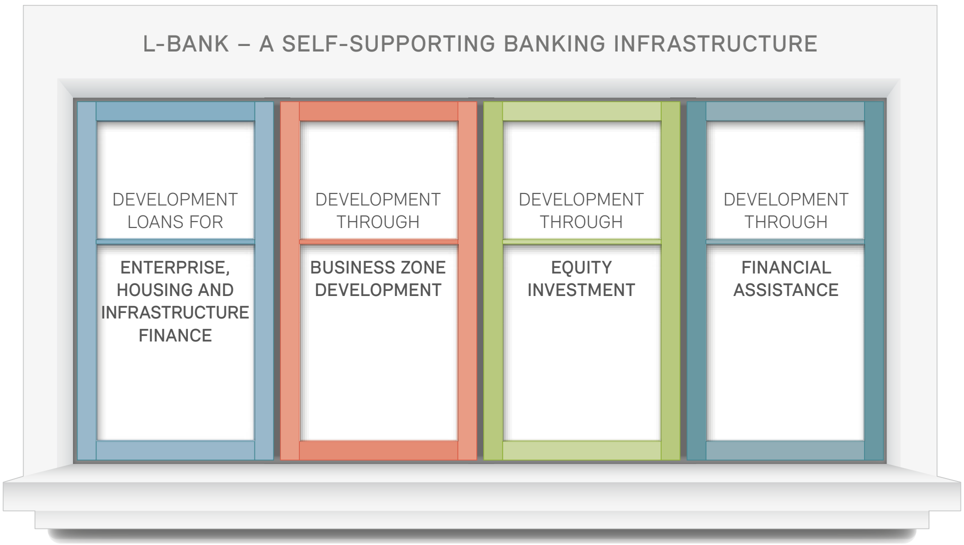
Hopefully this will all remain unchanged in the future – we're working on it. With our multifaceted development funding and financial aid programmes, with our high standards of professionalism, our extensive experience and our proven specialist expertise, we are totally involved in the ongoing development of our federal state. Our banking infrastructure acts as the platform for the efficient and effective formulation and implementation of our development programmes and financing services. And our focus on our clients and customer service ensures that we always deliver high quality.

In 2017, we were able to build on the positive developments of previous years. Adjusted for special items, our core development business maintained the high level achieved in 2016. We approved development finance totalling EUR 6.8 billion. This is equivalent to an increase of almost 2% in our development performance.

OUR CORE COMPETENCE: DEVELOPMENT FINANCE USING L-BANK'S FUNDING INSTRUMENTS

In our development business, we rely on our four-pillar model. We help the state government to shape the future of Baden-Württemberg by providing business development loans, housing and infrastructure finance, enterprise development through equity investment, enterprise development through business zone development activities, and by acting as a distributor of financial assistance. In doing so, we serve as an important source of inspiration. Thanks to the variety of development funding options on offer, we are a high-performing full-service provider of development finance, and this strong culture of service is reflected in the breadth of our service as well as the number of 'customers served'. Year after year, we provide development services for more than 160,000 development customers in Baden-Württemberg.

L-BANK'S 4-PILLAR MODEL



Reliability and continuity are important characteristics of our development funding. And, where sensible or necessary, we can refocus our efforts or respond to the latest developments at speed, in line with the needs of our target audience and the expectations of our customers. This is how we fulfil our development mandate – by helping to boost the ongoing development of our home region of Baden-Württemberg. With our development priorities – the economy, housing and infrastructure, as well as families, education and social projects – we support the federal state's economic, social and environmental objectives.

FOR L-BANK, DEVELOPMENT EQUALS 'FINANCE PLUS X'

Our development activities combine monetary and non-monetary services – focused on the needs of each target group, guided by the parameters specified by our owner. This results in attractive development products that further advance Baden-Württemberg.

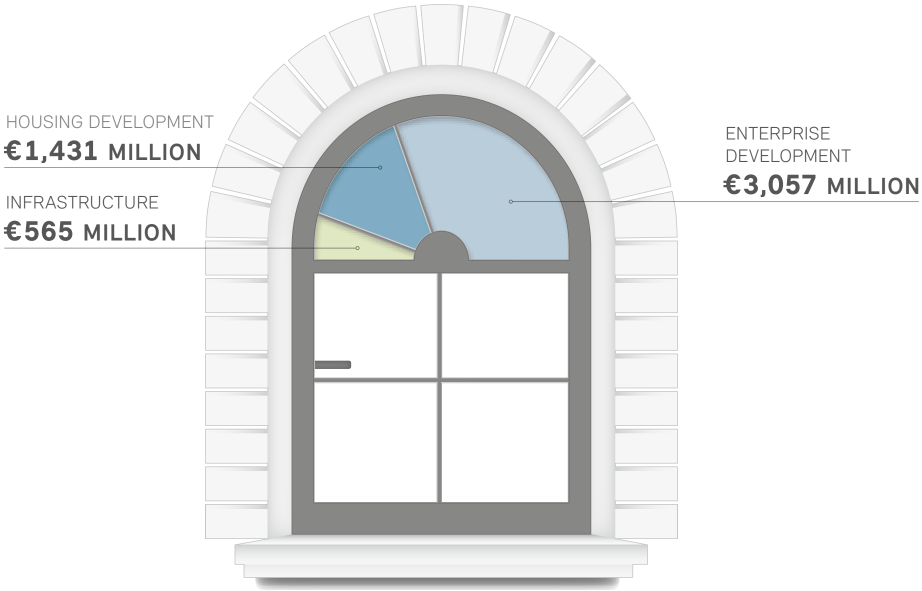
DEVELOPMENT THROUGH LOAN FINANCING

Attractive development loans are a useful means of pursuing a broad range of development objectives across many highly differentiated target markets. They are universally applicable funding instruments that also support a multitude of possible combinations. L-Bank issues development loans for housing development, enterprise development and infrastructure development.

And continued to do so in 2017, with great success. Despite the persistently low level of market interest rates, our loan-based core development business for enterprise and housing development exceeded the strong previous year (2016: EUR 4.3 billion) by reaching EUR 4.5 billion.

When configuring development offerings, L-Bank uses existing finance instruments provided by the federal government. To refinance our development activities, L-Bank also makes use of funds from the KfW banking group, Landwirtschaftliche Rentenbank and European Investment Bank (EIB). Through this close cooperation with development banks in Germany and the EU, we can channel federal and EU funding to Baden-Württemberg and bundle it there. This benefits Baden-Württemberg's development finance customers in more than just monetary terms, because this close collaboration has had a tremendously clarifying effect on what was previously a wildly growing development jungle, and created a comparatively rigorous supply policy.

DISTRIBUTION OF DEVELOPMENT LOANS –
€5,053 MILLION IN TOTAL



HOUSING DEVELOPMENT

The real-estate market is characterised by low supply and significant excess demand. More than ever before, affordable housing is a scarce commodity in Baden-Württemberg. It is becoming increasingly difficult for residents seeking to rent or buy their own homes to fulfil their housing dreams. Consequently, housing development is a high social priority.

Since April 2017, the revised Housing Construction BW 2017 regional development programme means that financial support for general social rental accommodation is now subject to standardised parameters throughout the federal state. Subsidised social rental accommodation can now be built in towns and municipalities in rural areas. This subsidised and socially regulated rental accommodation is reserved exclusively for low-income households, allowing them to benefit from subsidised homes as long as they are eligible for social housing. The programme's more attractive format, coupled with the expansion of the potential tenant base thanks to higher income thresholds, has helped to make the programme significantly more appealing.

SOCIAL HOUSING DEVELOPMENT WAS ADJUSTED TO MEET REAL NEEDS

LINES OF BUSINESS

DISTRIBUTION OF HOUSING ASSISTANCE –
€1,431 MILLION IN TOTAL

Overall, funding for rental accommodation has shown very positive development – the dramatic increase to EUR 752.2 million (2016: EUR 653.4 million) represents a new record. More than 6,400 residential units were built or modernised over the period.

SIGNIFICANCE OF RENTAL HOUSING DEVELOPMENT IS GROWING

The need for action in the social housing sector is especially urgent. The upward trend in construction and property costs on the one hand, combined with the rise in rental prices over the last few years on the other, has made the subsidised housing market unattractive for many investors. Even so, L-Bank has been able to finance around 1,000 social housing units each year in recent years. In the reporting year, it proved possible to arrest the steady decline in social housing construction. For 2018, funding for 2,000 to 2,500 socially regulated housing units is planned. This will make an effective contribution to easing the housing situation.

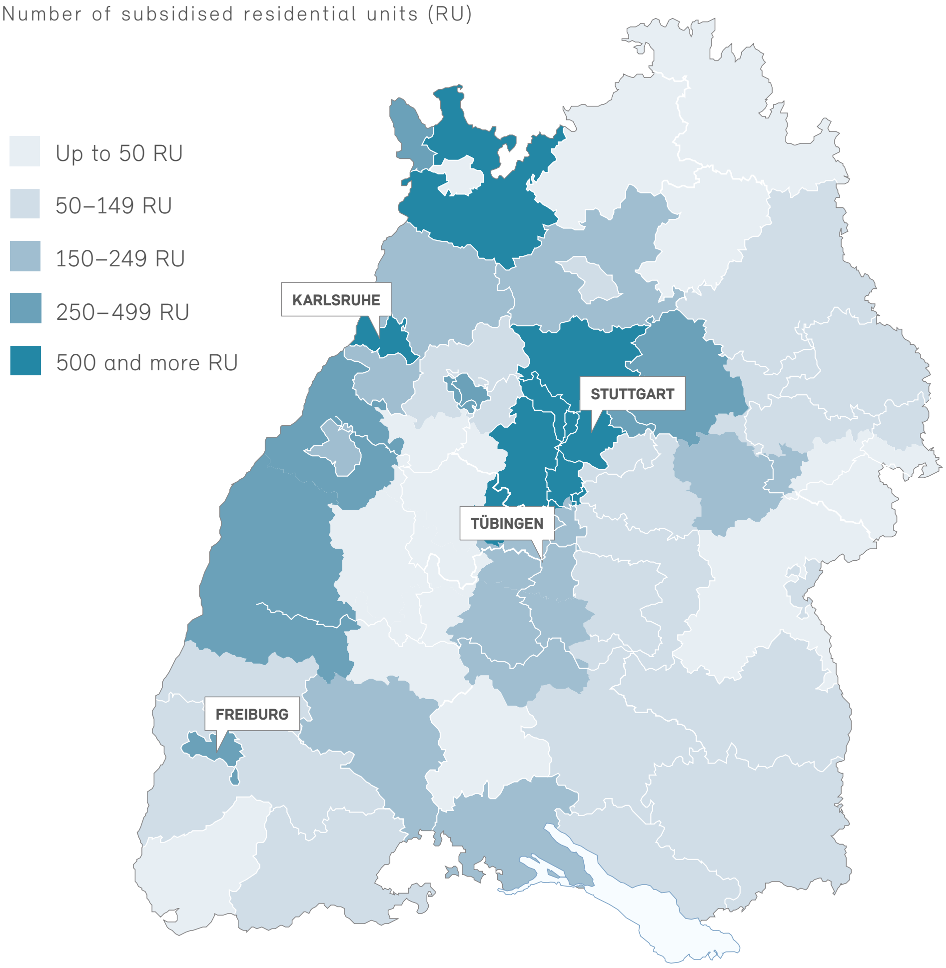
FINANCE FOR HOMEOWNERS' ASSOCIATIONS HAS BECOME ESTABLISHED IN THE MARKETPLACE

In the meantime, financial support for modernisation projects by homeowners' associations has become an established part of the Bank's development offering.

Under the state wide Housing Construction BW 2017 programme, we provided financial assistance to projects for enhancing the energy efficiency of residential buildings or converting them for easier physical access, or for modernising existing homes to use renewable energy. The volume of funding commitments increased to EUR 46.6 million (2016: EUR 32.9 million). More than 5,100 residential units were subsidised (2016: 3,783 residential units).

REGIONAL DISTRIBUTION OF STATE HOUSING ASSISTANCE IN BADEN-WÜRTTEMBERG

Number of subsidised residential units (RU)



The overstressed real-estate market is having a damping impact on the number of applications submitted. In recent years, real-estate prices have increased substantially almost everywhere, making it more difficult for families with children and mid-range incomes to buy their own homes. This outcome is also having an impact on development finance.

In state housing assistance, the funding conditions for home ownership finance were readjusted under the Housing Construction BW 2017 programme. Thanks to more favourable eligibility conditions, significantly more families with children were able to begin the process of acquiring their own homes than in the previous year. The number of owner-occupied residential units subsidised through state housing assistance increased by 235 or 24.7% to around 1,185. The funding volume rose to EUR 249.9 million from EUR 208.3 million in 2016.

THE FRAUGHT STATE OF THE REAL-ESTATE MARKET IS AFFECTING HOME OWNERSHIP FINANCE

ENTERPRISE DEVELOPMENT

Low interest rates, improved opportunities for internal financing and attractive alternative sources of funding meant that overall conditions for development loans as part of our enterprise development activities did not become any more favourable last year. Nevertheless, even in 2017 we still succeeded in substantially increasing the total lending volume approved. Loans totalling more than EUR 3.06 billion (2016: EUR 2.94 billion) were made available to businesses. Thanks to these loans, more than 8,000 companies were supported, 12,900 new jobs created and 309,000 existing jobs secured.

FINANCING OF SMES MATCHES BEST PREVIOUS LEVELS

As a business location, Baden-Württemberg is highly attractive. Businesses in Baden-Württemberg take full advantage of the opportunities on offer – both in Germany's domestic markets and in exports. In their efforts to secure their positions, they create a lively demand for investment loans. The volume of development loans extended to SMEs rose to EUR 2.26 billion (2016: EUR 2.19 billion), building on 2015's development lending record.

With the lending volume increasing by 33% to EUR 539 million (2016: EUR 405 million), the Growth Finance programme contributed to the good overall result. The programme provides SMEs with funding for all typical capital investment projects. This programme's abiding success is due to its exceptionally simple format and high level of visibility among SMEs.

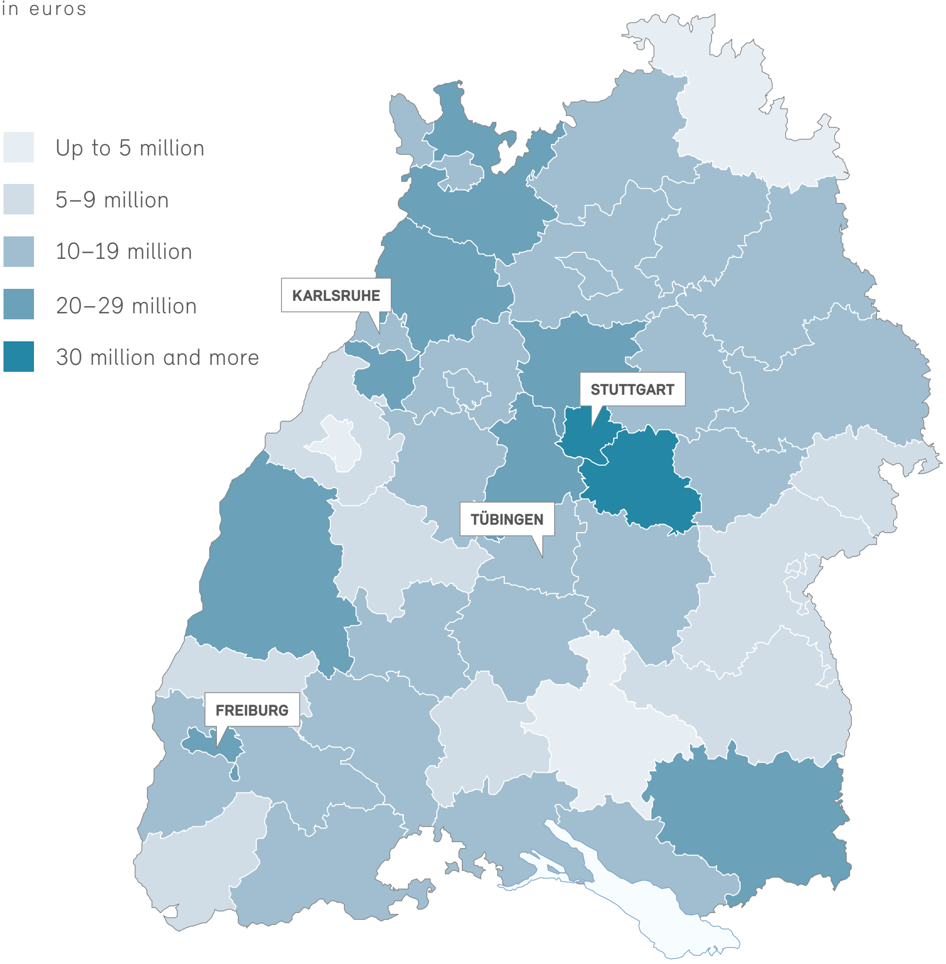
INVESTMENT FINANCE DRIVES THE DEMAND FOR FUNDING

Companies' forward-looking attitudes are especially pleasing. Development programmes such as the newly established Innovation Finance 4.0 programme have been taken up with particular enthusiasm. The programme extends the innovation financing concept first introduced in 2015 to include digitisation and the mobility value chain.

This is driving forward the digitisation of SMEs, as well as the structural transformation of the state's strong car manufacturing and automotive supply industry. The EUR 206 million distributed to date show that these areas of activity are taken very seriously by SMEs (2016: EUR 82 million).

REGIONAL DISTRIBUTION OF START-UP FINANCE IN BADEN-WÜRTTEMBERG

in euros



The other investment development programmes also continue to act as vital supports of the Bank's funding strategy for SMEs. L-Bank's Resource Efficiency Finance programmes provide SMEs with low-interest development loans for projects that improve their energy efficiency and protect Baden-Württemberg's environment. The programme reached its second-best result ever, at EUR 643 million (2016: EUR 671 million). This means that the Resource Efficiency Finance programme continues to distribute the highest volume of development funding, providing powerful support for the State of Baden-Württemberg's ambitious climate goals.

FINANCING START-UPS REMAINS ONE OF L-BANK'S CORE REMITS

Innovation and economic development in Baden-Württemberg have made very successful progress thanks to the efforts of existing companies over several decades. At the same time, it is important not to neglect young growth companies – and the fact that our entrepreneurial culture as a whole inspires so many people to become self-employed clearly shows how much the further development of our economy depends on all kinds of business start-ups. This is why L-Bank has worked so hard in recent years to systematically expand its financing ecosystem for fledgling companies. With great success! The volume of commitments for start-up financing rose by more than 10% to EUR 660 million (2016: EUR 599 million). In short, finance for business start-ups in Baden-Württemberg set a new record.

We continuously adjust our Start-up Finance and Start Finance 80 programmes, both used primarily to support smaller projects, to match changing economic circumstances. Thus in response to the trend towards higher financing volumes, the Bank raised the maximum possible gross lending ceiling. Team start-ups by four shareholders or partners can now apply for up to EUR 500,000 under the Start Finance 80 programme. We are also paying particular attention to the issue of business succession. The trend is clear: takeovers are becoming increasingly expensive; funding requirements for business transitions are climbing. So we help Baden-Württemberg's business successors to overcome this challenge. Assisting with business transitions from one generation to the next is a fundamental part of our start-up support. At least 35% of the lending volume approved in 2017 was allocated to funding for business successions.

SUCCESSORS ARE FOUNDERS WITH BETTER STARTING CONDITIONS

OUR MIKROCROWD PROGRAMME CLOSES A GAP IN THE NICHE MARKET

In 2017, L-Bank's new MikroCrowd development programme rounded out our strong start-up finance offering by incorporating microfinance. MikroCrowd brings together new and established forms of start-up finance. The advantages of crowdfunding – in particular, the built-in market testing and promotional effect resulting from social media exposure – are combined with the dependability and flexibility of a direct loan from L-Bank. MikroCrowd is designed to deliver new impetus to the start-up dynamic in this low-volume sector.

AGRICULTURAL PROGRAMMES STILL IN THE GREEN IN 2017

At EUR 140 million, agricultural development was similar to the previous year's level (EUR 145 million). Funding for renewable energy generation made a major contribution to this result under the Energy from the Countryside programme. This programme exceeded the previous year's result (EUR 71 million), reaching a total of nearly EUR 73 million.

Weather effects have a serious impact on farming yields – often with no realistic possibility of influencing outcomes. In order to cushion agricultural firms from the resulting hardship, in October 2017 we unveiled the Agriculture – Liquidity Protection development programme. This compensated for the damage caused by the late frost in spring 2017.

ENTERPRISE DEVELOPMENT THROUGH BUSINESS ZONE DEVELOPMENT

Ideas need capital … and suitable space for putting them into practice. Over the last few years, with the state government's encouragement, a rich and highly differentiated cluster landscape has evolved in Baden-Württemberg. We support this cluster policy through our technology parks and are helping to develop it into a regional innovation policy.

L-Bank's technology parks, currently based in Karlsruhe, Stuttgart, Tübingen, Reutlingen and most recently in Mannheim, facilitate the transfer of knowledge and technology from academia to industry. Our technology parks are located near universities and research facilities. Each park has a different focus and makes the most of our regional strengths. Thus Karlsruhe Technology Park (TPK), next door to the campus of the Karlsruhe Institute of Technology (KIT), strongly represents the IT industry; Stuttgart Engineering Park's (StEP) Aerospace Hub cooperates with the nearby university institutes; Tübingen-Reutlingen Technology Park (TTR), with sites in each of the two towns, focuses primarily on biotechnology, medicine and environmental technology. Mannheim Technology Park (TPMA), founded in 2016 and currently under construction, is intended to promote the formation of medical technology clusters on Mannheim's Medical Technology Campus, which is within walking distance of the Mannheim Medical Faculty, part of Heidelberg University.

RELIEF FROM EVERYDAY ANXIETIES MAKES IT EASIER TO FOCUS ON CUSTOMER NEEDS

Thanks to sophisticated building design combined with professional space management, we provide highly flexible workspaces that can be adjusted for many different kinds of use, expanded with customised additions or extensions, or enhanced with specialised equipment or amenities. The park management companies ensure that workspaces are customised and adjusted to individual companies' needs, both before and after they move in. The parks offer an outstanding infrastructure for multi-company support and traffic management, delivering multiple benefits to the firms based there. First, park and space management with flexible options for everything from individual desks to offices through to laboratories meeting the highest clean-room standards. And second, a range of supplementary support services, including nursery and primary schools. The comprehensive, needs-based solutions offered by each park make it easier for companies to concentrate on their core business.

Our various parks have become well-established in the marketplace. As at year-end 2017, 265 companies with 10,300 employees were based in L-Bank's technology parks, around 300 more than one year ago.

THE PARKS ARE SUCCESSFUL MODELS OF RAPID, CONTINUOUS GROWTH

The Mannheim Medical Technology (MMT) campus is still in its early stages of development. Over the next few years, L-Bank subsidiary Technologiepark Mannheim GmbH (TPMA) will invest up to EUR 40 million in three buildings with a total of 15,000 square metres of office, workshop and laboratory space on the MMT campus. Construction of the MMT campus began in March 2017 and the first of the three TPMA buildings on the campus is slated for completion in 2019. The resulting space will be leased to companies in the medical technology/life sciences sector, as well as companies offering industry-specific supplementary services.

THE MMT CAMPUS OPENS A WHOLE NEW CHAPTER

ENTERPRISE DEVELOPMENT THROUGH EQUITY INVESTMENT

Those who wish to grow need capital. No matter what your business status – start-up or established SME – you generally need venture capital to tackle new challenges, whether they are related to processes or products. You cannot finance the entrepreneurial risks associated with such business-building investments by means of third-party debt alone.

Equity is an essential platform for entrepreneurial activity. From the perspective of banks and savings banks, a solid equity base is a prerequisite for extending loans. And yet the equity ratio of German companies is low by international standards. In 2017, financial investors invested at least EUR 4.4 billion in Germany's larger SMEs. While this is an impressive figure, there is still plenty of extra potential. A lot of private capital is available in Baden-Württemberg. So far, however, not enough of this has been available for major shareholding commitments, often resulting in criticism of Germany's lack of risk culture. We are trying to respond to the unusual situation in Germany by launching two stimulatory initiatives.

For SMEs, equity capital is often the key to expanding entrepreneurial opportunities. By raising equity capital, they improve their balance sheet structure. In turn, this enables them to prepare for their next growth spurt, launch their digitisation strategy, create new products or open up new regions.

RISKY OPPORTUNITIES ARE TIED TO VENTURE CAPITAL

In spring 2016, L-Bank set up a new SME fund – LEA Mittelstandspartner – with a number of institutional venture partners. The fund focuses on companies in the industrial and IT sectors with the intention of accelerating their growth by taking an active, partnership-based investment approach to the major, capital-intensive challenges of digitisation and business globalisation.

With two investments and a total infusion of (to date) EUR 28.8 million, the fund made a good start. Since then, the fund has far exceeded its original target volume of EUR 100 million, closing with a final subscription of EUR 200 million. This fundraising success demonstrates what an attractive model this is: as initiator and anchor investor, L-Bank is attracting investors from beyond the borders of Baden-Württemberg. Institutional venture partners from the financial and insurance sectors are also on board, as are family offices, pension funds and Bürgschaftsbank Baden-Württemberg. LEA Mittelstandspartner is now one of the five largest funds in Germany, specialising in medium-sized growth companies involved in Industry 4.0 activities.

The major problem for young, growing companies is the amount of capital required, whether for carrying out research and development activities, monitoring markets and sales, or establishing long-term supplier relationships. As a rule, this means a long payback period. But during the seed and start-up phases, companies often generate few or no sales, meaning that they cannot generate in-house finance from the sales process. Even in the first growth phase, the release of funds from sales is not usually sufficient for businesses to develop the capacity they need for growth from internal funding alone. So for a considerable period of time, they must generate an inflow of funds from external sources.

INNOVATIVE START-UPS ARE HIGH-RISK PROJECTS WITH BIG PROFIT-MAKING POTENTIAL

This is where LEA Venture Partners for young companies, launched in 2017, comes in. The template so successfully applied to SME finance is now being transferred to start-up funding. L-Bank is the anchor investor; the State of Baden-Württemberg also takes a significant interest. With the involvement of Bürgschaftsbank Baden-Württemberg, the scene is set for an acquisition that will attract private venture partners. With this model, the public funds used for VC purposes can also be leveraged by institutional investors in Baden-Württemberg's finance industry, as well as private venture partners. The first closing was completed in July 2017 with subscription commitments of EUR 22 million. A target of EUR 50 million has been set for final closing, slated for June 2018 at the latest.

The fund focuses on technologically strong companies with growth potential and a focus on the IT, Internet, Industry 4.0 and digitisation sectors. In particular, it invests in the seed phase and in the first major financing round.

LEVERAGING PUBLIC FUNDS IS KEY TO UNLOCKING DEVELOPMENT POTENTIAL

Experience with the new funds shows that expectations are being met. The public funds used are leveraged in two ways: first, through the participation of private investors in each of the funds in which L-Bank acts as the anchor investor, and second, through the formation of a syndicate in the financing round. This amplifies and bundles Baden-Württemberg's venture financing capability in such a way that the new offers very effectively supplement the federal state's existing strong financing ecosystem for start-ups, which is supported in particular by Mittelständische Beteiligungsgesellschaft Baden-Württemberg and L-Bank on behalf of the Ministry of Economic Affairs, Labour and Housing.

DEVELOPMENT THROUGH FINANCIAL ASSISTANCE

Financial assistance is useful for responding exceptionally fast to acute problems or delivering a direct development stimulus. However, it can also be used as a long-term instrument for greater justice, for example in family policy. As the federal state's development services provider, we were heavily involved in the distribution of financial assistance provided by the State of Baden-Württemberg for business, infrastructure, families, education and social affairs in 2017.

As a full-service supplier, we are in a position to deliver all the elements required to execute a development process. From advising on and supporting applications, through reviewing and approving applications, right though to disbursing funds and verifying that they have been used appropriately – we can provide A-Z implementation of aid-based development programmes. The core service is and remains our banking infrastructure, through which we can ensure that funds reach their destination swiftly, without red tape.

OUR BANKING INFRASTRUCTURE MAKES A BROAD RANGE OF SERVICES POSSIBLE

In 2017, we paid out financial assistance totalling EUR 2.12 billion (2016: EUR 2.16 billion).

DISTRIBUTION OF FINANCIAL ASSISTANCE –
€2,119 MILLION IN TOTAL

FAMILY ALLOWANCES ARE STILL THE SINGLE LARGEST SERVICE ITEM UNDER FINANCIAL ASSISTANCE

The biggest development service under financial assistance, with a funding volume of EUR 944 million, is the family allowance. In 2017, more than 142,000 applications for family allowances were approved, up on the previous year by nearly 2%. As the central issuer of this benefit, we also provided comprehensive information and advisory services to families. Young parents were provided with information and helped through the application process in more than 310,000 counselling sessions.

With 8,192 new approvals (excluding family allowances), the number of cases reached a new high in 2017. In total, L-Bank is involved in some 45 financial assistance programmes as the development services provider for state, federal and EU funding.

Digitisation and e-mobility are examples of areas of innovation in which we are implementing new services for the federal state. The 'Digitisation Premium' pilot concept was an especially successful example of highly promising financial assistance services offered for the first time in 2017. L-Bank was entirely responsible for implementing the programme, which was set up by the Ministry of Economic Affairs, Labour and Housing, and targeted companies with up to 100 employees. The programme's primary purpose was to finance acquisitions of the ICT hardware and software required to digitise products, services and operational processes, all of which should give companies a not insignificant digitisation advantage in the future. The enormous demand for this funding clearly shows how well the Digitisation Premium meets the needs of Baden-Württemberg's SMEs.

NEW INCENTIVES FOR BOOSTING PRODUCTIVITY AND E-MOBILITY

Baden-Württemberg's state government is further expanding financial assistance for electromobility, relying on L-Bank's support to do so. On behalf of the Ministry of Transport, we have been implementing two new development programmes since November 2017: 'BW-e-Gutschein' (BW eVoucher) and 'Förderung E-Lastenräder' (eCargobike Finance). Using the BW eVoucher, authorised businesses and institutions such as car-sharing companies, taxi and delivery companies, municipalities, care and social services can apply for grants to fund the charging infrastructure and maintenance. Subsidies of 50% and up to EUR 4,000 per individual vehicle are available for financing electric cargo bikes for commercial, non-profit or community use.

SIMPLE, WITH NO HURDLES – L-BANK'S SERVICE QUALITY IS RIGHT AT ALL LEVELS

What is the development pathway like for our customers? From initial research through to actual decision, there are many points of contact at which prospective customers receive support from L-Bank and their commercial banks. We help customers navigate the various research and information stages, and in doing so, demonstrate the value added by our development products.

We also help them to prepare their applications. Transparency in every respect, coupled with detailed and easily understood information, support by expert advisers, plus a straightforward application process (despite all the funding and documentation requirements) are L-Bank's guiding principles here.

AWARENESS TRIGGERS ACTION – PEOPLE WILL ONLY USE OUR DEVELOPMENT PRODUCTS IF THEY KNOW ABOUT THEM

The starting point is the level of awareness of funding opportunities. Visibility and publicity are important. Our Economic Forums are a useful instrument here. Every year since 2006, as the State Bank of Baden-Württemberg, we have been using this series of events to provide comprehensive information on financing and development opportunities for businesses based in different regions of the federal state. In 2017, we took our Economic Forum to Constance for the first time. Experts give presentations on sustainability and digitisation, supplementing the detailed information on our development finance options.

WE WORK HAND IN HAND WITH OUR FINANCING PARTNERS

The pathway to our development loans generally leads through our financing partners. They act as our interface with our customers, so they are directly required as contacts. Whether creating new products or modifying existing ones – for our partners, the direct path to good-quality, decision-relevant information is especially important, preferably obtained without lengthy research processes or time-consuming enquiries. We provide simple, short pathways to high-quality information. We keep an eye on the requirements of our financing partners. And with the introduction of our new expert portal, we also provide an accompanying solution: an online platform for information acquisition that makes day-to-day work easier for advisers and consultants at banks, savings banks, building societies and insurance companies. Our expert portal has been providing a fast, digital information, communication and consulting service specifically geared to the needs of our financing partners since the middle of the year. The expert portal has been approved for a closed user group consisting of L-Bank's financing partners; we are gradually expanding the scope of its services. With more than 700 registered users, we have clearly created a solution that meets their needs.

IN DEVELOPMENT PROGRAMMES, CUSTOMER FOCUS IS THE KEY IMPACT FACTOR

Sometimes, however, it is also important to provide personal clarification and explanations of underlying concepts. This is why we hold on-site seminars and roadshows for our (banking) partners, at which we present our latest developments. And if time is short, we try to satisfy our partners' wishes by organising webinars, which we first started to offer last year.

LOCAL L-BANK ACTIVITIES IN THE REGIONS: BANK BREAKFASTS

Our bank breakfasts are also very popular. Together with L-Bank and Bürgschaftsbank, RKW Baden-Württemberg regularly organises 'bank breakfasts' at various locations in Baden-Württemberg. The target audience consists of experts from banks in the corporate customer sector, as well as selected multipliers; for us as a development bank, these are the key multipliers who need regular updates on the latest changes in the development landscape.

We have been holding our financing advisory days for many years, and have been very successful in explaining to business start-ups, fledgling companies and SMEs how to make best use of our development programmes. At these events, we always form a picture of the company or start-up project involved so that we can advise them as appropriate – whether they should perhaps reconsider projects, or take advantage of expert coaching to fill any information gaps, or resolve open issues when implementing their projects. Last year, we again organised more than 320 advisory sessions at Chambers of Commerce throughout Baden-Württemberg.

NO EITHER-OR, WE PREFER BOTH-AND: DIGITISATION SUPPORTS ADDITIONAL ADVISORY CHANNELS

Customer requirements are changing. Our ongoing challenge is to adapt our processes to these changing customer requirements. For example, more and more of the start-ups turning up at Chambers of Commerce meetings are already well prepared and want detailed information on how to finance their projects as quickly as possible. Here, too, digitisation is opening up new opportunities. In mid-2017, together with the Heilbronn-Franconia Chamber of Industry and Commerce and Bürgschaftsbank Baden-Württemberg, we launched the 'pilot phase' of our digital financing advisory days. Interested parties can benefit from advice on financing and development issues from L-Bank and Bürgschaftsbank at the Chamber of Industry and Commerce in Heilbronn via a direct video link – on an ad-hoc basis if desired. This brings us even closer to our customers and complements traditional face-to-face meetings with an attractive offer that enables us to respond quickly to customer requests.

REVOLUTIONISING THE DEVELOPMENT PROCESS: ACCESSING DEVELOPMENT LOANS ONLINE

In the past, applications for development finance programmes often required the processing of elaborate application forms and detailed documentation on the proposed use of the desired funding. For years, L-Bank has been committed to simplifying and streamlining these processes, wherever this is feasible under development finance legislation. In 2016, L-Bank's housing development products were integrated into KfW's online development funding platform 'Bankdurchleitung Online 2.0' (BDO 2.0). We have now taken the next step: in 2017, KfW and L-Bank agreed to integrate L-Bank's commercial lending products into KfW's online development funding platform. In parallel, as part of a pilot partnership, the funding platform will be further developed so that once it has been completed, it can also be used by other state development banks. This reflects L-Bank's systematic pursuit of its digitisation goals, whereby bank advisers and our private or business customers all benefit from greater transparency and speedier processes in the future.

L-BANK DEVELOPMENT WORKS – IN THE SHORT AND LONG TERM

A key aspect of development is the ability to rapidly issue financial incentives. But L-Bank's development finance means more than just lending, risk mitigation and subsidies. Those who wish to make a positive difference must leverage their financial support to raise social awareness.

Risk appetite or rejection, self-realisation or prioritisation of collectives – there are numerous underlying social attitudes that impact the various ways a society develops. To find social paths and goals that are beneficial in the long term, one must keep an eye on strategic considerations and help to ensure that decisions are based on reliable information.

SHORT-TERM SUPPORT PLUS LONG-TERM CHANGE – DEVELOPMENT CAN BE BOTH

For this, you also need a differentiated set of opinions. To this end, we work with various partners to address issues affecting the future. Our aim is to highlight the significance of selected issues and themes, raise awareness of any problems and discuss solutions. One way is to support relevant conferences and trade fairs. Here, we often take a step or two beyond mere financial commitment and also join network and lighthouse events as content provider and organiser, acting as initiator, partner or co-administrator to highlight key issues that are important for our collective future. This was the case, for example, at the first Baden-Württemberg Start-up Summit organised by the state government with L-Bank as key partner. For a whole day, everything at the Stuttgart Trade Fair centred on the topic of business start-ups and networking. Exciting visions of future technology, joint-venture models and partnerships were discussed. Entrepreneurial spirit and the entrepreneurial mindset were both represented by SMEs, fledgling companies and individuals interested in setting up their own business: the Start-up Summit showcased the diversity of Baden-Württemberg's entrepreneurial talent. And, with more than 2,600 participants, also provided a powerful example of how issues can be brought to the attention of the general public.

LIGHTHOUSE EVENTS CHANGE OPINIONS: START-UP CULTURE AS ONE EXAMPLE

Other events are more about helping players to network, or highlighting role models and exemplary business developments. This was the case at, for example, FinTech Days, an event sponsored by L-Bank. Representatives of financial service providers, FinTechs, InsurTechs and other interested parties from the financial sector met to celebrate the trade fair's motto 'Get finnovative'. The aim of the event is to network established players in the finance industry with start-ups in this field.

L-BANK AS INITIATOR AND CATALYST

The statewide Elevator Pitch competition series also helps start-ups to find valuable contacts. With L-Bank's support, the Initiative for Business Start-ups and Business Succession (ifex) launched by the Ministry of Economic Affairs, Labour and Housing has been running the competition since 2013. It offers business founders an attractive platform for presenting themselves and their business ideas to a jury and an audience made up of regional institutions, potential funders, business partners and customers. The key to winning is focusing on the essential: in just three minutes, competitors must arouse their audience's curiosity and convince them of the benefits of their products and/or services. Participating companies have a chance to win a prize and an opportunity to present themselves and their business offerings to the general public (and, of course, investors). But there are other benefits: the competition also makes it clear how attractive entrepreneurship can be and highlights it as an option for future life choices.

NETWORKING AND TARGETED MATCHING CREATE NEW OPPORTUNITIES FOR LIVING THE DREAM

Another tried and trusted instrument is Venture Capital Pitch Baden-Württemberg. VC Pitch BW was set up six years ago by Baden-Württemberg's Ministry of Economic Affairs, Stuttgart Financial and L-Bank, and is held annually on L-Bank's Stuttgart premises. Inspired by the event's motto, 'Best of Baden-Württemberg', the federal state's most innovative high-tech business founders present their business concepts. The aim is to bring together the best start-ups in the state with prospective regional, national and international backers. Thus we strive to expand our sphere of influence by creating or supporting platforms – to the advantage of Baden-Württemberg.

Thanks to high levels of personal commitment and the Bank's capabilities as the federal state's development services provider in almost all areas relating to development policy, L-Bank is also involved in the federal state's networking initiatives and stakeholder alliances.

SOCIAL ALLIANCES CREATE LASTING SOLUTIONS

Creating sufficient, affordable housing in Baden-Württemberg is one of the state government's most important priorities. With this aim, the Ministry of Economic Affairs, Labour and Housing launched the Baden-Württemberg Housing Alliance in 2016, as a platform for convening all partners and organisations involved in housing construction in the federal state to form multiple working groups at regular intervals. L-Bank is also involved in a second, broad-based network alliance dubbed Initiative Wirtschaft 4.0 (Economy 4.0 Initiative). First launched in May 2017, the initiative brings together more than 20 partner organisations consisting of companies, Chambers of Commerce and Industry, associations, trade unions, academic institutions and government agencies in an effort to position Baden-Württemberg as a premium international location for the digitised economy and promote cross-industry networking to companies seeking to digitise their operations.

DEVELOPMENT THROUGH LOAN FINANCING: 1 JANUARY TO 31 DECEMBER 2017

DEVELOPMENT LOANS FOR HOUSING, INFRASTRUCTURE AND ENTERPRISE DEVELOPMENT	VOLUME OF COMMITMENTS	COMMITMENTS	
	5,077,386,176.45	19,428	

	VOLUME OF COMMITMENTS	COMMITMENTS	RESIDENTIAL UNITS*
HOUSING DEVELOPMENT	**1,455,770,833.82**	**10,254**	**19,665**
Home ownership assistance	**632,512,058.61**	**9,045**	**7,727**
Home Ownership Finance – BW including finance for growing families – Structured loans (regional housing development)	249,912,866.35	1,868	1,185
Top-up and miscellaneous loans	89,259,912.00	887	
Living with Children	265,522,887.90	5,442	5,442
Living for the Future	25,433,203.91	802	1,062
Other programmes	2,383,188.45	46	38
Rental accommodation support	**752,167,702.83**	**802**	**6,431**
Rental Accommodation Finance – BW – New builds – MW15/MW25 (regional housing development)	135,567,700.00	110	774
Rental Accommodation Finance – BW – Approval of regulated tenancies (regional housing development)	15,412,400.00	272	493
Rental Accommodation Finance – BW – Modernisation (regional housing development)	41,606,800.00	58	876
Rental Accommodation Finance – L-Bank – New builds	241,616,251.00	137	2,084
Rental Accommodation Finance – L-Bank – Modernisation	80,615,563.61	103	2,204
Top-up loans (new builds/modernisation)	237,348,988.22	122	
Support for homeowners' associations (regional housing development)	**46,584,862.75**	**322**	**5,109**
Other grants and subsidies	**24,506,209.63**	**85**	**398**

* The total includes multiple counting, as the various home ownership finance programmes may be combined in certain cases.

	VOLUME OF COMMITMENTS	COMMITMENTS
INFRASTRUCTURE DEVELOPMENT	**564,537,885.00**	**92**
Municipal investment loan, direct	50,676,785.00	75
Municipal loans	3,500,000.00	1
Direct funding for the state	375,000,000.00	5
New Energy – Community wind farms	30,361,100.00	6
Other financial instruments	105,000,000.00	5

	VOLUME OF COMMITMENTS	COMMITMENTS	COMPANIES
ENTERPRISE DEVELOPMENT	**3,057,077,457.63**	**9,082**	**8,019**
Business start-up support	**659,650,989.44**	**3,336**	**2,945**
Start Finance 80	57,405,110.00	968	955
Start-Up Finance	602,245,879.44	2,368	1,990
SME finance	**2,257,185,125.84**	**5,066**	**4,447**
Growth Finance	538,618,323.57	1,950	1,784
Local Transit Finance	14,908,000.00	335	184
Tourism Finance	4,237,000.00	13	10
Liquidity loans	68,548,276.77	351	347
Investment Finance	519,312,706.28	582	467
Rural Area Development programme	58,682,936.60	347	335
Resource Efficiency Finance	642,887,460.96	926	824
Direct loans and syndicated finance	160,839,430.00	28	23
Surety and guarantee programme/Sureties for refinancing loans	15,138,386.66	14	9
Loans to associated companies	17,250,000.00	3	3
Refinancing of associated companies	6,665,000.00	10	10
Innovation Finance	206,152,605.00	474	418
CPD Finance	3,945,000.00	33	33
Agricultural development	**140,241,342.35**	**680**	**627**
Agricultural Liquidity Assurance BW	5,676,300.00	52	52
Agriculture Growth	52,009,997.35	362	338
Loans for environmental and consumer protection, sustainability, new energies	72,631,545.00	227	201
Loans for operating resources – Growth in agriculture and food industry	9,923,500.00	39	36

CORPORATE GOVERNANCE REPORT 2017

L-Bank, in its capacity as the State of Baden-Württemberg's development bank, has a statutory remit to support the federal state in the performance of its public duties and, in doing so, to implement and manage various development initiatives. A sound and responsible approach to corporate governance is a self-evident component of the Bank's approach to these non-commercial activities. L-Bank has enshrined the Public Corporate Governance Code of the State of Baden-Württemberg in the Bank's in-house rule book by resolutions of both the Board of Management and Supervisory Board, and observes all the terms of the Code. This Corporate Governance Report covers fiscal year 2017; the following declaration applies in full as at the reporting date, 31 December 2017.

DECLARATION OF COMPLIANCE

The Board of Management and Supervisory Board of L-Bank declare that:

We have complied, and continue to comply, with the recommendations of the Public Corporate Governance Code of the State of Baden-Württemberg (PCGK BW) to the extent that such recommendations apply to L-Bank in its capacity as a public-law institution.

In the previous year's report, we mentioned the recommendation in point 106, sentence 4 PCGK BW, according to which the placing of any additional assignments with the auditor by the Board of Management should be subject to the Supervisory Board's approval. In February 2017, the Supervisory Board revoked its policy decision regarding pre-approved, blanket consent to the placing of additional assignments with the auditor where the level of remuneration is not material. Henceforward, all additional assignments placed with the auditor will require the separate approval of the Supervisory Board. In January 2017, an additional assignment was placed with the auditor on the basis of the Supervisory Board's blanket consent quota, still in force at the time.

PROPORTION OF WOMEN ON THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD, AND IN EXECUTIVE MANAGEMENT POSITIONS

As at 31 December 2017, one woman was represented on the four-strong Board of Management. As at the reporting date, five of the 18 members of the Supervisory Board (27.8%) and 77 of the 219 employees in executive management positions (35.2%) were women.

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT FOR 2017 in EUR thousands

Name	Membership period	Fixed remuneration	Other non-cash benefits	Payments from third parties in relation to Board of Management activities	Total
Dr. Axel Nawrath Chair	01.01.–31.12.	682	24	8	713
Dr. Ulrich Theileis Vice-Chair	01.01.–31.12.	517	27	18	562
Dr. Iris Reinelt	08.05.–31.12.	275	18	3	296
Johannes Heinloth	17.07.–31.12.	195	14	2	210
Total		**1,668**	**83**	**30**	**1,781**

An occupational pension scheme is in place for the members of the Board of Management based on the rules applicable to L-Bank employees.

REMUNERATION PAID TO MEMBERS OF THE SUPERVISORY BOARD FOR 2017 in EUR thousands

Name	Membership period	Membership of Supervisory Board	Membership of committees	Attendance fees	Total
Edith Sitzmann [1)] Chair	01.01.–31.12.	9.0	3.9	2.0	14.9
Thomas Strobl [1)] 1st Vice-Chair	01.01.–31.12.	7.5	3.9	1.7	13.1
Dr. Nicole Hoffmeister-Kraut [1)] 2nd Vice-Chair	01.01.–31.12.	7.5	2.4	0.9	10.8
Dr. Jürgen Bufka	01.01.–31.12.	6.0	–	0.9	6.9
Dr. Maximilian Dietzsch-Doertenbach	01.01.–31.12.	6.0	3.9	1.5	11.4
Martin Gross	16.05.–31.12.	3.8	–	0.3	4.1
Roger Kehle	01.01.–31.12.	6.0	–	0.3	6.3
Gabriele Kellermann	01.01.–31.12.	6.0	3.9	1.4	11.3
Dr. Peter Kulitz	01.01.–31.12.	6.0	2.4	1.1	9.5
Andrea Lindlohr	01.01.–31.12.	6.0	–	0.9	6.9
Klaus-Peter Murawski [1)]	01.01.–31.12.	6.0	2.4	0.8	9.2
Prof. Dr. Wolfgang Reinhart	01.01.–31.12.	6.0	–	0.8	6.8
Dr. Dieter Salomon	01.01.–31.12.	6.0	–	0.5	6.5
Franz Untersteller [1)]	01.01.–31.12.	6.0	2.4	1.1	9.5
Joachim Wohlfeil	01.01.–31.12.	6.0	–	0.9	6.9
Clemens Meister	01.01.–31.12.	6.0	–	0.9	6.9
Tatjana Aster	01.01.–31.05.	2.5	–	0.6	3.1
Barbara Bender-Wieland	01.06.–31.12.	3.5	–	0.3	3.8
Thomas Dörflinger	01.01.–31.12.	6.0	–	0.8	6.8
Total		**111.8**	**25.2**	**17.3**	**154.2**

[1)] Subject to a duty of surrender to the State of Baden-Württemberg.

The Board of Management The Supervisory Board

MANAGEMENT REPORT – REPORT OF THE BOARD OF L-BANK FOR FISCAL YEAR 2017

BACKGROUND

Landeskreditbank Baden-Württemberg – Förderbank – (L-Bank) is the development bank of the German federal state of Baden-Württemberg. The Bank has its head office in Karlsruhe, with a branch office in Stuttgart. L-Bank is wholly owned by the State of Baden-Württemberg and, as a public-law institution, is subject to the supervision of the federal state government. In the context of the Single Supervisory Mechanism (SSM) introduced within the European Union, L-Bank is also one of the credit institutions that comes under the direct supervision of the European Central Bank (ECB).

L-Bank's business activities are governed by its statutory remit, namely to support the state government of Baden-Württemberg in the fulfilment of its public duties, especially in terms of structural, economic and social policy, by implementing development initiatives in accordance with European Union (EU) rules on state aid. L-Bank's development goals and operational targets – such as the Bank's target customers and development priorities – are determined by the Bank's owner in accordance with the provisions of the L-Bank Act, relevant political priorities and, with respect to activities relating to development programmes, the specific terms of each individual programme. As a result, the Bank's key business operations are heavily influenced by external factors and can therefore only be controlled by L-Bank to a limited extent.

ECONOMIC REPORT

BASIC PARAMETERS

In 2017, the German economy enjoyed a strong upward-trending cycle and recorded a positive growth rate for the eighth year in a row. According to estimates by the Federal Statistical Office, Germany's real gross domestic product (GDP) for the year as a whole grew by 2.2% over the previous year (as at January 2018). In view of the positive economic situation, the number of employees paying statutory social security contributions and the demand for new skilled employees continued to rise, reaching a high level across the state. At the same time, unemployment continued to decline despite the increased uptake of refugees in official unemployment statistics. According to the Federal Employment Agency, the unemployment rate for 2017 averaged 5.7%, 0.4 percentage points down on the previous year.

Over the year, Baden-Württemberg's economy, with its above-average dependence on exports, benefited strongly from the economic recovery in neighbouring European countries and the associated revival of external demand. Demand also rose in non-EU countries such as Switzerland, the USA and China. This more than compensated for the sharp decline in trade with the United Kingdom triggered by the continuing uncertainty surrounding Brexit. This lively foreign trade stimulated the manufacturing sector in particular. The construction industry also prospered thanks to the continued high demand for housing, increased public-sector investment in infrastructure, and strong commercial construction activity driven by increased corporate investment in capital equipment. The L-Bank/ifo business climate index – the barometer for gauging the mood of businesses in southwestern Germany – ceased to track perceived geopolitical uncertainties and rose continuously over the course of the year, reaching an all-time high in December. In addition to the positive development of business and commerce, private consumer spending contributed to the acceleration of the domestic economy. Consumption was driven by private households' historically exceptional income situation. According to the L-Bank/GfK consumer survey, the average level of income in 2017 substantially exceeded the already very good level achieved in the previous year. Overall, Baden-Württemberg's economy expanded by 2.5% over the full 12-month period (State Statistical Office, as at December 2017), thus grew at roughly the same rate as the German economy as a whole. Baden-Württemberg's labour market maintained an upward trend throughout the year under review, the annual average number of job vacancies advertised exceeding the 100,000 mark by some margin. According to the Federal Employment Agency, the average unemployment quota for 2017 was 3.5%, falling to 3.2% in December 2017 (as at January 2018).

BUSINESS PERFORMANCE

Once again, L-Bank's business operations in 2017 were affected by persistently low market interest rates. Continuing high levels of development finance reflected the robust investment activity of Baden-Württemberg's small and medium-sized enterprises (SMEs) and the consistently high demand for real-estate finance resulting from strong demand for housing construction. During the second half of the year, demand for development loans picked up as a result of increasing business investment in capital equipment.

The Bank's development activities in the year under review focused on enterprise and housing development initiatives. New business figures reflected increased start-up financing and SME financing in particular. New business in the housing development and infrastructure development segments declined.

Enterprise development

In order to support the sustainable growth of Baden-Württemberg's economy and safeguard jobs, L-Bank finances investment projects by start-ups and established SMEs in cooperation with commercial banks. It also finances projects in rural areas. The Bank awards low-interest loans and grants, and also assumes certain specific kinds of risk. In the year under review, favourable economic conditions coupled with companies' continuing willingness to invest resulted in increased demand for certain development programmes. Compared to the previous year, the volume of new business rose by 5.3% to EUR 3,359.6 million (2016: EUR 3,190.9 million).

Gratifyingly, and exceeding expectations, the volume of finance distributed to business start-ups rose by EUR 61.1 million to EUR 659.7 million (2016: EUR 598.5 million). This represents an increase of 8.3% over the previous record attained in fiscal year 2015. The growth in new business is primarily due to the 'Start-up Finance' development programme. The programme supports fledgling companies and business start-ups in their quest for commercial autonomy, and also helps them to take over and expand existing companies.

The volume of new business in development programmes targeting SMEs also increased, rising by 2.9% to EUR 2,257.2 million (2016: EUR 2,193.8 million) and thus confounding expectations that new business would show a slight decline. New business in the ‘Growth Finance’ and ‘Innovation Finance’ development programmes alone grew by 52.7% to EUR 744.8 million (2016: EUR 487.8 million). Under the Growth Finance programme, long-term loans are issued on preferential terms for typical SME investment projects. Commitments rose significantly to EUR 538.6 million (2016: EUR 405.5 million). The reason for the increased demand is the programme’s simplified design and improved conditions. Under the restructured Innovation Finance development programme, which provides SMEs with low-interest loans and grants for, among other things, developing new products, production processes and digitisation projects, the distributed funding more than doubled, rising by EUR 123.8 million to EUR 206.2 million (2016: EUR 82.3 million). By contrast, figures for new business under the ‘Resource Efficiency Finance’ development programme showed a slight decline. With this development programme, L-Bank specifically funds initiatives promoting the careful and sustainable use of resources. The total volume of commitments came to EUR 642.9 million (2016: EUR 671.3 million). The ‘Investment Finance’ programme supports business investments in rural areas. At EUR 519.3 million (2016: EUR 592.4 million), the funding volume declined by 12.3% compared to the previous year. New business figures for the ‘Liquidity Facility’ development programme (EUR 68.5 million vs. EUR 83.5 million in 2016) show that companies in Baden-Württemberg are benefiting from the positive economic development and so need fewer loans for operating resources and consolidation projects.

At EUR 140.2 million, the volume of new business in the Bank’s agricultural development programmes almost reached the previous year’s level (EUR 145.4 million). The ‘Agri-Food Industry – Environmental and Consumer Protection’ programme, which encourages the reduction of energy consumption and emissions in the agri-food industry, the processing and marketing of organically produced products, and improved consumer protection, saw higher demand than in the previous year; the lending volume rose from EUR 71.3 million to EUR 72.6 million. However, this growth could not fully compensate for declining demand in the ‘Agriculture – Growth’ programme in particular, which fell from EUR 60.4 million to EUR 52.0 million. This programme supports agricultural investment projects that aim to cut production costs or improve production and working conditions, thereby helping to increase the sector’s competitiveness.

Housing development

L-Bank funds the creation and acquisition of owner-occupied and rental housing through low-interest loans and subsidies as part of the federal state’s housing development programme. By financing modernisation, renovation and conversion projects, the Bank also helps to improve the energy efficiency of, and facilitate physical access to, existing properties. Contrary to expectations, the volume of new business fell to EUR 1,455.8 million (2016: EUR 2,023.9 million). This is due to the fact that the discontinuation in 2016 of L-Bank’s development programmes for financing energy efficiency – following significant improvements in the equivalent products offered by federally owned development bank KfW – was not offset by increases in other promotional programmes.

At EUR 632.5 million, the volume of new home ownership development business was significantly lower than in the previous year (EUR 1,257.5 million). In 2016, the expired 'Energy Efficiency Finance' programme still accounted for a total lending volume of EUR 621.1 million. As expected, the new business figures for the federal state's housing assistance programme showed an increase. As a result of optimised financing conditions, funds issued under the programme increased by 20.0% to EUR 249.9 million (2016: EUR 208.3 million). The 'Living with Children' programme helps families with children to buy or build their own homes. At EUR 265.5 million (2016: EUR 312.9 million), the volume of new business in this programme fell slightly below expectations, mainly due to adjustments in the terms and conditions. Demand for the 'Living for the Future: Renewable Energies' programme also declined to EUR 25.4 million (2016: EUR 31.3 million). This development programme provides finance for installing heating and hot-water systems that use renewable energy.

The Bank's various rental housing development programmes help to finance the construction and modernisation of rental housing in Baden-Württemberg. As expected, there was an increase in financing commitments to EUR 752.2 million, a significantly higher level than in the previous year (EUR 653.4 million). In the Bank's own development programmes for new construction and renovation projects, the volume of new business increased significantly by 24.7% to a total of EUR 559.6 million (2016: EUR 448.9 million). Contrary to forecasts, the volume of commitments under the federal state's housing assistance programme fell to EUR 192.6 million (2016: EUR 204.6 million). Finance for new construction projects declined from EUR 157.5 million to EUR 135.6 million. By contrast, the demand for funding in support of modernisation projects rose from EUR 35.8 million to EUR 41.6 million. Assistance for homeowners' associations, in the form of finance for energy-efficient renovation projects or modernisation of residential buildings to improve physical access, showed gratifyingly positive development. At EUR 46.6 million, the volume of new business was significantly higher than in the previous year (EUR 32.9 million).

The federal state's special 'Housing for Refugees' subsidy programme expired on schedule in 2017. The volume of state subsidies approved in the 2017 fiscal year for the long-term accommodation of refugees totalled EUR 24.5 million (previous year: EUR 80.0 million).

Other developments

To strengthen Baden-Württemberg's position as a business hub, L-Bank offers solutions for financing municipal and social infrastructure projects, and assists the public sector with the implementation of infrastructure projects by providing loans or other financing instruments. Due to the overall decline in public-sector demand, funding issued in the year under review only reached EUR 1,224.2 million (2016: EUR 6,432.9 million).

As a service on behalf of the State of Baden-Württemberg, L-Bank is responsible for distributing and administering a wide variety of financial assistance. The funds come from state, federal and EU budgets. In 2017, the Bank processed a total of 8,192 new approvals (2016: 8,056) representing a total funding volume of EUR 1,166.0 million (2016: EUR 1,231.3 million). As before, the most extensive programmes involved finance for hospitals (EUR 387.8 million vs. EUR 440.8 million in 2016) and projects relating to water, waste water, flood protection, contaminated sites and hydropower (EUR 120.7 million vs. EUR 116.1 million in 2016).

Funding approved for urban development projects rose to EUR 114.8 million (2016: EUR 66.8 million). The broadband initiative programme attained a volume of EUR 107.2 million (2016: EUR 102.2 million). Funding of EUR 62.4 million (2016: EUR 100.4 million) was approved on behalf of the European Regional Development Fund (ERDF). L-Bank also supported families on behalf of the federal and state governments, in particular by paying out family allowances. Rising birth rates and general wage increases boosted the funding approved for family allowances to EUR 944.1 million from EUR 912.4 million in 2016.

The bulk of L-Bank's investment portfolio consists of strategic and credit-equivalent shareholdings in companies in Baden-Württemberg, as well as shareholdings in subsidiaries involved in the regional development of Baden-Württemberg. As at the balance sheet date, the book value of the portfolio as a whole amounted to EUR 189.7 million (2016: EUR 237.8 million).

The book value of the strategic investments held by L-Bank on behalf of the State of Baden-Württemberg totalled EUR 125.9 million at year-end 2017 (2016: EUR 121.8 million).

L-Bank invests in SMEs based in Baden-Württemberg as a co-investor. On L-Bank's initiative, an external SME fund ('LEA Mittelstandspartner') was set up in 2016 to provide established companies with support, especially in overcoming imminent challenges such as the growing digitisation of products and value chains (Industry 4.0). The Bank succeeded in attracting further investors in 2017, so that, as expected, the fund's assets increased to EUR 200.0 million (L-Bank's stake: EUR 50.0 million). The new business activities in L-Bank's former Venture Capital portfolio were also transferred to an external fund ('LEA Venture Partners') in mid-2017. This venture capital fund was set up in cooperation with the State of Baden-Württemberg with a target volume of up to EUR 50.0 million (L-Bank stake: up to EUR 24.5 million), with the aim of providing venture capital to technologically strong companies with growth potential. The other investments in L-Bank's Venture Capital portfolio declined in 2017. Overall, the book value of the Bank's credit-equivalent shareholdings at the balance sheet date was EUR 46.0 million (2016: EUR 99.6 million).

L-Bank operates technology and business parks in Karlsruhe, Stuttgart, Tübingen, Reutlingen and Mannheim, through subsidiary companies. The parks' close proximity to universities and research institutions assists companies involved in transferring technology from the academic to the business worlds by providing them with suitable premises. These parks differ from other commercial premises for hire by the way they are managed and the additional services on offer, which include conference and training facilities as well as nursery and primary schools. As at 31 December 2017, the book value of the business zone development companies was EUR 17.8 million (2016: EUR 16.3 million).

As part of the Bank's approach to asset/liability management, L-Bank continues to pursue a conservative investment strategy with a clear focus on borrowers with good and very good credit ratings. Securities with AAA and AA ratings account for around two-thirds of the Bank's portfolio.

MANAGEMENT REPORT

Financial performance

The summary of operational income below provides a clear breakdown of L-Bank's financial performance. Transfers to the development fund and other development contributions, which under commercial law should be treated as interest expenses, commission expenses or other operating expenses, are shown here as payments to the State of Baden-Württemberg, hence as an appropriation of profits. As expected, net interest income declined significantly compared to the previous year due to low interest rates and the absence of compensating one-off effects. Nevertheless, net interest income remained L-Bank's most important source of income.

Once again, net commission income, at EUR 40.0 million (2016: EUR 40.9 million), mainly comprised payments from the State of Baden-Württemberg for services provided by L-Bank. These included, in particular, the distribution of family benefits (especially family allowances) and the granting of financial aid (EU structural funds and others).

Administrative expenses, which include depreciation on tangible assets as well as personnel and general expenses, rose in line with expectations by 11.8% year on year to EUR 184.8 million (2016: EUR 165.3 million). This was primarily due to expenditure on construction work required by bank buildings, for occupational pension plans and for the modernisation of the Bank's IT facilities.

The net result from other operating income/expenses showed positive development (2017: EUR 6.6 million; 2016: EUR 1.1 million). This was mainly due to net income on the sale of a building not used for banking operations. As expected, the operating result before risk provisions/valuations declined significantly to EUR 185.2 million (2016: EUR 245.6 million).

In line with expectations, net income from asset revaluation also fell (2017: EUR –31.7 million vs. EUR 92.9 million in 2016). As expected, it was not possible to repeat the previous year's high reversals of risk provisions. In addition, net income from asset revaluation was influenced by write-downs of development shareholdings and a strengthening of contingency reserves. L-Bank's operating result thus totalled EUR 153.5 million (2016: EUR 338.5 million). The Bank's distributable income totalled EUR 153.2 million (2016: EUR 337.0 million).

Due to the introduction of the new development contribution system on 1 January 2017, L-Bank's current development contributions only had a minor impact on earnings in 2017. The development fund (provision) set up in the previous year for 2017, totalling EUR 80.0 million, was fully utilised. Out of the Bank's earnings for the year, an amount of EUR 80.0 million was transferred to the development fund for 2019's development contributions. A development fund of EUR 80.0 million is still available for 2018 development contributions; the fund was also set up in 2016. An addition of EUR 20.0 million was made to the fund for general banking risks (2016: EUR 0 million).

Net profit for the year totalled EUR 50.6 million (2016: EUR 49.3 million). Taking account of the profit carried forward from the previous year, net profit amounted to EUR 50.8 million. The Board is planning to allocate EUR 50.0 million of this income to other retained earnings in order to increase the Bank's Tier I capital ratio, and to carry forward the remaining EUR 0.8 million.

BREAKDOWN OF OPERATING INCOME in EUR millions

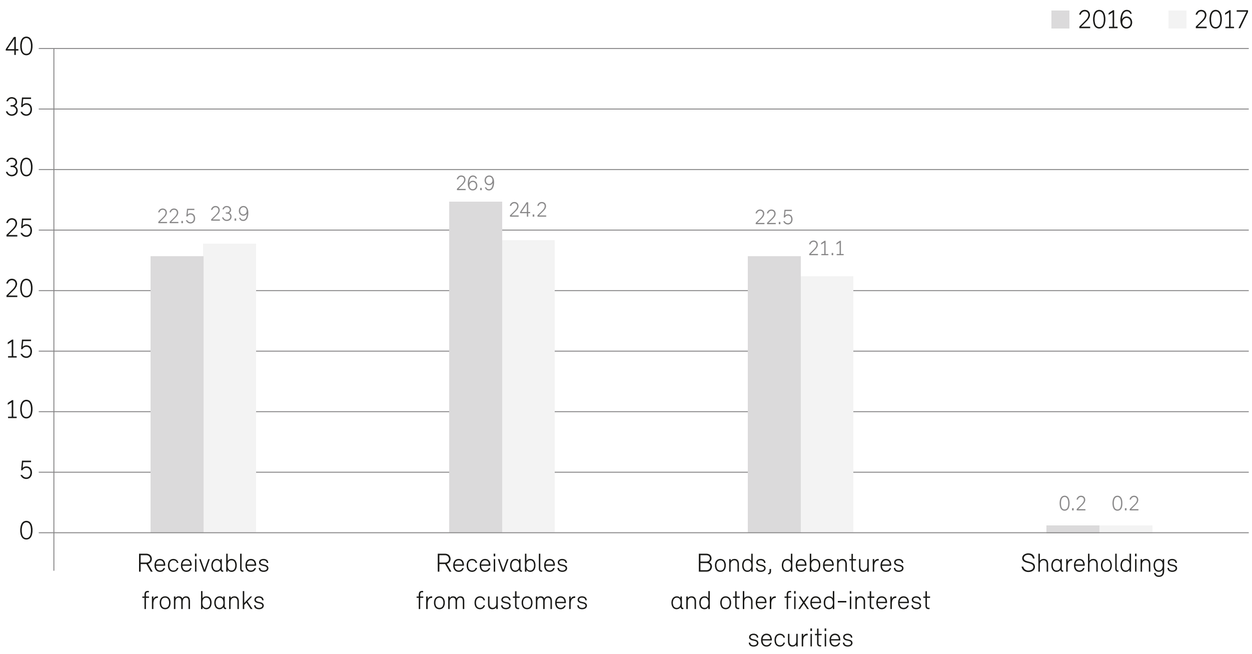
	01.01.2017 to 31.12.2017	01.01.2016 to 31.12.2016	Change	Change in %
Net interest income	323.4	368.9	–45.5	–12.3
Net commission income	40.0	40.9	–0.9	–2.2
Net result from other income/expenses	6.6	1.1	5.5	> 100.0
Administrative expenses	184.8	165.3	19.5	11.8
Operating result before risk provisions/valuations	**185.2**	**245.6**	**–60.4**	**–24.6**
Net income from asset revaluation	–31.7	92.9	–124.6	< –100.0
Operating result	**153.5**	**338.5**	**–185.0**	**–54.7**
Taxes on income	0.3	1.5	–1.2	–80.0
Distributable income	**153.2**	**337.0**	**–183.8**	**–54.5**
Expenses for interest subsidies and other subsidies	2.6	113.6	–111.0	–97.7
Contribution to road construction programme	–	14.1	–14.1	–100.0
Addition to development funds (provision)	80.0	160.0	–80.0	–50.0
Addition to fund for general banking risks	20.0	–	20.0	–
Net income	**50.6**	**49.3**	**1.3**	**2.6**

Assets and liabilities

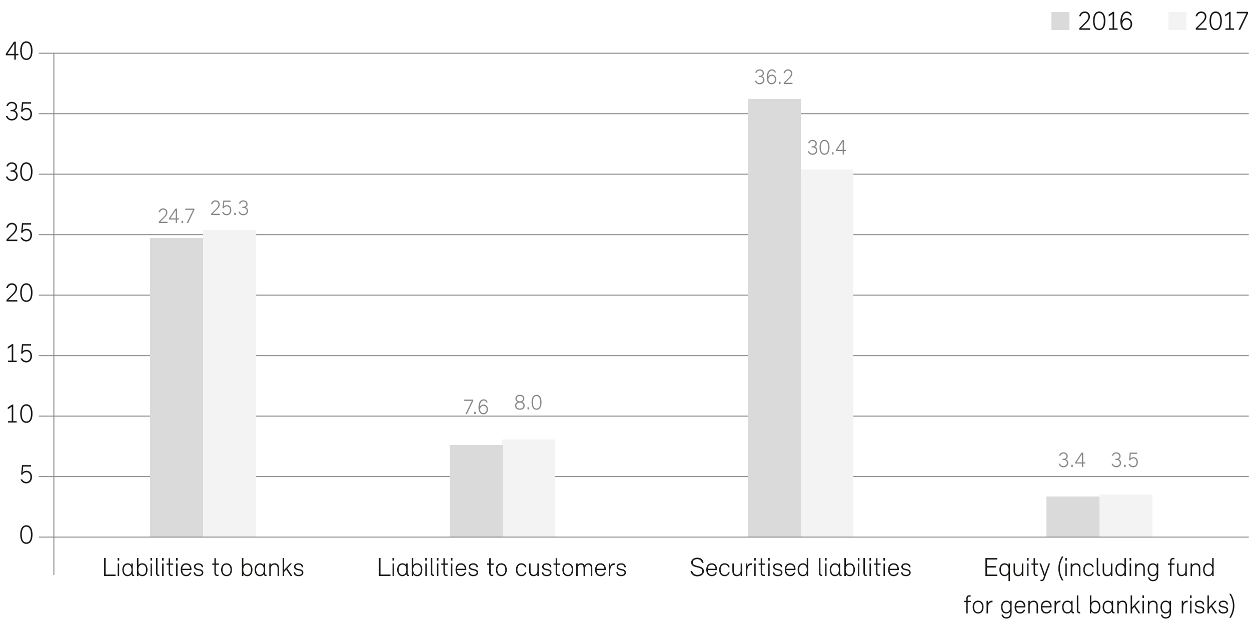
In line with expectations, L-Bank's total assets remained more or less unchanged, totalling EUR 70,670.0 million at the balance sheet date (2016: EUR 75,075.4 million). The decline resulted from maturities in receivables from customers and securities, as well as fluctuating exchange rates. On the liabilities side, securitised liabilities in particular saw a decline.

The business volume, which also encompasses contingent liabilities and irrevocable lending commitments, was down by 5.4% to EUR 77,724.0 million at the balance sheet date (2016: EUR 82,118.2 million).

SELECTED ITEMS UNDER ASSETS in EUR billions



SELECTED ITEMS UNDER LIABILITIES in EUR billions



Financial situation

As the State Bank of Baden-Württemberg, L-Bank benefits from the federal state's maintenance and public (statutory) guarantee obligation, as well as an explicit state guarantee. The latter means that L-Bank's de facto credit rating is identical to that of the State of Baden-Württemberg. Consequently, credit rating agencies Moody's Investors Service and Standard & Poor's continue to rate L-Bank as Aaa and AAA respectively, these being their top ratings. In addition, banks can count L-Bank bonds towards their short-term liquidity coverage ratios (LCR) as assets with the highest liquidity standing.

During the year under review, L-Bank was once again able to make flexible use of the refinancing options on offer to meet its objectives in terms of funding volumes, maturity profiles and structure. The Bank focused on maturities in the two-year to five-year range. The principal instrument used here is the Bank's Debt Issuance Programme, with a funding limit of EUR 30,000.0 million, of which EUR 17,564.3 million was utilised as at 31 December 2017 (2016: EUR 23,144.7 million). The total volume of medium and long-term refinancing through borrowings on the capital markets amounted to EUR 4,757.1 million (2016: EUR 9,960.5 million). As at the year-end, utilisation of the Commercial Paper Programme, which is used for short-term refinancing and has an upper funding limit of EUR 15,000.0 million, amounted to EUR 9,104.1 million (2016: EUR 8,306.4 million).

For certain development programmes, L-Bank also made use of refinancing products available from other development institutions such as KfW and Landwirtschaftliche Rentenbank, to the extent that such products were compatible with the Bank's own programmes.

During the past fiscal year, the Bank's liquidity was assured at all times, and the Bank complied with all regulatory capital requirements.

Capital adequacy is calculated in accordance with the requirements of the Capital Requirements Regulation (CRR). The following table provides a breakdown of the Bank's equity as at 31 December 2017, prior to approval of the annual financial statements by L-Bank's Supervisory Board.

EQUITY INSTRUMENTS in EUR millions

Common Equity Tier I capital after deductions	3,437.5
Additional Tier I capital after deductions	0.0
Supplementary capital after deductions	381.1
Total equity	3,818.6

SUMMARY OF THE BANK'S BUSINESS DEVELOPMENT AND POSITION

L-Bank's business development and its financial position, cash flows and financial performance were satisfactory in the year under review.

PERSONNEL

As at the balance sheet date, the number of staff employed by L-Bank totalled 1,241 (2016: 1,232). L-Bank pursues a strategy of filling jobs that become vacant from internal resources wherever possible, by applying staff development policies that include in-house professional development such as on-the-job training. However, the external labour market remains indispensable for the recruitment of specialists, especially in IT and auditing. With a staff turnover rate of just 1.93% (2016: 1.79%), L-Bank has a very stable headcount.

One of the main reasons for personnel changes were initiatives associated with the Bank's modernisation and digitisation projects, involving the redistribution of human resources. In particular, preparing a replacement for the Bank's mainframe system required the involvement of many specialists from all L-Bank departments.

As part of meeting the Bank's goal to actively streamline the changeover from one generation to the next, L-Bank offers employees a phased-retirement programme based on a block model. The programme targets employees aged 57 and above who have worked for the Bank for at least 20 years. Given that the average employee age is 47.4 (2016: 46.5), this gives L-Bank an opportunity to plan for long-term recruitment as positions become vacant due to demographic factors.

When filling executive positions, L-Bank strives to achieve an appropriate gender balance whilst always taking suitability, skills and performance into consideration. As a rule, this means that male and female candidates are considered in equal proportions. In the year under review, Dr Iris Reinelt was appointed to a position on the senior management team. 35.2% of all the Bank's executive managers are women (2016: 34.2%). Overall, L-Bank employs more women than men: female employees accounted for 57.5% (2016: 57.9%) of the workforce as at the balance sheet date.

Because staff development is an especially high priority, L-Bank offers a broad range of continuing professional development options to its most important resource: its personnel. In addition to an emphasis on professional qualifications, the CPD portfolio also includes options for developing methodological, social and personal skills.

In addition, L-Bank's full-spectrum personnel development programme is aimed at junior staff who wish to develop their careers as managers or specialists. Based on individual analyses of each employee's potential, those who take part in the programme are put through tailor-made development courses to further develop areas of knowledge in which they are hoping to specialise. Here, in addition to seminars and training courses, L-Bank relies in particular on elements such as project work, management workshops and social learning to build up the active skills of its junior staff.

SUSTAINABILITY REPORT

The basis of all L-Bank activities is the Bank's statutory public-service mandate. It underpins the Bank's actions, which are all directed towards the sustainable development of the State of Baden-Württemberg and of the Bank itself. As a state-owned company with development responsibilities in key socio-political areas, this confronts L-Bank with very special challenges. Both as an organisation and in terms of the instruments it uses, the Bank has a duty to set an example and is an important source of inspiration for Baden-Württemberg.

L-Bank is responsible for protecting life's natural resources for future generations and, through its ecological, social and societal activities, helps to ensure that Baden-Württemberg continues to evolve as a dynamic, commercially successful region that offers an exceptional standard of living. By basing its business operations on sustainability criteria, and by providing targeted development products, L-Bank acts as a positive example of ongoing economic and social development. One of the priorities of L-Bank's sustainability management strategy is to raise employee awareness of sustainable business practices. Thus L-Bank is helping to make sustainable business activities more visible, as well as easier to understand and experience, as it seeks to develop the federal state's corporate culture in line with the guiding principles of sustainable development. One component of sustainability management is environmental management. The Eco-Management and Audit Scheme (EMAS) is a voluntary instrument devised by the European Union for enabling organisations and companies to continuously improve their environmental performance. The EMAS certificate awarded under the scheme is a seal of approval indicating exemplary environmental management. The Bank made use of this option by setting up and validating an environmental management system that complies with EMAS specifications.

In order to encourage companies in Baden-Württemberg to enshrine the concept of sustainability in their business methods, the sustainability business initiative launched by the federal state has developed the WIN Charter. As one of the Charter's first signatories, L-Bank has assumed a pioneering role in this regard and is also involved in promoting the WIN Charter. L-Bank produces a WIN Charter sustainability report to provide more information on the WIN Charter's sustainability targets and the Bank's progress towards meeting these targets. This report also sets new targets for the coming reporting period, thereby introducing a systematic improvement process. The Bank presented its second WIN Charter report in fiscal 2017.

Every three years, L-Bank publishes detailed sustainability reports that present the Bank's impacts on the environment, society and the economy in tangible terms. The last report appeared as part of the integrated Annual and Sustainability Report 2016. The entry into force of the CSR Directive Implementation Act, whereby EU Directive 2014/95/EU was transposed into German law in March 2017, places additional legal requirements on L-Bank's duty to document its own business activities. The relevant disclosures are made in the non-financial report, published as a separate section of the annual report. The annual report is published on L-Bank's home page (www.l-bank.de).

OUTLOOK

Although international trade is threatened by numerous geopolitical and trade policy-related uncertainties, and consequently Germany's export economy is still exposed to various risks, the German economic upswing can be expected to continue throughout 2018 (viewed as a whole). In effect, Germany is currently caught up in a stable, broad-based upward spiral driven by a multisectoral, globally synchronous economic upsurge.

The German economy's currently high rate of expansion should continue through at least the first half of 2018. This is indicated by the buoyant intake of orders from Germany and abroad at the end of 2017; the prospect of good business with foreign countries in the early part of the year is also reinforced by companies' ongoing optimism regarding their export expectations. The stimulating effect of the low interest rates induced by the ECB should also have a continuing impact. As the year wanes, however, supply-side limiting effects are likely to prevent the German economy from growing even more strongly. The more or less fully utilised labour market is making it less attractive for companies to invest in more capital equipment, while the rising employment figures are beginning to flatten out. Overall, L-Bank expects to see stable growth of Germany's real gross domestic product in 2018 in the 2.2%–2.5% range. This growth is feasible even in view of the very limited options for further employment increases. The joint economic forecast published by German economic research institutes in autumn 2017 predicts an unemployment rate of 5.5% for 2018. At the same time, the situation – close to full employment with a growing number of job vacancies – indicates the increasing difficulty of recruiting specialist and management personnel. The shortage of skilled workers is also likely to cause price increases, which could have a damping effect on growth later in the year.

Due to these positive economic conditions and steadily rising employment, we expect to see a moderate rise in inflation. Deutsche Bundesbank is predicting a higher rate of inflation for 2018 and 2019 – between 1.6% and 1.7%, if we assume that wage agreements in various sectors will be perceptibly higher. Overall, we can expect real wages to increase in parallel with this development, so that 2018 is likely to be another strong year of consumption.

Baden-Württemberg is even more strongly reliant on international relationships than Germany as a whole. Between 2006 and 2016, the federal state's international trade orientation increased disproportionately, showing a particular tendency towards long-distance trade (especially with the USA and China). This strength is simultaneously a weakness – an economic risk to which Baden-Württemberg is exposed in view of protectionist tendencies in, for example, US trade policy, not to mention the United Kingdom's ongoing Brexit efforts.

In principle, however, it is reasonable to assume that Baden-Württemberg's economy will benefit from the recovery of the eurozone economy and the increased investment in capital equipment and expansion, precisely because of its concentrated focus on exports and technology. Taking account of development estimates for Germany as a whole, the indicators for Baden-Württemberg's economy in 2018 are predominantly positive, and incoming orders from abroad rose sharply in the last quarter of 2017. The overall picture suggests that Baden-Württemberg's exports should once again make a major contribution to regional gross domestic product in 2018. In the new year, the domestic economy will continue to act as an important mainstay of local economic growth. Full order books, buoyant exports and robust domestic consumption – both private and public – are boosting the economy and encouraging companies to take a more expansive approach to investment planning. The labour market should continue to show positive development during the first half of the year, further boosting private consumption.

In the coming year, L-Bank expects – based on overwhelmingly positive prognoses by employers – that the working population in Baden-Württemberg will continue to grow, albeit at the more moderate rate of 0.3% compared to 2017 due to the fact that the federal state already enjoys almost full employment. Since Baden-Württemberg is nearer to reaching natural supply-side growth limits (in terms of corporate production capacity and limited labour market expansion) than most other federal states, the southwestern region's performance is likely to fall somewhat below the national average in 2018. The Statistical Office of Baden-Württemberg is predicting real GDP growth of 2.25% for 2018 (as at December 2017). This prediction is supported by, among other things, the extremely positive business and export expectations of Baden-Württemberg-based companies reflected in the monthly L-Bank/ifo economic survey. L-Bank expects real growth to range between 2.1% and 2.4%.

Support for enterprise development – especially for Baden-Württemberg's SMEs – and housing development will continue to be lynchpins of L-Bank's business activities in 2018. Essentially, the Bank plans to continue its development activities through the existing programmes. In light of the economic forecasts described above, the Bank expects to see a moderate improvement in overall demand.

Overall, the volume of new business in business start-up and SME financing is expected to reach approximately the same level as the previous year, or perhaps slightly higher. For 2018, the Bank plans to optimise a number of development programmes. Changes will involve enlarging the group of companies eligible for development assistance and expanding the lending volumes per eligible project. The subscription volume of the external venture capital fund launched in collaboration with the State of Baden-Württemberg in 2017 will continue to increase.

The Bank also intends to further expand its business zone development activities, in particular by adding new locations for technology parks. The sale of properties in the parks remains part of the Bank's overall strategy.

Volumes of new housing development business are expected to rise slightly in 2018. The home ownership side of the federal state's housing assistance programme should continue to build on the progress made in 2017. In view of the improved funding conditions, new business figures should slightly exceed the level reached in 2017. The Bank expects to see a slightly higher demand for the 'Living with Children' and 'Living for the Future' development programmes. The volume of new business under the federal state's rental accommodation programme should remain high in 2018. There are two reasons for this: first, the planned increase in total costs eligible for funding, and second, the continuing high level of funding available for state subsidies. With respect to the financing of homeowners' associations, the aim is to repeat the very high levels of development funding achieved in 2017. Demand for living space will remain high, especially in urban areas.

In view of the relatively stable economic environment, L-Bank predicts that the 2018 operating result before risk provisions/valuations will remain at a comparable level to 2017. This is partly due to the expectation that net interest income will reach more or less the same level as it did in the year under review, with interest rates remaining low. At the same time, expenses are expected to remain more or less unchanged. The reduced costs associated with the Bank's buildings and the successful modernisation of the Bank's IT facilities are likely to be offset by higher expenses resulting from regulatory requirements. The Bank is expecting income from asset revaluation to remain similar to the level achieved in the reporting year.

Total assets in 2018 are likely to be comparable to the previous year's levels.

In terms of refinancing, L-Bank expects to be able to continue to raise funds on the capital market without any problems, thanks to its very good rating. The Bank is well placed on the national and international money and capital markets, with good diversification of funding sources.

Overall, L-Bank is forecasting a slight increase in new business over 2018 as a whole compared with 2017. No significant changes in the Bank's financial performance, cash flows and financial position are expected.

OPPORTUNITIES AND RISK REPORT

To manage risks associated with L-Bank's business activities, the Bank has installed a risk management system with the aim of enabling it to:

- ensure the Bank's risk-bearing capacity and solvency at all times,
- assess the Bank's overall risk exposure at any time,
- immediately identify, assess, communicate and control material individual risks, and
- identify risk-related developments, combined with possible responses.

The Bank's risk management model is based on the premise that, even in the event of unexpected losses, the Bank's survival should be sustainably assured without the support of the State of Baden-Württemberg. It is based primarily on:

- the application of a coherent business strategy and resulting risk strategy,
- constant monitoring of the Bank's risk-bearing capacity and solvency and related reporting to the Board of Management, the Supervisory Board and the relevant supervisory authorities,

- the creation of a recovery plan setting out possible courses of action to deal with any events that have a substantial negative impact on the Bank's financial performance, cash flows or financial position,
- full documentation in writing of the Bank's corporate structure and all business processes involving risks,
- the implementation and continuous updating of risk management and risk control processes, and
- the creation of a compliance controlling and a risk controlling function, as well as an Internal Audit unit.

By devising development programmes, identifying specific market segments in need of financial support, and determining the regional focus, the State of Baden-Württemberg effectively defines the Bank's business activities. In return, it also explicitly and unconditionally guarantees the Bank's liabilities through a public (statutory) guarantee and maintenance obligation.

From a supervisory perspective, the Bank's business operations are regulated and monitored by the European Central Bank in conjunction with the responsible German authorities. This supervision aims to monitor compliance with CRR rules and Germany's implementation of Directive 2013/36/EU (Capital Requirements Directive IV). Article 97 of this Directive requires the competent supervisory authorities to examine the internal processes of financial institutions in order to verify their internal risk-bearing capacity. Previously this review was carried out on the basis of the guideline for the 'Supervisory assessment of bank-internal capital adequacy concepts' issued by Germany's financial supervisory authorities on 12 December 2011. The additional cover stipulated by the European Central Bank through the SREP (Supervisory Review and Evaluation Process) over and above the minimum capital ratios defined in the CRR also relates to elements of internal risk-bearing capacity. To this extent, the assessment of internal risk-bearing capacity is governed by both European and German regulations that are not always free of contradictions. The following disclosures relating to the Bank's internal risk-bearing capacity are based on the above-mentioned guidelines issued by the German Federal Financial Supervisory Authority (BaFin), and, for the purposes of calculating internal capital adequacy, assume that counterparty default risks and operational risks are covered twofold by using only Common Equity Tier I capital that is not required to satisfy the minimum capital adequacy requirements of the CRR, including the combined capital buffer.

HOW RISK MANAGEMENT IS ORGANISED

The core elements of the Bank's risk management approach are defined by senior management in the form of internal guidelines (operational directives). In particular, the Board of Management regulates the implementation of risk inventories, methods for determining the materiality of risks, risk quantification methods, validation methods, the performance of internal stress tests, procedures for reviewing risk-bearing capacity, the capital planning process, the definition of risk tolerances, risk reporting, and the processes and powers for controlling and monitoring risks. The senior management team has delegated the implementation of internal guidelines to various risk managers, as well as to the risk controlling function, the compliance function, the head of the Internal Audit unit and the Security Office. Within the L-Bank hierarchy, these functions report directly to the senior management team. To assist them in fulfilling their remits, they have set up a Stress Testing Committee, a Recovery Planning working group and a Regulatory Compliance Committee. The Chief Risk Officer (CRO) bears overall responsibility for assessing and monitoring all counterparty default, market price, liquidity and operational risks for the Bank as a whole. She reports exclusively to senior management on these risks.

The senior management team regularly briefs the Supervisory Board on the risk situation, risk management, risk controlling and any other risk-related information, and – where necessary – reports on specific incidents. The Supervisory Board also approves the recovery governance principles set down in the Bank's recovery plan. The Supervisory Board has set up various committees to deal with specific subject areas. At meetings of the Risk Committee, the senior management team reports on counterparty default, market price, liquidity, operational and reputational risks. The Risk Committee is also briefed on the Bank's risk strategies and on any matters which, in view of the associated risks, are especially relevant. For its part, the committee advises the senior management team on questions relating to the Bank's overall willingness to assume risks, and to risk strategies.

The Audit Committee is primarily responsible for discussing the audit report with the auditor and for preparing the Supervisory Board's approval of the annual financial statements and the Board of Management's proposal for the appropriation of profits.

The remit of the Personnel Committee covers the responsibilities of an appointments committee and a remuneration control committee. The Personnel Committee is also responsible for preparing Supervisory Board resolutions on the remuneration paid to senior management, on matters relating to the latter's employment contracts, and on other contractual issues. It adopts resolutions setting out the terms and conditions of employment for senior executives and other employees, and also assigns L-Bank's powers of attorney.

The senior management team defines an interest rate and currency-risk profile for the investment book; the Treasury department is responsible for implementing this profile. The Treasury department is also responsible for liquidity management, while observing the control parameters specified by senior management. Counterparty risk is managed by setting up limits approved by senior management; these may be documented by the Bank's individual lending departments as part of a competence system. Operational risks are managed by risk managers. The latter are divided into central risk managers, who manage operational risks affecting the entire Bank, and decentralised risk managers, who manage the risks associated with specific working procedures. Operational risks resulting from unlawful actions to the detriment of the Bank are assessed by means of a threat analysis. Risks arising from services by third parties that fail to comply with contractual terms are accounted for in the materiality analysis of outsourced contracts. Whereas central risk managers are appointed by senior management, the role of decentralised risk manager is generally fulfilled by the heads of the individual departments, who may also delegate specific tasks to departmental staff as part of their organisational remit.

The Controlling department is responsible for the quantitative and qualitative assessment and communication of risks. These assessments are based on a company-wide database containing standardised records detailing all the Bank's transactions and business partners. The evaluations produced as part of the risk management process are regularly compared against balance sheet-based evaluations and data used for reporting purposes (e.g. the CRR). The Controlling department is also responsible for monitoring compliance with all risk management policies, and for reporting on the risk situation to senior management.

The Bank takes a highly controlled approach to counterparty default risks, market price risks and liquidity risks, managing such risks in accordance with the relevant regulatory requirements and the Bank's internal policies. With regard to operational risk, L-Bank pursues an avoidance strategy, whilst adhering to the principle of profitability.

The Credit Analysis department assesses the credit standing of individual borrowers and specific portfolios, and proposes appropriate borrower-based lending limits to senior management, as well as lending limits for portfolios and countries. The Credit Analysis department also acts as the back office and casts the back-office vote on business decisions involving risk.

In order to comprehensively assess risk exposure, the Stress Testing Committee carries out regular stress analyses. In doing so, they pay particular attention to risk concentrations.

Taking a risk-focused, process-independent approach, the Internal Audit department reviews and assesses the effectiveness and adequacy of the Bank's risk management system, as well as the orderly conduct of all L-Bank's material activities and processes, doing so on behalf of senior management. The department reports directly to the senior management team. The Internal Audit department carries out its duties independently and impartially, and is not required to accept instructions regarding the evaluation or reporting of audit results.

The Compliance unit is responsible for corporate compliance, money laundering and fraud prevention, as well as securities compliance.

The Security Office's main areas of responsibility include supporting the senior management team in all issues related to information security policy, coordinating information security and all associated measures, monitoring the effectiveness of security measures, ensuring the continuous improvement and further development of the security process, and regularly reporting on information security.

L-Bank's risk management takes account of the Bank's shareholdings to the extent that losses directly or indirectly caused by or arising from the latter could have a long-term negative impact on the Bank's financial position, cash flows or financial performance.

BUSINESS AND RISK STRATEGIES

In the Bank's business strategy, the senior management team sets a target for, among other things, the Bank's Tier I capital ratio, and decides which products should be used to meet the Bank's public-service mandate through development programmes and other development business. The Bank's statutory public-service mandate results in concentrations of counterparty default risks (cluster risks) in particular industries, types of collateral and regions. In order to achieve a balanced aggregate risk profile, the senior management team defines quality requirements for the portfolio structure as a whole in the Bank's business strategy. These include policies defining the credit rating criteria (risk categories) for new business that must be satisfied by borrowers who are not involved in the Bank's development programmes.

The Bank's risk strategy is derived from its business strategy. In its risk strategy, senior management specifies the procedures that should be used to audit the Bank's risk-bearing capacity, lays down policies for new products and markets, and defines the strategies for dealing with counterparty default risk, market price risk, liquidity risk and operational risk.

As part of a quantitative assessment of the Bank's risk-bearing capacity, the senior management team defines the Bank's risk appetite in the risk strategy by specifying the scope of risk coverage capital that should be set aside as cover for losses.

For this purpose, based on a regularly updated risk inventory and the new product process, the risks to which the Bank is exposed are identified and, in a further step, categorised in terms of their materiality. The quantitative assessment of the Bank's risk-bearing capacity is supplemented by stress analyses, with a particular emphasis on risk concentrations.

With respect to managing credit risk, the risk strategy includes policies specifying borrowers' minimum credit ratings and risk margins, and obliges business units to secure loans against collateral from borrowers that is deemed to be recoverable. In addition, the budgets and ceilings for aggregate lending by each business unit are defined for the next three years. Budgets for development programmes are based on the amount of subsidy funding that has been made available in each case. Budgets for other development business are based primarily on levels of demand from the commercial banks with which L-Bank cooperates. Lending business associated with development aid business is primarily determined by the refinancing options available. Any investments made for this purpose must meet exceptionally high standards of creditworthiness. In conformance with the Bank's risk-bearing capacity, the risk strategy duly shows – after making proper allowance for existing risk concentrations – the projected scope of future counterparty default risks.

With respect to market price risks, the Bank pursues a strategy of following projected interest rate developments to generate predictable levels of income with acceptable levels of risk, primarily within a maturity range of up to 24 months. The underlying projections of interest rate developments are derived from capital market parameters. Due to the current volatility, these transactions are intensively monitored on a daily basis, with ongoing reviews being conducted at least weekly by senior management. Additionally, the banking supervisory authorities assume the existence of market price risks associated with the investment of equity capital in longer-term securities.

The Bank uses the national and international capital markets to obtain refinancing on favourable structural and cost terms. The public guarantee and maintenance obligation provided by the State of Baden-Württemberg means that the Bank benefits from the latter's excellent credit standing on the capital markets. Potential refinancing risks due solely to a substantial downgrade of the federal state's credit rating are permanently classified as negligible.

The Bank controls operational risks by applying the principle of profitability. This means that regardless of the existing comprehensive internal control procedures, and regardless of statutory or regulatory requirements, the Bank only takes special mitigation or avoidance measures if the potential loss exceeds the costs of taking such measures.

RISK-BEARING CAPACITY

Risk-bearing capacity represents the highest and most comprehensive level at which the Bank's risk exposure is analysed at L-Bank. It is the basis for the operational implementation of the Bank's risk strategy, because when the risk strategies for all material risks are formulated, risk tolerances are explicitly specified in the form of VaR limits. As part of establishing these limits, a conscious decision is made regarding the scope of potential future risks. And because planned new business activities can only be implemented if the resulting risks are covered by the Bank's risk coverage capability, the analysis of risk-bearing capacity effectively determines the maximum scope of potential new business (especially development aid business) and indicates any capital increase that may be required in good time. The review of the Bank's risk-bearing capacity is supplemented by analyses of the expected shortfall, as well as stress scenarios.

The risk-bearing capacity review process consists primarily of the following components:

- Risk inventory, including determination of materiality of risks,
- Determination of risk exposures and comparison with existing risk coverage capabilities from both periodic and net present value perspectives,
- Performance of a capital planning exercise in a baseline scenario and in three stress scenarios with definition of value-at-risk limits,
- Validation of risk measurement methods using stress-test analyses.

RISK INVENTORY

The starting point for reviewing risk-bearing capacity is a risk inventory, carried out at regular intervals. The risk inventory first checks whether the risk management system takes account of all circumstances that could influence the Bank's financial position, financial performance and cash flow situation (risk coverage). Then follows a critical analysis to determine whether risk assessment, management and reporting permit an appropriate evaluation of all risks identified by L-Bank. Finally, each individual risk's materiality and relevance to management objectives is assessed using a combination of qualitative and quantitative analysis.

The risk management system takes account of all identified risks. During reviews of the Bank's risk-bearing capacity, potential losses are calculated and management limits specified for all material risks as a matter of course. Where these potential losses cannot be meaningfully assessed against the value at risk, the risks are limited using other management instruments.

If it is not economically feasible to carry out a value-at-risk assessment in view of the risk profile, the potential losses are evaluated using a simplified method, whereby the total potential losses measured using simplified methods may not exceed 2% of the sum total of all value-at-risk limits (aggregate loss ceiling). The suitability of the simplified method, as well as the assumptions made and calculation methods used, are reviewed as required, but at the very least as part of the regular risk inventory.

Immaterial risks are accounted for by applying appropriate risk management policies. These risks are generally not taken into account when reviewing the Bank's risk-bearing capacity. If, however, these risks cannot be managed in a sensible way, they are accounted for by reducing the Bank's risk-coverage capability.

The materiality of a risk or sub-risk also depends on the relevant perspective. The following table provides an overview of risk inventory results.

POTENTIAL RISKS AND RISK COVERAGE CAPABILITY

The aim of monitoring L-Bank's risk-bearing capacity and of controlling risks is to safeguard the Bank's continuing existence over the long term. The Bank's risk-bearing capacity is monitored from a periodic and a net present value perspective. The results are reported to senior management on a monthly basis. The Risk Committee and the competent supervisory body are informed of the Bank's risk-bearing capacity in the quarterly risk report.

		Periodic perspective			Net-present-value perspective
Type of risk	Sub-risk	Material	VaR limit used to determine potential loss and management?	Included in capital planning?	Potential loss determined?
Counterparty default risk	Default risk	Yes	Yes	Yes	Yes
	Migration risk	No	No	No	Yes
	Credit-spread risk	No	No; write-down on risk coverage capability	Yes	Yes
	Country risk	Yes	Yes	Yes	Yes
	Sovereign risk	Yes	Yes	Yes	Yes
	Issuer risk	Yes	Yes	Yes	Yes
	Shareholding risk	Yes	Yes	Yes	Yes
	Concentration risk – individual borrowers	Yes	Yes	Yes	Yes
	Concentration risk – industries	Yes	No; write-down on risk coverage capability in stress scenario	No	No
	Concentration risk – Collateral	Yes	No; write-down on risk-coverage capability in stress scenario	No	No
Market price risk	Internal interest rate risk	Yes	Yes	Yes	Yes
	Foreign exchange risk in the bank book	Yes	Yes	Yes	Yes
Liquidity risk	Insolvency risk	Yes	No; managed via key indicators	No	No
	Market liquidity risk	No	No	No	No
	Funding liquidity risk	Yes	Yes	Yes	Yes
Operational risks	Human error	Yes	Yes	Yes	Yes
	Technical failure	Yes	Yes	Yes	Yes
	Behavioural risk	Yes	Yes	Yes	Yes
	Procedural failure	Yes	Yes	Yes	Yes
	Fraud	Yes	Yes	Yes	Yes
	Legal risk	Yes	Yes	Yes	Yes
	IT risk	Yes	Yes	Yes	Yes
	Compliance risk	Yes	Yes	Yes	Yes

		Periodic perspective			Net-present-value perspective
Type of risk	Sub-risk	Material	VaR limit used to determine potential loss and management?	Included in capital planning?	Potential loss determined?
Operational risks	Transfer risk	No	No; managed via country limits	No	No
	Conversion risk	No	No; managed via country limits	No	No
Income risk	Yields on margins in new financial aid business	No	No	No	No
	Yields on margins in new development business	No	No	No	No
	Spread when refinancing existing incongruities	No	Yes; as funding liquidity risk	Yes	Yes
	Spread when refinancing new loans	No	No	Considered in stress scenario	No
	Equity investment	No	Yes; as IRRBB	Yes; as IRRBB and additional risk in stress scenario	Yes; as IRRBB
Reputational risk		No	No; managed via complaint management	No	No
Pension risk	Market price risk effect	Yes	Yes	Yes	Yes
	Liquidity risk effect	Yes	Yes	Yes	Yes
	Income risk effect	No	No; write-down on risk coverage capability	Yes	Yes
Model risk		No	No; managed via validation	No	No
Option risk	Market price risk effect	Yes	Yes	Yes	Yes
	Income risk effect	No	No; write-down on risk coverage capability	Yes	Yes
	Liquidity risk effect	Yes	Yes	Yes	Yes

Periodic perspective

Calculations of the relevant risk coverage capability are based on profit and loss considerations. Only Common Equity Tier I capital that is not required to satisfy the minimum capital adequacy requirements of the CRR (including combined capital buffer) is taken into consideration. Given that the risks are calculated on the basis of a one-year holding period, the Bank applies equity requirements based on those that will apply 12 months after the valuation date, in accordance with the phase-in scheme. For reasons of prudence, L-Bank increases the required minimum total capital ratio (including combined capital buffer) by 0.5 percentage points and applies a bank-specific countercyclical capital buffer of 1.0%, which is well above current requirements. In a second step, the Bank supplements this disposable Tier I capital with any reserves that, in terms of their loss-bearing function, are comparable in quality to the available equity capital and – when calculating the Bank's risk exposure as defined by regulatory requirements – have not already been treated as risk-reducing factors. In addition, 'write-up reserves' that stem from the fall in value of interest-subsidised loans and predate the German Accounting Law Modernisation Act (BilMoG) are also taken into consideration.

To ensure that risk-bearing capacity is maintained beyond the reporting date, reviews are carried out to determine how the Bank's risk coverage capability will develop over the next 12 months, ignoring any income from new business transactions, but including any potential losses not included in the respective value-at-risk figures.

Potential losses are calculated for all material types of risk, based on a uniform confidence level of 99.0% and a 12-month risk assessment horizon; they are then compared with the calculated risk coverage capability.

The following tables illustrate the development of the Bank's risk coverage capabilities as well as the specific risks to which they pertain. 'Aggregate risk positions' includes the sum total of the risk exposure to counterparty default risks, market price risks and operational risks, calculated in accordance with the CRR. The Bank calculates credit risk using the standardised approach to credit risk, market price risks using the standard method, and operational risks using the baseline indicator approach.

REGULATORY CAPITAL ADEQUACY REQUIREMENTS

Regulatory capital ratios	31.03.2017	30.06.2017	30.09.2017	31.12.2017
Aggregate risk positions in EUR millions	18,908.4	18,949.7	18,816.0	18,416.8
Tier I capital in EUR millions	3,383.9	3,437.8	3,437.6	3,437.5
Equity in EUR millions	3,803.9	3,840.1	3,829.3	3,818.6
Tier I capital in %	17.90	18.14	18.27	18.67
Total capital ratio in %	20.12	20.26	20.35	20.73
Tier I capital requirement in % (incl. combined capital preservation buffer, excl. Pillar II requirement)	7.252	7.254	7.253	7.252
Total capital requirement in % (incl. combined capital preservation buffer, excl. Pillar II requirement)	9.252	9.254	9.253	9.252

Taking into consideration the CRR requirements applicable for 12 months following the calculation date, a bank-specific countercyclical capital buffer of 1.0% and the Bank's own markup of 0.5 percentage points on the minimum Tier I capital ratio, the disposable Tier I capital is calculated as follows:

	31.03.2017	30.06.2017	30.09.2017	31.12.2017
Tier I capital in EUR millions	3,383.9	3,437.8	3,437.6	3,437.5
Required for counterparty default risk (incl. CVA)	1,633.0	1,636.7	1,624.8	1,589.4
Required for market price risks	0.0	0.0	0.0	0.0
Required for operational risks	45.1	45.1	45.1	45.1
Required for Bank's own markup	94.6	94.7	94.1	92.1
Required for missing supplementary capital	100.1	111.4	118.0	120.0
Disposable Tier I capital in EUR millions	1,511.1	1,549.9	1,555.6	1,590.9

As at the balance sheet date, with disposable Tier I capital amounting to EUR 1,590.9 million, accumulated profit of EUR 70.8 million, eligible contingency reserves totalling around EUR 145.7 million, and after the EUR 77.4 million write-down for credit spread risks based on credit ratings, the Bank's P&L-based risk coverage capability amounted to EUR 1,730.0 million, which is offset by the potential risks listed below.

	31.12.2017
Risk coverage capability	1,730.0
Total potential losses	324.0
VaR counterparty default risk	215.6
VaR market price risk (IRRBB)	39.9
Embedded options	19.4
VaR liquidity risk	43.0
VaR operational risks	1.7
Immaterial business transactions	4.4

The Bank carries out capital planning to safeguard its risk-bearing capacity beyond the reporting date. This is integrated into the strategy process. It represents a periodic review of the Bank's risk-bearing capacity over the next three years. This multi-year analysis of the Bank's risk-bearing capacity also ensures that any risks resulting from planned new business activities are covered by the Bank's risk coverage capability and will not lead to capital shortages. The process uses the calculation routines described above.

To manage future risks and safeguard its future risk-bearing capacity while taking business and risk strategies into account, the Bank sets value-at-risk (VaR) limits. In doing so, the possibility that a transaction's VaR may increase due to 'technical' processes despite an unchanged risk position (e.g. unchanged investment of equity capital but simulated interest rate increase) cannot be precluded. To ensure that risk-bearing capacity is maintained even in the event of such processes, the Bank makes loss buffers available. The sum total of these VaR limits and loss buffers represents the aggregate loss ceiling as defined by the Bank, which, in view of the requirement to secure L-Bank's long-term survival, may not exceed 80.0% of the risk coverage capital.

When offsetting potential losses against risk coverage capital in this way, the Bank does not take account of any risk-reducing diversification effects between the different risk types.

As at the balance sheet date, the aggregate loss ceiling was distributed as follows:

AGGREGATE LOSS CEILING AND INDIVIDUAL LOSS CEILINGS AS AT 31.12.2017 AND 01.01.2018
in EUR millions

	31.12.2017	01.01.2018
Aggregate loss ceiling	940.0	1,000.0
Counterparty default risks	460.0	475.0
Market price risks	150.0	165.0
Embedded options	24.0	25.0
Liquidity risks	200.0	230.0
Operational risks	10.0	10.0
Loss buffers for transactions evaluated using simplified method	6.0	5.0
Loss buffers	90.0	90.0
Proportion of risk coverage capital taken up by aggregate loss ceiling	54.3%	57.8%

Thus the aggregate loss ceiling accounted for 54.3% of the Bank's risk coverage capability at the balance sheet date. Over the past fiscal year, this proportion has varied between 51.6% and 58.1%.

In addition to the baseline scenario described above, capital planning is also carried out with the help of three (non-adverse) stress scenarios that focus on earnings risk, operational risk and counterparty default risk. In each of the stress scenarios, the Bank's multi-year risk-bearing capacity is assumed to be a given.

Net present value perspective

In an additional analysis, the net present value of all existing assets and liabilities, less the administrative expenses associated with them, is presented as risk coverage capability. As part of this analysis, any hidden liabilities in fixed assets resulting from the avoidance of lower of cost or market write-downs, as well as negative market values of credit default swaps (CDS), are also taken into account. As well as net present value counterparty default risks, market price risks, liquidity risks and operational risks, this risk coverage capability is then assessed relative to credit spread risks and migration risks; all risks are calculated with a confidence level of 99.98%. Migration risk is assessed with the help of a Monte Carlo simulation, based on the risk of a decline in value due to borrowers' deteriorating credit ratings. Market-wide credit spread risk is assessed with the help of historical simulations, based on the risk of a rating-independent decline in the value of securities and credit default swaps due to market-wide credit spread movements.

As at the balance sheet date, the business portfolio's net present value is calculated as EUR 5,464.1 million. This is offset by net present value (NPV) administrative expenses totalling EUR 282.6 million, plus imputed NPV risk provisioning costs of EUR 303.5 million and hidden liabilities from CDS of EUR 0.0 million, resulting in a value-based risk coverage capability of EUR 4,877.9 million. As at the balance sheet date, 71.8% of this was taken up by VaR values totalling EUR 3,502.3 million. Utilisation of net present value risk coverage capital in 2017 ranged between 70.8% and 82.4%.

MODEL VALIDATION

Part of the risk inventory involves performing an analysis of the limits and restrictions of the models used to evaluate 'material risks' to ensure that they deliver sufficiently reliable forecasts of loss distributions and thus of value-at-risk figures. Regular validation exercises are also carried out on models and methods for evaluating material risks. The validation methods, scope of the individual validation actions, responsibilities for these methods and the regular intervals at which they should be applied are all specified for each type of risk. The Bank uses standard methods to assess risks. In the case of counterparty default risk, the validation criteria are especially high, because the quality of the assessment results depends first on the number of simulations and second on the quality of each model's parameters for probability of default, correlation and recovery rate. The suitability of the model parameters applied is reviewed as part of the regular quantitative parameter validation cycle. If the findings of these validation exercises result in adjustments of measurement procedures or their underlying assumptions, all such adjustments must first be approved by senior management.

Performing stress analyses

By their nature, the actuarial models used for risk measurement assume, when setting various influencing parameters, a degree of stability in financial market conditions. However, the financial market crisis has revealed limits to the predictive powers of quantitative risk models in various areas. In view of the fact that actuarial models cannot by their very nature reflect all events, all quantitative risk assessments are continuously supplemented by comprehensive analyses in the form of stress scenarios. By performing these stress analyses, the Bank identifies clusters of risk factors that may have a major impact on the Bank's financial position, cash flows and/or financial performance.

In the course of these analyses, scenarios relating to a single type of risk are developed and subsequently analysed in isolation to establish their impact on counterparty default risk, market price risk, liquidity risk and operational risk. In a second stage, the key risk factors for each individual risk type are defined as actual risk carriers (e.g. unemployment as a factor in counterparty default risk), and the Bank then investigates how they interact with risk factors affecting other types of risk. At this stage in the process, the analysis is based on, inter alia, the Bank's in-house expertise combined with a scoring method. By identifying the interactions between risk factors, the Bank gains an insight into risk concentrations both within individual risk types and across all risk types. This enables the Bank to formulate stress scenarios that match the interactions between risk factors and cover all types of risk.

The quantitative impact of the formulated scenarios on default rates, recovery rates, refinancing conditions and losses due to operational risks (the parameters of the Bank's risk factors) are based on expert estimates.

The estimated parameters are then used to calculate the Bank's net present value and balance sheet liability (income statement expense). Of particular importance here is a multi-risk scenario of particular relevance to Baden-Württemberg's economic structure, which assumes a severe economic downturn caused by a slump in automotive industry sales.

With respect to market price risk, various extraordinary changes in yield curves are modelled, based either on standardised interest rate changes such as parallel shifts, or on rare historical interest rate changes over the past 20 years. This means the interest rate scenarios include exceptionally sharp or extreme interest rate rises and falls, as well as changes in the shape of the yield curve. In stress analyses of liquidity risk, underlying criteria for market-wide effects include a change in the central bank's interest rate policy (increase in base rates) and capital market-driven changes in L-Bank's refinancing conditions. The analyses examine the impact of a deterioration in the Bank's own credit rating plus a change in investors' risk tolerance, both reflected in changing refinancing spreads at given credit ratings.

Stress scenarios used to evaluate operational risks are based on an assumption of heightened probability both that the loss scenario will occur and that the quantitative impact in the event of a loss will be higher.

The analytical system described above does not entirely preclude the possibility that certain scenarios threatening the Bank's existence may never be identified. Consequently, in order to clarify the limits of the Bank's risk-bearing capacity, the Bank makes certain assumptions regarding charges arising from losses, and retroactively determines the conditions under which such losses might occur (inverse stress tests). Stress analyses performed for purposes of recovery planning are used for this exercise, such that the results of recovery planning analysis are incorporated into the risk management system.

RISK MANAGEMENT AND RISK CONTROL

L-Bank's risk management and risk controlling processes include the identification, assessment, management, monitoring and communication of material risks. Counterparty default risk, market price risk, liquidity risk and operational risk, as well as any associated risk concentrations, are identified as material risk types.

COUNTERPARTY DEFAULT RISK

Counterparty default risk refers to a possible loss resulting from a counterparty's failure to meet its contractual obligations. These obligations may result from a lending transaction as defined in the German Banking Act (Art. 19 KWG), or from a performance obligation relating to a transaction involving payment on delivery. The reason for non-fulfilment of a contract may be specific, relating to the borrower's credit standing or particular circumstances. The Bank classifies political reasons for non-performance under country risk. Country limits are in place to restrict this type of risk. Country-specific transfer and conversion risks are classified as legal risks and thus under operational risk.

The active management of counterparty default risk begins with the lending process, involving

- → assessment of the borrower's credit rating (including a review of the borrower's capacity to meet principal repayments),
- → adherence to the country risk limit,
- → the possible use of collateral,
- → the calculation of a risk margin based on probability of default, and
- → a review of the need for a back-office vote.

When managing counterparty default risk, the Bank stipulates a minimum risk category for each of the individual business segments using a 14-level system. It is up to senior management to take a decision on any exceptions from these minimum risk categories.

Business segments	Risk category
Loans provided under programmes	The credit ratings required for programme-related activities are stipulated in the development programmes agreed between the State of Baden-Württemberg and L-Bank, and in the Bank's in-house directives
Other loans (including securities and financial investments)	1 to 5
Interest rate derivatives without collateral	1 to 3
Interest rate derivatives with collateral	1 to 5
Credit derivatives	1 to 5, no new business
Countries (transfer risk)	1 to 12, but no new business in the peripheral eurozone countries Development aid business: focusing on risk categories 1 to 2

In order to limit the losses associated with all loan-related decisions that create a new, or increase an existing, counterparty default risk for the Bank, care is taken to ensure that appropriate collateral is provided, to the extent that such collateral is suitable for bank use in view of the legal form or credit rating of the counterparty concerned. To limit the credit risk associated with the use of collateral, the value of the collateral provided must not depend on the borrower's credit rating.

The Bank experiences losses when borrowers default on their loans. To compensate for these losses, risk-based margins must be applied. In view of L-Bank's business model, however, it is not possible to set individual risk-based margins for development loans issued under the Bank's development programmes. With respect to development aid business, most transactions are conducted with capital market participants. For these borrowers, the Bank mainly trades in credit spreads on the capital markets, meaning that L-Bank only has limited influence on margins. In the case of all loans for which margins are not fixed by third parties (programme loans) and for which conditions are not set on the capital markets, a risk margin is calculated on the basis of the probability of default and incorporated into the decision-making process.

With respect to the Bank's lending business, the front-office and back-office areas at L-Bank are strictly separated at all levels, up to and including senior management level. Divisions I and IV are front-office areas, and divisions II and III are back-office areas. This organisational separation of powers is also consistently guaranteed in the event of deputising. Given that risk-related loan decisions require the approval of the back office (back-office vote) and the back office is responsible, in particular, for controlling credit risks, the organisational separation of lending business into back and front offices avoids any imbalance when making loan-related decisions.

The following table shows the composition of the loan portfolio by product type as at 31 December 2017. When calculating the loan portfolio, outstanding amounts, arrears, irrevocable loan commitments and undrawn, externally approved lines of credit associated with loans, securities and shareholdings are included. Financial derivatives are stated at the respective credit-equivalent amounts, whereby collateral loans that cannot be offset against market values are included as time deposits.

LOAN PORTFOLIO AS AT 31.12.2017 in EUR millions

	Private clients	Companies and self-employed persons	Companies in the financial sector	Public sector	L-Bank total	Allocation in %
Loans	6,123.0	7,382.6	20,258.0	4,564.0	38,327.6	52.3
Promissory notes	0.0	0.0	1,415.6	9,697.7	11,113.2	15.2
Securities (bearer bonds)	0.0	686.0	7,058.4	13,007.9	20,752.3	28.3
CDS	0.0	0.0	0.0	991.7	991.7	1.4
Sureties	0.0	365.8	90.4	0.0	456.1	0.6
Financial derivatives	0.0	0.0	804.5	0.0	804.5	1.1
Time deposits	0.0	0.0	45.5	0.0	45.5	0.1
Shareholdings	0.0	48.2	126.9	102.5	277.6	0.4
Current accounts, cash	0.0	0.0	435.2	18.9	454.2	0.6
Total	**6,123.0**	**8,482.6**	**30,234.5**	**28,382.7**	**73,222.8**	**100.0**

QUANTITATIVE ASSESSMENT BASED ON VALUE-AT-RISK CALCULATIONS

Risks from unanticipated losses are restricted by applying the VaR limits enshrined in the risk-bearing capacity concept.

As a general rule, losses are estimated using the Monte Carlo simulation method based on probabilities of default. The probability of default is allocated on the basis of the external or internal rating category assigned to the customer as a result of the Bank's analyses. As well as the customer's credit rating, the sector in which the customer operates and other risk-related characteristics are also taken into account. The calculation is based on a holding period of one year and a confidence level of 99% from a periodic perspective and 99.98% from a net present value perspective. If a sufficient default history is available (in the case of private clients and corporate clients in the rental housing sector), the Bank's own borrower correlations and recovery rates are incorporated into the assessment. Otherwise, the regulatory borrower correlations are applied. When calculating the amount of the loss, any security provided in the form of cash collateral or loans granted to end-borrowers in accordance with the 'borrower's bank' principle is taken into consideration. For the remaining unsecured portion, the regulatory (IRBA) recovery rate of 55% is applied to 'Companies in the financial sector'. A recovery rate of 78% is assumed for 'Public sector' business lines, based on the results of a benchmark survey. For borrowers in the 'Other companies' category, no representative loss history is available, which is why, pursuant to an expert opinion, a recovery rate of 30% is applied. For all securities eligible for bail-in, a residual debt servicing capability of 25% is assumed as their servicing is prioritised over any subordinated risk claims (for which the regulatory residual debt servicing capability is 25%).

The value at risk for counterparty default risks is calculated on the basis of a Monte Carlo simulation that takes account of borrower correlations through which individual borrower concentration risks are incorporated into the assessment. In addition, sub-portfolio-specific concentration risks are calculated by making value-at-risk assessments for the individual sub-portfolios and using the sum of these individual values as the total value at risk in the risk management system.

The following table provides an overview of the proportion of the aggregate loss ceiling taken up by counterparty default risks in the course of 2017:

VALUE AT RISK FOR COUNTERPARTY DEFAULT RISKS IN 2017 in EUR millions

	01.01.2017		31.03.2017		30.06.2017		30.09.2017		31.12.2017	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	940.0	408.6	940.0	299.5	940.0	386.0	940.0	360.1	940.0	324.0
Share of counterparty default risks in %	48.9	41.6	48.9	61.8	48.9	66.2	48.9	66.4	48.9	66.5
Counterparty default risks	460.0	170.1	460.0	185.0	460.0	255.5	460.0	239.0	460.0	215.6
Private clients	60.0	0.0	60.0	0.0	60.0	1.1	60.0	1.6	60.0	0.0
Companies in the financial sector	200.0	59.7	200.0	57.9	200.0	155.6	200.0	138.1	200.0	128.9
Other companies	150.0	110.3	150.0	127.1	150.0	98.8	150.0	99.3	150.0	86.7
Public sector	50.0	0.0	50.0	0.0	50.0	0.0	50.0	0.0	50.0	0.0

Timely and adequate risk provisions

L-Bank makes adequate allowance for counterparty default risks that have become acute by setting aside risk provisions. For this purpose, the Bank has set up dedicated processes based on various tools used for the early detection of risks, and has issued appropriate guidelines. The following table shows the changes in value adjustments for each business unit, as well as the corresponding risk portfolios. It shows valuation allowances that are deducted from the outstanding loans to determine net positions when calculating the capital required pursuant to the CRR. From the periodic perspective, any valuation allowances that are not deducted from book values when calculating the required capital pursuant to the CRR remain available to L-Bank as risk coverage capital (e.g. contingency reserves pursuant to Art. 340f HGB).

VALUE ADJUSTMENT RATIOS AS AT 31.12.2017 in EUR millions

	Private clients		Companies and self-employed persons		Companies in the financial sector		Public sector		Total		
	Adjustment	Portfolio	Adjustment	Portfolio	Adjustment	Portfolio	Adjustment	Portfolio	Adjustment	Portfolio	Ratio %
31.12.2011	100.4	7,251.9	567.1	11,659.9	31.6	33,710.5	0.0	20,177.2	699.1	72,799.5	1.0
31.12.2012	88.6	6,771.8	505.8	10,959.8	31.6	31,236.1	0.0	23,941.6	626.0	72,909.2	0.9
31.12.2013	92.9	6,373.7	432.1	10,886.2	31.6	31,300.6	0.0	23,846.3	556.6	72,406.8	0.8
31.12.2014	87.6	6,091.8	373.2	11,006.3	21.9	30,211.3	0.0	23,039.4	482.7	70,348.9	0.7
31.12.2015	88.8	5,873.0	265.4	9,183.5	15.0	30,393.8	35.8	27,784.3	405.0	73,234.6	0.6
31.12.2016	95.6	6,307.2	202.1	8,641.0	15.0	31,621.9	0.0	31,371.6	312.7	77,941.8	0.4
31.03.2017	88.0	6,230.4	196.4	8,759.2	15.0	35,044.6	0.0	30,371.7	299.4	80,405.9	0.4
30.06.2017	82.3	6,178.9	170.3	8,811.2	15.0	34,592.4	0.0	30,210.3	267.6	79,792.7	0.3
30.09.2017	79.4	6,154.4	154.5	8,438.1	15.0	35,968.9	0.0	29,870.8	248.9	80,432.2	0.3
31.12.2017	80.1	6,123.0	123.3	8,482.6	25.6	30,234.5	2.8	28,382.7	231.8	73,222.8	0.3

Qualitative assessment based on credit rating and collateral classifications

For the qualitative assessment of counterparty default risks, each borrower is assigned a credit rating expressed as a risk category. In assigning individual ratings, L-Bank takes account of the peculiarities of the relevant client's structure. For borrowers involved in development finance for owner-occupied housing, the homogeneity of the customer group means that they are assigned a default rating based on the average probability of default. The following table shows the default probabilities for the individual risk categories and shows internal risk categories against the corresponding external risk categories.

RISK CATEGORIES AND CORRESPONDING DEFAULT PROBABILITIES

Risk category	1	2	3	4	5	6	7	8	9	10	11	12	13	14
Mean probability of default in %	0.01	0.03	0.06	0.13	0.27	0.56	1.15	2.35	4.75	9.37	17.63	30.72	100	100
Range of probability of default in %	0.01	0.02	0.04	0.09	0.19	0.39	0.80	1.65	3.35	6.70	12.95	23.55	100	100
	0.02	0.04	0.09	0.19	0.39	0.80	1.65	3.35	6.70	12.95	23.55	100		
External (S&P)		AA+		A		BBB			BB–	B	CCC+	CC	Default	Default
	AAA	AA	A+	A–	BBB+	BBB–	BB+	BB	B+	B–	CCC	C		
		AA–									CCC–			
	Investment grade						Non-investment grade							

Organisation units responsible for extending loans are always obliged to ensure that lending decisions are backed by sufficient collateral, in order to reduce the unsecured portion and thus the loss exposure. L-Bank has specified acceptable types of collateral, and also specified the maximum value that should be assigned to each type when determining the unsecured portion of the loan. Collateral that – for material or formal reasons – may not be assigned any explicit collateral value must still be accepted when granting loans if the acceptance of such collateral is standard industry practice and if, in the event of realisation, the Bank can expect to realise recovery proceeds.

To indicate the loss exposure, the risk-mitigating effects of certain types of collateral are taken into consideration.

Receivables from regional banks that are guaranteed by 'grandfathering' and are underwritten by public guarantee and maintenance obligations are assigned to risk category 1. Similarly, loans that are guaranteed by municipalities and real-estate loans secured on residential properties in Baden-Württemberg are also allocated to risk category 1. Where collateral is provided in the form of property charges on residential property in Baden-Württemberg – independent of the real-estate loan, but within the relevant lending ratio – it is assigned to risk category 4. In the case of Pfandbriefe and similar bond issues (e.g. covered bonds), the external rating is used.

The following table shows the risk portfolios for each of the Bank's business units.

RISK STRUCTURE OF THE LOAN PORTFOLIO AS AT 31.12.2017 in EUR millions

Risk category	Private clients	Companies and self-employed persons	Companies in the financial sector	Public sector	L-Bank total	Allocation in %
1	3,679.3	4,108.9	6,427.6	23,211.8	37,427.6	51.1
2	8.7	257.3	1,493.5	4,824.7	6,584.2	9.0
3		957.6	7,031.3	27.4	8,016.3	10.9
4	1,867.6	1,595.2	11,935.8	64.7	15,463.2	21.1
5	194.0	963.4	2,590.8		3,748.1	5.1
6	245.0	159.3	393.2	254.1	1,051.6	1.4
7	68.4	162.3	19.1		249.9	0.3
8	1.6	134.0	195.0		330.6	0.5
9	1.3	16.7	45.8	0.0	63.7	0.1
10		8.8	15.5	0.0	24.3	0.0
11	13.1	3.5	50.0		66.6	0.1
12	1.4	18.7	29.8		49.9	0.1
13	23.5	69.0	0.8		93.3	0.1
14	19.2	28.0	6.3		53.5	0.1
Total	**6,123.0**	**8,482.6**	**30,234.5**	**28,382.7**	**73,222.8**	**100.0**

The total exposure shown above, amounting to EUR 73,222.8 million, includes securities and CDS totalling EUR 21,744.0 million. L-Bank aims to hold securities and CDS to final maturity. With the exception of buy-backs of own issues and purchased securities with a residual maturity of less than one year at the time of purchase, all securities are assigned to fixed assets. The Bank consequently treats them as loans and applies a moderated form of the lower of cost or market principle. No securities have been written down due to permanent impairments. As at 31 December 2017, general value adjustments totalling EUR 16.1 million are in place (2016: EUR 15.0 million). The credit quality of the securities and CDS is shown below. Any savings on the lower of cost or market value of securities or negative market values of CDS are reported under hidden liabilities.

RISK STRUCTURE OF THE SECURITIES/CDS PORTFOLIO AS AT 31.12.2017 in EUR millions

Risk category	Portfolio	Hidden liabilities	Credit-spread risks
1	15,782.1	81.3	823.0
2	3,657.5	1.8	96.3
3	372.6	0.2	8.1
4	793.7	0.0	32.3
5	843.8	0.0	15.6
6	250.3	0.0	4.5
7	0.0	0.0	0.0
8	0.0	0.0	0.0
9	44.1	11.1	7.6
10	0.0	0.0	0.0
11	0.0	0.0	0.0
12	0.0	0.0	0.0
13	0.0	0.0	0.0
14	0.0	0.0	0.0
Total	**21,744.0**	**94.3**	**987.4**

Monitoring of problem loans

Loans are classified as non-performing exposures (NPEs) if there are strong indications that in order to avert or minimise losses, actions may be necessary that go beyond the normal scope of client support and intensified contact with the client, and may extend to requiring the provision of additional collateral as part of collaborating with the client in an intensive support process. Loans are classified as NPEs according to the following criteria:

→ The client is in material default of payment, i.e. is more than 90 days in arrears with a payable that is greater than 2.5% of the total debt and greater than EUR 100, or
→ the client's internal rating places them in risk category 13 or 14, or
→ an individual risk provision has been made against the client, or
→ collateral provided to L-Bank by the client is being liquidated (by compulsory auction, foreclosure or private sale), or
→ the client is classified as 'forborne' and is undergoing problem-loan processing.

As at the year-end, the NPE portfolio amounted to EUR 192.9 million. The unsecured portion of the NPEs, as determined after a prudent valuation of the collateral provided, is fully covered by risk provisions.

When classifying NPEs, the Bank distinguishes between restructuring exposure (risk category 13) and workout exposure (risk category 14). The portfolio was distributed across the Bank's business units as shown below.

NPE PORTFOLIO AS AT 31.12.2017 in EUR millions

	Total risk portfolio	NPE portfolio		Restructuring portfolio		Workout portfolio	
		Total	in %	Total	in %	Total	in %
Private clients	6,123.0	86.7	1.42	57.9	0.95	28.8	0.47
Rental housing customers	5,570.3	40.6	0.73	23.3	0.42	17.3	0.31
Companies in the financial sector	30,234.5	7.1	0.02	0.8	0.00	6.3	0.02
Other companies	2,912.3	58.5	1.94	49.9	1.65	8.7	0.29
Public sector	28,382.7	–	–	–	–	–	–
Total	**73,222.8**	**192.9**	**0.26**	**131.8**	**0.18**	**61.1**	**0.08**

'Forborne loans' are balance sheet assets where the Bank has given a borrower in financial difficulties extra concessions as part of the restructuring process (e.g. in the form of debt deferral agreements, maturity extensions, repayment holidays or debt rescheduling) in order to re-establish or assure the borrower's capacity to meet principal repayments in the event that the said capacity has ceased to exist or is acutely at risk. Such a loan must be reported as an NPE and forborne loan for a period of one year after the financial difficulties have been resolved. The loan must then be classified exclusively as a forborne loan for a further two years (forbearance period). As at 31 December 2017, the forborne loan portfolio amounted to EUR 114.6 million. Of this, an amount of EUR 33.4 million is still in the forbearance period.

Assessing risk concentrations

Due to its public-service mandate, L-Bank is exposed to certain risk concentrations.

In housing finance, for example, there is a concentration risk associated with the collateral provided. The value of residential property is determined according to the provisions of the Lending Value Ordinance, whereby L-Bank claims the privileges associated with small loans and generally omits on-site inspections. Due to the general conditions in the housing development market, a proportion of around 26.2% is secured independently of real-estate loans. The collateral is contractually agreed in the form of land charges.

Because housing development funding is restricted to the jurisdiction in which the guarantor is located, the Bank's housing finance activities are associated with a concentration risk linked to residential property in Baden-Württemberg. In the event of a severe economic downturn, the default rate would rise and proceeds from the realisation of collateral would fall. In order to assess this risk, L-Bank analysed the cyclical sensitivity of the various regions in Baden-Württemberg. The Bank also analysed regional risks threatening the solvency of borrowers in the individual regions in the event of a severe economic downturn. The risk that a borrower in a given region becomes insolvent increases as a function of the regional economy's dependence on exports, as well as the level of unemployment prevailing in the region. The risk of insolvency decreases if residential property prices in the region are relatively low and the region in question has a well-integrated infrastructure. The risk of insolvency is expressed as the variance between the level of borrowers' risk in a region and the risk confronting an average borrower in Baden-Württemberg. A scoring system was used to determine the relative exposure. This showed that 59.0% of the Bank's housing development finance is committed in regions with above-average sensitivity to economic cycles. Thus, measured in terms of the federal state's economic sensitivity, the economic sensitivity of the loan portfolio rates as slightly above average.

Guarantees are subject to another collateral-related concentration risk. Of the guarantees received (without public guarantee or maintenance obligation) worth around EUR 8,645.0 million, the State of Baden-Württemberg accounts for some EUR 7,480.8 million. Due to the credit standing of the State of Baden-Württemberg, L-Bank regards this risk as negligible. Another EUR 991.8 million is associated with sureties/guarantees provided by other local authorities in Germany. A total of EUR 172.3 million is based on sureties/guarantees provided by private individuals, companies, banks, public-sector bodies in Germany other than local authorities, and central and regional governments abroad.

Due to L-Bank's business model, there is a further concentration risk associated with receivables from banks (EUR 28,049.7 million). Also included in this amount are receivables from central banks and other public bodies that are not taken into consideration when determining the degree of interconnectedness of an institution with the financial system pursuant to Commission Delegated Regulation (EU) 1222/2014 of 8 October 2014. However, the contagion risk to which L-Bank is exposed through receivables from banks is classed as exceptionally low. L-Bank extends loans for business development purposes via the borrowers' commercial banks. The Bank's exposure to these borrowers' bank loans amounted to EUR 19,406.3 million as at 31 December 2017. These lendings to banks are secured by the assignment to L-Bank of claims on end clients. Another EUR 8.2 million is attributable to the fact that L-Bank has underwritten the commercial banks' exposure to end-client risk. EUR 8,635.3 million of the Bank's total lending commitment relates to transactions associated with development aid business, whereby the Bank invests low-cost funds from refinancing in low-risk or risk-free issuers. Of this amount of EUR 8,635.3 million, EUR 6,032.0 million is secured by public guarantee/maintenance obligation, and EUR 201.0 million against Pfandbriefe. After deducting receivables from central banks and multilateral development banks, the remaining unsecured volume is EUR 1,137.8 million. Roughly 78.3% of this is assigned to risk categories 1 to 4 and approximately 21.7% to risk categories 5 to 8.

In regional terms, the Bank's public-service mandate means that it is exposed to a concentration risk for the region 'Germany'. A total of 92.6% of the risk portfolio is assignable to Germany, of which 70.6% relates to the State of Baden-Württemberg.

REGIONAL STRUCTURE OF THE LOAN PORTFOLIO AS AT 31.12.2017 in EUR millions

	Private clients	Companies and self-employed persons	Companies in the financial sector	Public sector	L-Bank total	Allocation in %
Germany total	**6,122.8**	**8,182.2**	**26,811.8**	**26,703.6**	**67,820.4**	**92.6**
Austria		39.0	71.1	499.2	609.3	0.8
Belgium		0.0	6.0		6.0	0.0
Finland				20.0	20.0	0.0
France	0.2	30.4	276.4	679.6	986.5	1.3
Italy				250.3	250.3	0.3
Luxembourg		10.0	44.1		54.1	0.1
The Netherlands		36.5	703.5	110.0	849.9	1.2
Portugal		4.0			4.0	0.0
Spain			34.7		34.7	0.0
Other eurozone countries	0.0	0.0	0.0	0.0	0.0	0.0
Eurozone total	**0.2**	**120.0**	**1,135.7**	**1,559.1**	**2,814.9**	**3.8**
Denmark			97.0	70.0	167.0	0.2
Great Britain*		2.3	259.3		261.5	0.4
Switzerland	0.0	122.7	180.3		303.0	0.4
Rest of Europe			44.4	50.0	94.4	0.1
Non-eurozone total	**0.0**	**125.0**	**580.9**	**120.0**	**825.9**	**1.1**
Europe total	**0.2**	**244.9**	**1,716.6**	**1,679.1**	**3,640.8**	**5.0**
USA		51.1	375.2		426.3	0.6
Canada	0.0	0.0	88.3	0.0	88.3	0.1
International organisations**	0.0	0.0	1,156.7	0.0	1,156.7	1.6
Other countries		4.4	85.9		90.3	0.1
Overseas total	**0.2**	**300.4**	**3,422.8**	**1,679.1**	**5,402.4**	**7.4**
Total	**6,123.0**	**8,482.6**	**30,234.5**	**28,382.7**	**73,222.8**	**100.0**

* Includes Guernsey, Jersey, Isle of Man and Cayman Islands.
** World Bank, European Investment Bank, European Bank for Reconstruction and Development, European Investment Fund.

The Bank's risk exposure in the crisis-affected peripheral eurozone nations stood at approximately EUR 289.0 million as at 31 December 2017. Of this, roughly EUR 250.3 million (86.6%) is payable by national governments. The residual portfolio of exposed commitments in crisis-affected peripheral eurozone countries will amount to EUR 4.0 million as at 31 December 2021.

Managing and monitoring counterparty default risk

Counterparty default risk is managed by setting individual limits for issuers, counterparties and borrowers. The Bank limits cluster risk by establishing budgeted volumes for risk categories, industries and regions. In this respect, L-Bank's public-service mandate imposes tight constraints. Consequently, the representation of cluster risks is useful, above all, as a means of raising awareness of the concentration risks associated with the Bank's public-service mandate. The maximum loan amount that L-Bank may issue to a single borrower incurring a commercial risk outside the Federal Republic of Germany is restricted by appropriate limits set at country level (country limits).

Issuer, counterparty, borrower and country limits are set by the senior management team, based on an internal analysis of credit quality and monitored on a daily basis. When any of these limits are exceeded, appropriate risk response measures are initiated on the same day.

As part of the Bank's risk strategy, the senior management team stipulates the credit rating requirements to be fulfilled by any development business unrelated to development programmes. Such transactions are generally carried out in the context of development aid business, with the Bank seeking to generate income from refinancing rather than by assuming risk. For the purposes of proper risk management, the Board has stipulated that a market-standard, risk-based margin should be set for any transactions where margins are not specified under the terms of a development programme.

The operational management of counterparty default risk is based on first-time, ongoing and incident-related evaluations of credit standing and collateral. The latter are used for managing portfolios when extending credit, and also for initiating risk-response measures at the earliest possible moment, thereby minimising lending losses. As part of this risk early warning system, the Bank analyses deteriorating credit ratings at client level, analyses loans at the intensive processing or problem-loan processing stage, and analyses levels of compliance with Art. 18 KWG, as well as changes in the recovery rates of defaulted loans in the housing development sector.

The specified processes for dealing with problem loans and non-performing commitments include a tightly controlled system of warning processes, which ensures that claims are safeguarded and outstanding debts are settled at the earliest possible stage.

Counterparty default risk is strongly influenced by the state of the economy, the low level of interest rates, but also by changes to personal circumstances (e.g. divorce). It is likely that persistently low interest rates will continue to have a positive impact on counterparty default risk. Furthermore, an improvement in the economic situation may have a positive impact on the portfolio's risk structure and lead to reversals of value adjustments.

MARKET PRICE RISK

Market price risk refers to potential losses caused by unfavourable price movements on the money and capital markets. L-Bank has no trading book, thus market price risks only arise in the non-trading portfolio (bank book).

Market price risk mainly exists in the form of interest rate risks and, to a negligible extent, currency risks. The Bank's lending business includes some risks from embedded options.

L-Bank has not separated out funds invested to cover pension provision commitments to employees. These investments form part of the euro bank book. Consequently, for the purposes of assessing market price risk, payments expected to cover pension commitments have been taken into consideration based on the figures used to calculate these pension commitments.

In the case of structured transactions and foreign-currency transactions, market price risk is excluded using micro hedges. Essentially, computed market price risk relates to the investment of the Bank's equity. The Bank avoids other interest rate positions – especially in the medium-term and long-term segments – primarily by the use of interest rate swaps and cross-currency interest rate swaps. As at 31 December 2017, the portfolio of interest rate swaps had a nominal value of EUR 75,025.0 million. Cross-currency interest rate swaps had a nominal value of EUR 14,139.1 million, currency swaps had a nominal value of EUR 9,145.6 million. As a general rule, hedging relationships are reported in the balance sheet in the form of valuation units within the meaning of Art. 254 HGB, as per Art. 256a in conjunction with Art. 340h HGB with respect to currency translation, and complying with IDW RS BFA 3 in respect of the loss-free valuation of the bank book.

Quantitative assessment based on value at risk

Risks on unanticipated losses are calculated using a VaR model. For this purpose, the Bank uses the historical simulation method. As interest rates are still very low, only absolute (not relative) changes in interest rates are taken into account when calculating the VaR. The calculation is based on historical interest rate changes over a period of 10 or 25 working days during an observation period of 1,250 days. Accordingly, two models are produced for the daily monitoring of limits and the higher risk value is applied.

For the purposes of monitoring risk-bearing capacity, one model is used for each of the periodic and net present value perspectives with a confidence level of 99% and 99.98% respectively, and a holding period of 250 days. The following table shows the parameters that are being used for the current calculations:

PARAMETERS USED IN HISTORICAL SIMULATIONS

	Holding period (trading days)	Historical observation period (trading days)	Confidence level	Application
Absolute interest rate changes	10 and 25	1,250	99.00%	Daily limit monitoring
Absolute interest rate changes	250	2,500	99.00%	RBC, periodic perspective
Absolute interest rate changes	250	5,000	99.98%	RBC, NPV perspective

In the periodic perspective, the Bank also checks whether the negative impact of a parallel shift in the yield curve by ±200 basis points on annual net interest income exceeds the period-specific present-value VaR. The higher value is imputed when reviewing the Bank's risk-bearing capacity for market price risks in the euro bank book.

The following table provides an overview of the proportion of the aggregate loss ceiling taken up by market price risks in the course of 2017:

VALUE AT RISK FOR MARKET PRICE RISK IN 2017 in EUR millions

	01.01.2017		31.03.2017		30.06.2017		30.09.2017		31.12.2017	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	940.0	408.6	940.0	299.5	940.0	386.0	940.0	360.1	940.0	324.0
Share of market price exposure in %	16.0	13.1	16.0	14.4	16.0	15.7	16.0	14.6	16.0	12.3
Market price risks	150.0	53.4	150.0	43.0	150.0	60.5	150.0	52.4	150.0	39.9

Qualitative assessment based on stress scenarios

VaR values allow potential unanticipated losses to be quantified based on certain assumed market continuities. Because such steady, linear market trends can no longer be taken for granted in view of the experience of the financial market crisis, the Bank also systematically simulates stress, extreme and worst-case scenarios.

L-Bank uses the stress tests to investigate potential losses as a result of various, more or less extreme market changes. For example, the impact of a regulatory scenario involving a parallel shift in the yield curve by 200 basis points upwards or downwards is explored with a view to assessing the impact of any resulting loss on equity capital. Given that the open interest-rate risk positions in the medium-term and long-term segments essentially relate to the investment of equity capital, only scenarios with rising interest rates represent stress situations. The risks reported here largely relate to an estimated loss of additional revenue. The following table shows the loss of market value in the event of such a parallel shift of the yield curve.

NEGATIVE CHANGES IN NET PRESENT VALUE DUE TO A SHIFT OF 200 BASIS POINTS IN THE YIELD CURVE

	Year-end 31.12.2017	Maximum 2017	Minimum 2017	Average 2017
Loss of net present value in EUR millions	316.3	402.6	243.4	313.0
Proportion of equity in %	8.3	10.6	6.4	8.2
Loss of net present value with repayment of equity in EUR millions	35.4	60.3	32.1	46.0
Proportion of equity in %	0.9	1.6	0.8	1.2

MANAGING MARKET PRICE RISKS

The VaR limits specified by the senior management team are used as the basis for managing market price risks. To further limit interest rate risk in the non-trading portfolio, senior management regularly defines a maturity-based target risk structure. This sets out the target interest rate risk profile. The permissible variance of actual from target risk structure is restricted by setting a limit for each maturity band.

The Controlling department is responsible for monitoring interest rate risk and currency risk by comparing the VaR figures calculated each day with the specified limits. The senior management team is kept informed of market price risks in a daily risk report, as well as a full monthly report.

The interest rate risks reported relate in the main to the relatively long-term investment of equity capital. Consequently, the only way to reduce the interest rate risk would be to invest equity capital on a short-term basis. To this extent, L-Bank's interest rate risks and earnings risks are diametrically opposed. Any increase in capital market interest rates would have a positive impact on net interest income.

LIQUIDITY RISK

As far as L-Bank is concerned, liquidity risk encompasses the risk that payment obligations cannot be met when they fall due (insolvency risk). It also includes the risk that sufficient levels of liquidity cannot be obtained on the expected terms when required (funding liquidity risk).

In the year under review, L-Bank's excellent position on the capital markets – supported by the State of Baden-Württemberg's guarantee – meant that refinancing could be obtained on terms that were favourable to both the Bank and its investors.

Quantitative assessment using value at risk

Funding liquidity risk is the risk of a potential deterioration in the refinancing options available to L-Bank. The value at risk (VaR) is calculated on the basis of historical changes in L-Bank's refinancing conditions. The underlying assumption is that the Bank is only able to refinance net disbursements on less advantageous terms. The resulting additional refinancing expenses within the one-year risk observation period represent the VaR.

VALUE AT RISK FOR FUNDING LIQUIDITY RISK IN 2017 in EUR millions

	01.01.2017		31.03.2017		30.06.2017		30.09.2017		31.12.2017	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	940.0	408.6	940.0	299.5	940.0	386.0	940.0	360.1	940.0	324.0
Share of liquidity risks in %	21.3	42.4	21.3	15.0	21.3	11.1	21.3	11.6	21.3	13.3
Liquidity risks	200.0	173.3	200.0	44.9	200.0	42.8	200.0	41.8	200.0	43.0

Market price and liquidity risks from embedded options that are not included in the value at risk for market price and liquidity risks are valued separately and updated annually. In 2017, a VaR of EUR 24.0 million was assigned to these risks.

Quantitative assessment using regulatory ratios

Up until 30 September 2015, insolvency risk was only monitored using the ratios specified in the German Liquidity Regulation. This liquidity ratio still had to be reported until the liquidity rules on LCR set out in Basel III had been implemented in full on 1 January 2018. Since 1 October 2015, the Bank has also been required – pursuant to the CRR in conjunction with Commission Delegated Regulation (EU) 2015/61 – to measure its insolvency risk using the LCR and to comply with this ratio. In order to enable banks to adapt gradually to the new minimum requirement, they were required to achieve an LCR compliance level of 0.8 in 2017.

Quantitative assessment based on stress scenarios

To safeguard its solvency at all times, the Bank maintains liquidity buffers to cover its liquidity requirements. These liquidity buffers consist exclusively of liquid securities which are classified according to their assumed convertibility into cash, as: highly liquid (convertible within seven days) or liquid (convertible within 30 days). It is important to ensure that the Bank's liquidity requirements for time frames of one week or one month are covered by appropriate liquidity buffers, even in conditions of stress. For this purpose, the Bank analyses stress scenarios based on in-house, market-driven or combined causes. An in-house stress

LIQUIDITY RATIO IN 2017 PURSUANT TO THE LIQUIDITY REGULATION AND LIQUIDITY COVERAGE RATIO AS DEFINED IN THE CRR IN CONJUNCTION WITH DELEGATED REGULATION (EU) 2015/61

Month	Liquidity ratio (LiqV)	Liquidity coverage ratio (LCR)
January	3.52	3.85
February	3.16	2.77
March	2.25	1.82
April	3.43	2.55
May	3.49	2.40
June	2.79	1.95
July	3.20	2.15
August	3.70	2.28
September	3.12	2.18
October	3.75	2.47
November	3.89	2.69
December	4.26	2.73
Average ratio	**3.38**	**2.49**

scenario is used to simulate the early outflow of liquid funds as a result of the exercising of all termination rights relating to deposit business over a one-month period. A market-wide stress scenario is used to simulate an immediate deterioration of 100 basis points in the refinancing conditions across all maturities with a simultaneous fall in the price of all securities in the amount of the haircut. Additionally, the two scenarios are considered in combination, without taking any risk-reducing correlation effects into account.

Liquidity buffers are reviewed on a monthly basis. In addition, a monthly forecast calculation based on conservative assumptions and taking advantage of the maximum liquidity limit required in a single month is used to check whether the liquidity buffers will also be sufficient to cover the need for refinancing funds under stress conditions for the whole of the following month.

LIQUIDITY BUFFER SUBJECTED TO STRESS SCENARIOS AS AT 31.12.2017 in EUR millions

	Liquidity forecast	Stress scenario In-house causes	Stress scenario Market causes	Stress scenario In-house and market causes combined
7-day buffer				
Liquidity buffer	14,686.3	14,686.3	13,908.0	13,908.0
Liquidity requirement	666.0	666.0	671.5	671.5
Convertible liquidity buffer (at balance sheet date)	14,020.3	14,020.3	13,236.5	13,236.5
Minimum convertible liquidity buffer (monthly forecast)	9,189.2	9,189.2	8,381.2	8,381.2
30-day buffer				
Liquidity buffer	15,967.8	15,967.8	14,982.1	14,982.1
Liquidity requirement	3,703.0	3,703.0	3,726.4	3,726.4
Convertible liquidity buffer (at balance sheet date)	12,264.8	12,264.8	11,255.6	11,255.6
Minimum convertible liquidity buffer (monthly forecast)	8,363.9	8,213.9	7,335.7	7,185.7
Minimum convertible buffer (with maximum requirement)	5,251.0	5,101.0	4,247.1	4,097.1

The minimal variance between the liquidity forecast and the stress scenarios is due, firstly, to the fact that the liquidity forecast is drawn up in line with the principle of prudence, so for example the Bank does not assume that the maturities of due time deposits will be extended. Furthermore, thanks to L-Bank's business model, in terms of refinancing the Bank only has a very negligible amount of indeterminate cash flows that could, in stress situations, create an unexpected need for liquidity.

In addition to calculating the liquidity buffer, the Bank also calculates a survival time frame. This indicates how long the Bank can meet its payment obligations without refinancing and without adjusting its business operations (even under stress conditions) by means of liquid assets. In the stress scenario, all callable refinancing arrangements are assumed to be due on the next call date (worst-case assumption). The survival time frame must not be less than 60 days. This limit serves as an early warning threshold to ensure that the Bank has an adequate liquidity buffer.

Management of liquidity risks

Operational liquidity management comes under the remit of the Treasury department. The system is based on a computer-assisted liquidity forecast that depicts all anticipated cash flows over the next ten years. The system produces a daily analysis for the current month and the following two months. A monthly analysis is produced for any months remaining in the fiscal year, and for the following fiscal year. An annual analysis is produced for years 3 to 10. When producing this liquidity forecast, the Bank assumes that contractual maturities will apply. For future interest rate adjustments relating to housing development, the Bank extrapolates the current nominal interest rate. No assumptions are made regarding the extension of time deposits. These are updated on a daily basis as part of liquidity management. Budgeted figures for anticipated disbursements are updated monthly, based on new business forecasts.

The Bank has formulated a number of policies for managing liquidity risk. In addition to limiting the maximum liquidity requirements for a single month, the Bank also limits funding liquidity risk by restricting the refinancing transactions required per maturity year. Holdings of ECB-eligible securities and securities that can be converted on demand may not fall below a minimum threshold.

Liquidity risk is assessed on a monthly basis. Along with market price risk, compliance with risk management policies is reported to the senior management team on a daily basis.

The Bank continues to be able to obtain refinancing on very favourable terms thanks to the explicit guarantee provided by the State of Baden-Württemberg and the latter's unchanged first-class credit rating. The ongoing international demand for liquid and safe investments continues to offer the Bank broadly diversified and reliable opportunities to raise capital.

OPERATIONAL RISK

Operational risk represents the risk of losses due to the inadequacy or failure of internal processes, individuals or systems, or as a result of external events. This definition includes legal risks. The Bank has classed the additional transfer and conversion risks (for transactions in foreign currencies) associated with transactions with business partners abroad as legal risk.

Assessment procedures and management

For operational risks, VaR is estimated using a model similar to that used in the insurance industry to determine the risk of major disasters. The model is based on historical observations and expert estimates of the probability of occurrence of, and extent of the damage resulting from, disruptions in any risk-bearing process at the Bank. The estimates, which are audited, are aggregated to arrive at an overall VaR for the Bank as a whole. The Bank is obliged to resort to estimates simply because, to date, the Bank has only experienced a minimal number of loss events associated with operational risks, and the consequential damages have been negligible. Hence it is not possible to provide an informed calculation of the VaR on the basis of historical loss events alone.

The size and scope of operational risks are identified and assessed with the aid of structured interviews across all departments. The identified risks are assigned to five categories. These are measured by the impact on L-Bank's financial position of a potential risk were it to materialise, and also the anticipated frequency of such an occurrence.

VALUE AT RISK FOR OPERATIONAL RISK IN 2017 in EUR millions

	01.01.2017		31.03.2017		30.06.2017		30.09.2017		31.12.2017	
	Limit	Used	Limit	Used	Limit	Used	Limit	Used	Limit	Used
Aggregate loss ceiling	940.0	408.6	940.0	299.5	940.0	386.0	940.0	360.1	940.0	324.0
Share of operational risks in %	1.1	0.7	1.1	0.9	1.1	0.9	1.1	0.9	1.1	0.5
Operational risk	10.0	2.8	10.0	2.8	10.0	3.3	10.0	3.1	10.0	1.7

In addition to standard levels of insurance taken out in order to reduce the business impact of certain loss events, the internal control system acts as the basis for avoiding operational risks. It includes comprehensive implicit and explicit procedures for safeguarding the Bank's process workflows (e.g. two-person verification; random spot checks; procedural requirements in the case of changes to operating processes or structures; an IT permissions management system that excludes conflicts of interest between incompatible activities; rigorous selection criteria for new recruits). The system as a whole is based on the Bank's written documentation, which takes a modular approach to the formulation of the rules governing corporate structure and workflow.

To ensure that the Bank only enters into transactions that it can process and manage appropriately from a risk perspective, a new product process is applied to all new types of transaction. Prior to first-time acceptance, test cases are used to determine the extent to which existing processes and procedures are sufficient to cope with the new type of transaction.

In each case, the result of these test runs is a concept in which all HR, organisational, IT, accounting and fiscal consequences associated with the new transaction are presented.

Operational risk is also reduced through ongoing monitoring of adherence to relevant legal and regulatory provisions (e.g. compliance, prevention of money laundering and fraud, data protection). The aim of the Compliance department is to exclude risks that could arise from non-compliance with legal requirements. Consequently, it is the role of the department to help implement effective procedures to ensure that L-Bank complies with the statutory regulations and policies that govern the Bank's activities, and to put in place the necessary controls. Compliance with the latter is assured by means of appropriate organisational measures and the ongoing monitoring of relevant business transactions.

Given the portfolio structure, transfer and conversion risks are generally of very limited significance for the Bank. The risk that L-Bank might suffer losses due to the restriction of payment transfers and/or currency convertibility as a result of statutory interventions in or against the countries involved is regarded as negligible.

With respect to workflow organisation, the Bank differentiates between operational directives – which represent binding prescriptions for action – and operational manuals. Operational directives always apply, regardless of the underlying workflow or IT systems used. Operational manuals and IT user manuals, on the other hand, describe specific processes. L-Bank has broken down the entire loan administration process into multiple stages: granting of loans, further processing of loans, processing of problem loans, loan restructuring and loan workout (settlement). Criteria have been established for each stage in the process and must be complied with when a loan is being processed. These processing criteria constitute the master lending process. A master process has also been established for trading transactions. This sets down the processing criteria for reviewing opportunities for trades; for agreeing, recording, forwarding and changing closing dates; for updating the trading transactions portfolio; for the legal form of contracts; for closing trades outside the Bank's own trading rooms and normal working hours (late trades); for recording and monitoring telephone calls; and for ongoing supervisory activities relating to settlement and controls.

The rules governing corporate structure specify where particular business activities are carried out (organisation chart and schedule of responsibilities). The rules governing 'management and representation' specify who may carry out specific business activities. Statutory requirements pertaining to employment law and industrial relations are managed by service agreements and employment policies.

RECOVERY PLANNING

L-Bank is now required by the European Central Bank to prepare a recovery plan. The recovery plan must be drawn up in accordance with the relevant European regulations and with the German Recovery and Resolution Act (SAG). The recovery plan supplements L-Bank's existing tools for managing risk and the Bank as a whole. These aim to improve the Bank's responsiveness so that future crises can be avoided.

L-Bank's senior management has set up a 'Recovery Planning' working group. Under the direction of the Controlling department, this working group prepares L-Bank's recovery plan and is responsible for updating it. The plan contains a strategic analysis, complete with a breakdown of the Bank's significant transactions, functions and relationships. The plan also presents the methods used to select the recovery indicators, and subsequently describes them in detail. The effectiveness of the selected courses of action are reviewed in the form of stress analyses. Also included in the recovery plan is information on the allocation of responsibilities for the recovery process. The Bank's recovery governance and thresholds were established by the senior management team and Supervisory Board.

Recovery governance

Recovery governance is based on existing structures and reporting lines. Where thresholds are exceeded, a Crisis Committee is convened, at which senior management and the relevant specialist departments discuss the cause and likely duration of the aberration, and consult on appropriate courses of action. In such circumstances, the senior management team will also decide on the appropriate communication strategy. Because all risk-related decisions at L-Bank are made by the senior management team, the latter also bears sole responsibility for determining the necessary recovery measures.

Findings

Overall, L-Bank has found that its business activities and web of relationships do not pose any risk to the stability of the financial system or real economy. Furthermore, the Bank has recourse to various courses of action that could be used to avoid situations that might pose a risk to the Bank's continued existence.

KEY FEATURES OF THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEM IN TERMS OF THE ACCOUNTING PROCESS

With respect to the accounting process, L-Bank has put a comprehensive internal control and risk management system in place that is continuously reviewed and developed. The system includes specific rules relating to corporate structure and workflow management. These rules ensure compliance with existing accounting standards and regulations, as well as the orderliness and reliability of the Bank's accounting functions. The accounting process set down in the system covers everything from the booking and processing of a transaction through to the preparation of the annual financial statements and management report. L-Bank's senior management team is responsible for defining the Bank's internal control and risk management system as it relates to the accounting function. System implementation is the responsibility of the Accounting department, in collaboration with the Controlling and Payment Transactions departments. In addition, the Internal Audit department carries out regular, process-independent checks in order to monitor the reliability of the internal control and risk management system as it affects accounting.

L-Bank prepares its financial statements in accordance with the provisions of the German Commercial Code (HGB) and German Bank Accounting Directive (RechKredV), with due regard for generally accepted accounting principles. The practical interpretation of these regulations is set out in internal manuals and directives governing the various workflows within L-Bank. The Accounting department is responsible for monitoring internal documents on a regular basis, and for adapting them in line with any legal or regulatory changes.

The comprehensive management reporting function and the Accounting department's involvement in the standardised process for introducing new products also help to ensure that the accounting treatment of new products is correct.

Documentation of the accounting process is carefully organised so that it is easy to understand. All relevant documents are archived in compliance with the statutory time frames.

The two departments most heavily involved in the accounting process have clearly separated functions. The Payment Transactions department manages subledgers for loans, securities, and debt and equity accounting. The data is automatically transferred by an interface to the general ledger. The Accounting department is responsible for managing the general ledger, laying down rules for assigning items to accounts, operating the bookkeeping and ledger management system and administrating the financial accounting system.

L-Bank uses standard software for its financial accounting. This supports the following functions:

- Prevention of unauthorised access by a system of permissions based on authorisation levels,
- Prevention of errors by means of plausibility checks,
- Detection of errors by means of two-person verification, standardised reconciliation routines, and comparisons of budgeted with actual figures.

At the same time, these measures serve to ensure that assets and liabilities are correctly assigned and reported, and also plausibly valued.

The annual financial statements and management report are derived from the Bank's financial accounting. For the management report in particular, financial and risk control data is obtained from the internal management information system, which is subject to a comparable system of internal controls. The annual financial statements and management report are also subject in their entirety to additional manual controls based on the two-person verification principle (routine double checks).

Up-to-date, reliable and relevant reports on the risk management system as it relates to accounting are regularly submitted to senior management and heads of department. Senior management provides the Supervisory Board and its committees with regular updates on the progress of the Bank's business activities, and also provides ad hoc reports on any exceptional events as and when they occur.

Karlsruhe, 5 March 2018

Dr. Axel Nawrath Dr. Ulrich Theileis

Dr. Iris Reinelt Johannes Heinloth

REPORT OF THE SUPERVISORY BOARD

During fiscal year 2017, the Supervisory Board and the three committees set up by the Board discharged the duties assigned to them by law and by the Bank's articles of association and standard operating procedures. In particular, the Supervisory Board monitored the orderly conduct of the Bank's business. For this purpose, pursuant to the relevant statutory provisions, as well as the Bank's articles of association and rules of procedure, the Board of Management regularly briefed the Supervisory Board and its committees on the development of the Bank's business and risk exposure, as well as major and material business transactions throughout 2017.

The Supervisory Board and its committees discussed and made decisions on matters falling within the scope of its responsibilities and any business transactions that required its approval. To determine the guidelines for business activities, the Supervisory Board discussed business policy issues with the Board of Management and – following prior discussion in the Risk Committee – approved the Bank's business and risk strategy. At the suggestion of the Personnel Committee, the Supervisory Board appointed two new members to the Board of Management in spring 2017; consequently, the Board of Management has had four members since July 2017.

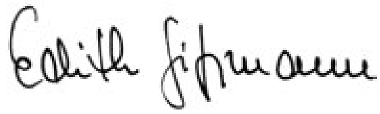
The Supervisory Board met four times during 2017, convening its committees on a total of ten occasions. Four of these committee meetings were held by the Audit Committee, three were held by the Risk Committee, and three by the Personnel Committee. Between meetings, urgent decisions were taken by written circular on a total of eight occasions.

The Supervisory Board reviewed the separate non-financial report, prepared for the first time for the 2017 fiscal year. PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft was commissioned to carry out an external limited-assurance engagement of the report's content. The auditor's notes on the report were discussed by the Supervisory Board and the Audit Committee with the auditor's involvement. On completion of this review, the Supervisory Board concluded that no objection need be raised to the separate non-financial report for 2017.

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft carried out the statutory annual audit for fiscal year 2017, issuing an unqualified auditor's opinion. The auditor provided the Audit Committee with progress reports on the audit, and also took part in discussions of the 2017 financial statements by the Supervisory Board and Audit Committee. In these discussions, the auditors reported on the main findings of their audit activities, answered questions and provided additional information. The Supervisory Board and Audit Committee discussed the auditor's report. In accordance with the outcome of the audit, the Supervisory Board has concluded that the annual financial statements for 2017 prepared by the Board of Management do not give rise to any objections. Accordingly, at its meeting on 25 April 2018, the Supervisory Board took note of and approved the Bank's annual financial statements for 2017.

The Supervisory Board also approved the Board of Management's proposal to allocate EUR 50,000,000.00 of the distributable net profit for fiscal year 2017 (totalling EUR 50,802,762.78) to other retained earnings and to carry forward the remaining amount of EUR 802,762.78.

Stuttgart, 25 April 2018



Chair of the Supervisory Board
Edith Sitzmann MdL
Minister of Finance for the State of Baden-Württemberg

NON-FINANCIAL REPORT – REPORT OF THE BOARD OF L-BANK FOR FISCAL YEAR 2017

BACKGROUND, CLASSIFICATION AND METHODOLOGICAL APPROACH

The activities of and actions taken by Landeskreditbank Baden-Württemberg – Förderbank – (L-Bank) are all based on the Bank's statutory public-service mandate. The Bank's business activities are focused on the sustainable development of the Bank and the State of Baden-Württemberg. The public-service mandate formulated in the L-Bank Act involves a high degree of responsibility. If L-Bank wishes to support growing prosperity over the long term and advocate intergenerational justice, the Bank itself must act as a role model. In order to fulfil this long-term responsibility, L-Bank's core sustainability guidelines were integrated into the Bank's business strategy in November 2013, to act as a framework for the Bank's business activities.

In 2013, for the first time, L-Bank included a systematic report on the Bank's corporate social responsibility in its annual report. The second CSR report was presented in 2016, in the form of a combined sustainability and annual report. Together with the Bank's validation under the Eco-Management and Audit Scheme (EMAS) in 2016 and the Environmental Statement presented as part of the validation process, these documents provide a complete picture of the Bank's performance. To supplement this information, the Bank also reports annually on selected sustainability aspects under the terms of the WIN Charter. These annual reports document the material economic, ecological and social impacts of L-Bank's activities. For L-Bank, the starting point and central criterion is balanced corporate development – corporate development in which economic stability is fundamental, but which also takes non-financial aspects into account.

The entry into force of the CSR Directive Implementation Act (CSR-RLUG) has extended the statutory requirements for documenting the impacts of L-Bank's business activities. In the following report, L-Bank complies with its reporting obligations pursuant to Art. 340a (1a) HGB with respect to the disclosures required for an understanding of L-Bank's business performance, the conditions in which the Bank operates and the future development of L-Bank and its impacts on non-financial aspects. This takes the form of a separate non-financial report (Art. 289b (3) HGB) as a chapter in this annual report (hereinafter 'non-financial report').

The way in which the content of the non-financial report is structured reflects the legislative requirements and is intended to create transparency regarding the non-financial aspects of L-Bank's business activities. The report is based on the guidelines of the Global Reporting Initiative (GRI), which serve as the framework for this non-financial report's descriptions of management approaches and the underlying concepts. With this non-financial report, L-Bank continues to build on past reports. However, the report's content has been selected on the basis of the materiality considerations set down in the HGB.

In an interdisciplinary, multistage process, the HGB's non-financial criteria ('aspects') were assessed for their relevance to L-Bank, and the individual components were then reassessed in terms of their materiality within the meaning of Art. 289c (3) HGB. The key parameters here were the influence of each component on the Bank's own business activities and/or the structure of the Bank's business relationships or products and services, and its anticipated impact on non-financial criteria.

The disclosures and information in the non-financial report focus on the materially significant components specific to L-Bank as determined by this systematic approach, which are assigned to the relevant aspects set down in Art. 289c (2) HGB (namely environmental matters, employee-related matters, social matters, respect for human rights, prevention of bribery and corruption and – a supplementary aspect – client matters).

NON-FINANCIAL ASPECT	COMPONENTS DEFINED AS MATERIAL PURSUANT TO ART. 289C (3) HGB
Environmental matters	Ecological value added by development products
Employee-related matters	Personnel planning, personnel development, working conditions
Social matters	Social value added by development products, support for entrepreneurship
Respect for human rights	Informational self-determination, freedom of assembly and right to collective bargaining
Prevention of bribery and corruption	Prevention of money laundering and financing of terrorism
Client matters (supplementary aspect)	Digitisation of business partner relationships and information security

In fiscal year 2017 and as at the reporting date, no material risks have been identified that are or will be very likely to have severely negative impacts on these aspects. No references have been made to the amounts reported in the annual financial statements, and no additional explanations have been provided.

The information in the non-financial report was subjected to a limited-assurance audit ('engagement') of business operations by auditing firm PwC in accordance with ISAE 3000 (Revised), and the assurance engagement was awarded an unqualified auditor's opinion.

BUSINESS MODEL

L-Bank's business model and the way it has been implemented in each of the Bank's areas of development activity are described in the 'Background' and 'Economic report' sections of the management report.

In accordance with the Minimum Requirements for Risk Management (MaRisk) in banking institutions, L-Bank has installed a risk management system that is bank-specific and optimised to meet the requirements of L-Bank's statutory public-service mandate. L-Bank reports on this in the 'Opportunities and risk report' section of the management report.

ENVIRONMENTAL MATTERS

According to the state constitution, all public institutions in Baden-Württemberg are responsible for protecting the natural environment and its resources for future generations. The key concerns here are environmental and climate protection. As one of Europe's leading regional economies, Baden-Württemberg makes a disproportionate contribution to the increase in climatically harmful greenhouse gases; consequently, the state has a special responsibility for climate protection. Climate protection has been firmly embedded in Baden-Württemberg's legislation since 2013. With this in mind, the federal state has set itself the goal of organising the state's administrative bodies so they are largely climate-neutral by 2040. L-Bank has voluntarily adopted this objective for its own business management.

L-Bank regards itself as having a dual duty to protect the environment and the climate; first, as a development bank providing relevant incentives to private individuals, municipalities and businesses, and second, by acting as a role model for other companies and society as a whole.

To fulfil this obligation, L-Bank has implemented an integrated environmental management system validated under EMAS and certified under the ISO 14001 standard. The management system documents the Bank's direct and indirect environmental impacts. L-Bank's environmental indicators are recorded and evaluated annually, validated by an independent environmental auditor and published in the environmental statement. Thus L-Bank is transparent about its impact on the environment, while at the same time acting as a role model.

L-Bank's carbon footprint amounted to 1,099 t of CO_2 equivalents (CO_2e) in 2017, breaking down as follows:

Direct greenhouse-gas emissions (GHG emissions) (Scope 1)	132 t CO_{2e}
Indirect GHG emissions from energy supply (Scope 2)	475 t CO_{2e}
Other indirect GHG emissions (Scope 3)	492 t CO_{2e}
Total	**1,099 t CO_{2e}**

The Bank's carbon footprint was calculated using the methodology provided by the Association for Environmental Management and Sustainability in Financial Institutions (Verein für Umweltmanagement und Nachhaltigkeit in Finanzinstituten e.V. – VfU). Scope 3 includes GHG emissions from business travel, outsourced activities, water treatment and waste treatment, and GHG emissions associated with consumables.

ECOLOGICAL VALUE ADDED BY DEVELOPMENT PRODUCTS

The greatest opportunities for reducing carbon emissions are to be found in the refurbishment of existing buildings, in the transport sector, and in the enhancement of energy and material efficiency in business. Through development programmes, L-Bank can provide investment incentives for energy-efficient construction, environmentally compatible refurbishment and the use of renewable energies, thereby indirectly reducing carbon emissions and contributing to climate protection. Investments in climate and environmental protection initiatives are good for the environment and also help develop Baden-Württemberg's technological strength as a business location. Under the 'Resource Efficiency Finance' development programme, which L-Bank offers in conjunction with the Ministry of Economic Affairs, Labour and Housing and the Ministry of the Environment, Climate and Energy, small and medium-sized enterprises (SMEs) are awarded low-interest development loans with repayment subsidies for projects that increase their material and energy efficiency, and for environmental protection projects. Advice provided by external experts helps with quality assurance and, in some cases, is mandatory (see also the 'Economic report' section of the management report).

Almost all of L-Bank's housing development products provide direct incentives for environmental and climate protection. In addition, individual development programmes such as MikroCrowd BW – a development programme for small start-ups that combines microfinance and crowdfunding – use exclusion criteria to define requirements for environmentally compatible actions by applicants.

By using webinars to deliver selected training courses to our commercial bank partners, we are increasingly digitising the advice we provide on our development programmes. In 2017, we also put in place the technical and infrastructural framework for delivering advisory sessions by video. In addition, the e-file system already used by individual departments will shortly be rolled out across the whole of L-Bank, meaning that the processing of funding applications will become both paperless and, thanks to the Bank's green electricity supply, largely climate-neutral.

EMPLOYEE-RELATED MATTERS

L-Bank's long-term success as a services company is based on its workforce.

PERSONNEL PLANNING

As part of its strategic approach to corporate governance, L-Bank's personnel strategy is based on the Bank's business strategy. Among other things, it includes the Bank's remuneration and recruitment strategy, personnel planning, and a fully integrated personnel development concept.

Personnel planning involves analysing how many employees L-Bank needs and, in particular, what kinds of skill sets and abilities these employees should have, and whether the identified needs should be covered by professional development training in-house or by recruitment. Personnel planning is further refined during the annual strategy discussion between the Personnel department and the specialist departments; external recruitment needs are based on the outcomes of this discussion. The future prospects of existing L-Bank employees are given priority.

Working conditions and employee benefits are designed to optimise L-Bank's attractiveness as an employer. This serves both to retain and attract highly qualified employees.

As an important part of business planning, personnel planning and recruitment are the subject of reports to the Board of Management. The Personnel department is developing a recruitment strategy. The strategy calls for more recruitment of junior staff through training programmes run in conjunction with the Baden-Württemberg Cooperative State University (DHBW Mosbach), involving the training and retention of Bank trainees and students. In addition, L-Bank is structuring and systematising the transition from one generation of employees to another by implementing a phased retirement programme; this makes the planning progress more secure (see also management report, 'Personnel' section).

PERSONNEL DEVELOPMENT

L-Bank's employee capacities and competencies are managed by systematic staff development based on the 360-degree personnel development concept adopted by the Board of Management. Employee strengths are further developed, while any weaknesses are evened out. All training and continuing education initiatives take account of the ever-shortening half-life of knowledge.

Various L-Bank departments work together in a committee to discuss and approve the design of the personnel development programme. The committee is a decision-making body that meets several times a year.

Attractive training schemes are central to L-Bank's development of junior staff. To deliver this training, L-Bank works closely with DHBW Mosbach. L-Bank offers high-school graduates work-study places as students specialising in Business Administration for Banks, and in Business IT. L-Bank's training manager has regular exchanges with the head of department at DHBW. By discussing their experiences, training managers at the various training companies which partner DHBW share valuable intercompany knowledge and ideas.

Internal talent management is crucial for employees' further development. Based on L-Bank's skills profile, it opens up a wide variety of career paths for employees by focusing on their strengths. Employees are given the opportunity to participate in a personnel development programme, and thus develop new career prospects (see also management report, 'Personnel' section).

WORKING CONDITIONS

Employees spend a large part of their lives in the workplace, so working conditions have a major impact on their overall physical and mental well-being.

L-Bank fulfils its duty of care and protects its employees from health hazards arising at work or through work. Occupational health and safety is continuously developed with the active involvement of employees and the Staff Council. The central body is the Occupational Safety Committee, which meets quarterly. The committee discusses any issues arising, agrees corrective actions and monitors their implementation. As part of the EMAS audit, an external environmental auditor checks whether the Bank is complying with the relevant environmental protection and occupational safety regulations and standards.

The Bank uses risk assessment to ensure that hazards to which employees are exposed in the course of their professional activities are identified, assessed and eliminated by the implementation of suitable measures. As part of the ongoing occupational safety review, L-Bank carried out a risk assessment of mental stress in 2017.

Of particular importance to L-Bank is occupational health management, which focuses on prevention. At the Bank's in-house health centres, for example, employees can train on stamina-building machines and use special back-training equipment.

SOCIAL MATTERS

In the economic system favoured by social market economies, companies are the initiators and facilitators of change and progress, thereby safeguarding a society's prosperity. Start-ups and SMEs in particular have a leading role to play in this system. Whereas start-ups create jobs with their new ideas, progress in productivity is primarily driven by SMEs.

While the economic platform is one side of the social equation, social cohesion is the other. To build a strongly cohesive society, it is vital to promote equal opportunities. L-Bank's development objectives and operational targets are all guided by the State of Baden-Württemberg's development policy.

SOCIAL VALUE ADDED BY DEVELOPMENT PRODUCTS

The public-service mandate embodied in the L-Bank Act includes a high level of responsibility for Baden-Württemberg's society and economy. The starting point for all development projects is the provision of development funding. To safeguard its development business in the long term – not least from a regulatory perspective – on 1 January 2017 L-Bank set up the development contribution system described in the 'Financial performance' section of the management report.

L-Bank offers a broad range of development products, including programmes for family benefits, funding for energy efficiency and environmental protection schemes, housing development finance, funding for business start-up and enterprise development, agricultural development and municipal funding for regional and business zone development. In terms of family support, for example, L-Bank is the central issuer of family benefits in Baden-Württemberg. The relative significance of each development programme in terms of volume is discussed in the 'Economic report' section of the management report.

So that development funding does not distort competition in the commercial sector, L-Bank ensures that all development programmes are implemented in accordance with European Community rules on state aid. To this end, the Bank applies the Commission Regulation (EU) 1407/2013 on de minimis state aid. State aid is only permitted if the amount of aid is considered minor. In the Bank's case, the state aid provided is regarded as de minimis aid and is therefore exempt from the application of competition regulations.

Depending on the development programme, L-Bank carries out contract award and state-aid audits as one of the steps in the development finance procedure. Irrespective of the individual development programme, L-Bank uses appropriate documentary evidence to ensure that public funding is used appropriately.

SUPPORT FOR ENTREPRENEURSHIP

Entrepreneurship is the foundation of the market economy and the driving force behind economic development. In this sense, entrepreneurship creates the basis for prosperity in our society.

L-Bank supports entrepreneurship by providing advice and training, by raising awareness, and through its development funding programmes. The Bank aims to work with the State of Baden-Württemberg to create attractive conditions for entrepreneurship and thus generate and safeguard jobs in Baden-Württemberg. L-Bank supports fledgling companies and SMEs at various stages of development and in every business situation with suitable instruments, from debt financing to quasi-equity financing, and from equity and sureties through to grants awarded on behalf of the federal state. Business zone development is another of L-Bank's support services. Through subsidiary companies, L-Bank operates technology and business parks in Karlsruhe, Stuttgart, Tübingen, Reutlingen and, since 2017, in Mannheim. A full description of the Bank's business units appears in the 'Economic report' section of the management report.

L-Bank extends loans for business development purposes using the 'borrower's bank' principle. The commercial banks ensure that funding requirements are met and, once the project has been completed, provide L-Bank with proof that the public funding has been used as intended. L-Bank ensures that the process of extending loans is carried out lawfully by auditing commercial banks on a spot-check basis. L-Bank commissions studies from third parties in order to further develop the Bank's range of development funding products (by identifying needs) and ensure that the public funding provided adds the desired social value.

To raise awareness of the concept of entrepreneurship, L-Bank focuses on specific activities. Competitions such as the statewide Start-up BW Elevator Pitch and the State Prize for Young Companies play an important role here. The Elevator Pitch offers business founders an attractive platform for presenting themselves and their business ideas to a jury and an audience made up of regional institutions, potential sponsors, business partners and customers. The State Prize for Young Companies is intended to recognise entrepreneurial role models and thereby promote entrepreneurial spirit.

RESPECT FOR HUMAN RIGHTS

Human rights are fundamental rights protecting the freedom and autonomy of every individual. Respect for human rights is a central standard for all L-Bank's business activities and part of its self-image as a publicly owned company.

Thanks to L-Bank's compliance with statutory and legal regulations, and taking into account the fact that the Bank's development business is limited to Baden-Württemberg, there is no material risk that the Bank will violate the rights of indigenous peoples or come into conflict with forced or child labour. With the adoption of the National Action Plan on Human Rights (NAP) in 2016, the German federal government aims to further improve the human rights situation. Building on an impact analysis, companies should assume their share of the responsibility for this. L-Bank has been a participant in the 'FIT FOR NAP' programme since 2017, looking to further develop processes of due care based on human rights.

As a public-sector contracting authority, L-Bank complies with the Public Procurement Directives and all relevant laws when awarding contracts. This ensures that all companies involved comply with their legal obligations when executing commissions.

A complaints management system safeguards the fundamental right to report violations by and make complaints about the Bank.

INFORMATIONAL SELF-DETERMINATION

The basis of data protection is the fundamental right to informational self-determination. In simple terms, informational self-determination means: every individual has the right to decide for him- or herself who collects, processes or uses which parts of his or her personal information. It is important for us to protect our clients' and partners' data, as well as that of our employees. L-Bank safeguards the right to informational self-determination, hence also to data protection, by means of IT systems, clearly defined processes and the conduct of its employees. Upon joining L-Bank, every new employee is given a mandatory training course in data protection.

The Board of Management has appointed a Data Protection Officer as the contact and information person for data protection issues; the officer submits regular reports to the Board of Management. There were no significant data protection incidents in 2017. Data processing is subject to internal controls by the Data Protection Officer and external controls by the State Commissioner for Data Protection.

FREEDOM OF ASSEMBLY AND THE RIGHT TO COLLECTIVE BARGAINING

As both employer and contracting authority, L-Bank has an impact on human and labour rights. Freedom of assembly and the right to collective bargaining are fundamental to the protection of workers' rights. Because L-Bank's employees work in Germany, we believe that we comply with and guarantee our employees' rights by complying with Germany's statutory regulations.

The State Staff Representation Act (Landespersonalvertretungsgesetz) governs the representation of employee interests at L-Bank, hence also employees' operational participation. These interests are protected by a Central Staff Council which is responsible for company-wide issues, as well as two local staff representative bodies in Karlsruhe and Stuttgart. Employer and staff representatives work together in a spirit of partnership and trust, in compliance with German legislation and collective bargaining agreements, for the benefit of employees and to fulfil the duties incumbent upon the Council. The Staff Council exercises its rights of participation through co-determination, collaboration and consultation. In addition, the Chair of the Central Staff Council and the two Chairs of the Karlsruhe and Stuttgart Staff Councils sit on L-Bank's Supervisory Board in an advisory capacity.

PREVENTION OF BRIBERY AND CORRUPTION

L-Bank's credibility and success is directly related to the personal integrity and honesty of all individuals acting on behalf of L-Bank. In view of this, a sound and responsible approach to corporate governance is a self-evident component of the Bank's corporate culture. L-Bank has enshrined the State of Baden-Württemberg's Public Corporate Governance Code in the Bank's in-house rule book by resolutions of both the Board of Management and Supervisory Board, and observes all the terms of the Code. L-Bank does not tolerate corruption or bribery. This attitude is reflected in the Code of Ethics and Conduct. The Code formulates binding principles, values and standards of conduct for all bank employees. Whenever further regulations and process descriptions are required over and above this set of values, they are added and defined by internal guidelines (operational directives).

The fight against bribery and corruption has many facets. As a financial institution, the prevention of money laundering and the financing of terrorism are material issues for L-Bank. Our management approach is based on compliance with legal and regulatory requirements. The various departments set up in the Bank to prevent money laundering, terrorism financing and other crimes enjoy the full support of the Board of Management at all times. The Compliance unit ensures compliance with internal, statutory and regulatory provisions and policies by monitoring compliance with due diligence requirements and other precautionary policies. The Money Laundering Officer and his deputy report directly to the full Board of Management. All internal security measures required under Art. 25h KWG in conjunction with Art. 6 GwG have been implemented.

Employees who wish to report their suspicions of possible violations of the legal provisions that apply to the Bank can use an internal whistle-blowing system for this purpose, which also allows reports to be made anonymously. The confidential treatment of this information is a top priority for L-Bank.

Risk analyses are used as the basis for devising security measures for preventing money laundering and terrorism financing, tailored specifically to L-Bank. Every two years, Internal Audit checks whether and to what extent laws are being correctly implemented and applied, and also checks compliance with internal guidelines (operational directives).

When new recruits join L-Bank, they are given mandatory in-house training on the prevention of money laundering and fraud, securities compliance, data protection and information security. In departments to which money laundering is relevant, supplementary training courses are compulsory every three years. The Bank monitors participation in these courses.

Identifying contractual partners pursuant to Art. 10 (1) item 1 of the Money Laundering Act (AMLA) is one of the most important aspects of the Bank's general duty of care towards clients. L-Bank has set up the processes and procedures necessary to fulfil this duty of care. Here, L-Bank's business model as a development bank which does not accept deposits from the general public, and which has neither branches nor cash operations, was considered to reduce the risk associated with the prevention of money laundering and terrorism financing.

The multiple-control principle applied by L-Bank ensures that important decisions which must be made, such as, when onboarding new clients or engaging in critical activities, are neither made nor implemented by a single individual. In addition to the multiple-control principle, powers of authorisation are clearly defined and regulated in an internal guideline (operational directive).

A comprehensive reporting system ensures that the Board of Management is continuously updated on these issues. Furthermore, in the event of serious violations of the provisions of the German Securities Trading Act (WpHG) or the AMLA, ad hoc reports on individual incidents are submitted to the Board of Management.

In short, L-Bank has the resources and internal procedures at its disposal to detect and prevent money-laundering operations involving profits from terrorist activities, organised crime or other serious criminal offences.

CLIENT MATTERS

As the State Bank, L-Bank issues public development funding for the whole of Baden-Württemberg. L-Bank's principal, the State of Baden-Württemberg, as well as its development customers and business partners, expect L-Bank to process their requests swiftly and cost-efficiently while applying a high level of data security.

Digitisation is not just changing the Bank's internal value creation processes, it is also transforming its relationships with clients and business partners. To be able to continue serving access channels, distribution and process platforms and development clients in the federal state, as well as further develop the Bank as a force for future progress, L-Bank is stepping up its efforts to digitise key development funding areas. The Bank's business strategy, for example, gives a high priority to the phased digitisation of both internal processes and the Bank's interfaces with clients and business partners.

Indeed, the Bank's business strategy addresses digitisation as a strategic requirement. Together with the Bank's IT strategy, digitisation is the most concrete reflection of the technological direction taken by the Bank. While the IT strategy contains information on the restructuring of IT systems and IT processes, it is also the basis for the ongoing phased development of the Bank's value chain and the configuration of customer contact points. As the basis for this technical renewal, the mainframe replacement project and the project to upgrade core banking software – in particular the subledger system, which is used to manage development loans – were implemented in a series of steps that were largely completed by the turn of the year 2017/2018.

L-Bank's objective is to respond to customer inquiries quickly, simply and flexibly. With this in mind, L-Bank has already linked residential housing products offered via clients' commercial banks to KfW's online sales and service platform 'Bankdurchleitung Online 2.0' (BDO 2.0). The resulting digital development funding approval system will be further developed in cooperation with KfW and gradually extended to include other brokering products. This fundamental realignment is accompanied by steps to digitise downstream process stages. Since 2017, for example, extension offers have been submitted to central banks in digital form.

By setting up a closed user area (expert portal) in 2017, the Bank has improved the delivery of information to financing partners. The portal provides our partners with all essential information on our contacts, development programmes, events and so on. The Bank will gradually expand the expert portal to include additional user roles. The underlying content management system (CMS) was selected with a view to the planned relaunch of the L-Bank website in 2018.

The Portfolio Management committee, which reports to the Board of Management, coordinates and prioritises the individual digitisation projects. Rules have been defined for the change process. Any operational risks are assessed and managed; the process follows the already defined new product process where appropriate, and the level of protection is determined by a Security Office that is independent of the Bank's operational IT units. In terms of process, scrum methodology is used, following an agile software development approach. The IT security concept is used to support this approach.

The Security Office's main areas of responsibility include supporting the Board of Management in all areas of information security policy, coordinating information security and all associated measures, monitoring the effectiveness of security measures, ensuring the continuous improvement and further development of the security process, and regularly reporting on information security.

Karlsruhe, 5 March 2018

Dr Axel Nawrath Dr Ulrich Theileis

Dr Iris Reinelt Johannes Heinloth

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L-BANK BALANCE SHEET AS AT 31 DECEMBER 2017

ASSETS	31.12.2017 EUR	31.12.2017 EUR	31.12.2017 EUR	31.12.2016 EUR
1. CASH RESERVE a) cash in hand		25,910.77		27,970.82
b) current balances with central banks thereof: with Deutsche Bundesbank EUR 123,083,040.27 (EUR 46,856,500.84)		123,083,040.27		46,856,500.84
			123,108,951.04	**46,884,471.66**
2. RECEIVABLES FROM BANKS a) due on demand		392,882,262.66		384,069,106.67
b) other claims		23,479,072,698.12		22,069,857,423,40
			23,871,954,960.78	**22,453,926,530.07**
3. RECEIVABLES FROM CUSTOMERS thereof: secured through real-estate liens EUR 4,753,685,126.34 (EUR 4,982,907,109.62) municipal loans EUR 10,629,127,060.81 (EUR 12,761,595,162.08)			**24,167,522,835.03**	**26,894,345,770.11**
4. BONDS, DEBENTURES AND OTHER FIXED-INCOME SECURITIES a) bonds and debentures aa) from public issuers thereof: eligible as collateral with Deutsche Bundesbank EUR 5,898,496,964.33 (EUR 5,786,324,889.55)	6,006,008,473.86			5,893,472,291.72
ab) from other issuers thereof: eligible as collateral with Deutsche Bundesbank EUR 13,591,857,334.55 (EUR 14,698,284,615.38)	15,071,849,240.98			16,532,024,414.91
		21,077,857,714.84		22,425,496,706.63
b) own notes nominal value EUR 62,000,000.00 (EUR 79,050,000.00)		62,085,724.85		79,738,704.49
			21,139,943,439.69	**22,505,235,411.12**
Carried forward			69,302,530,186.54	71,900,392,182.96

ASSETS	31.12.2017 EUR	31.12.2017 EUR	31.12.2017 EUR	31.12.2016 EUR
Carried forward			69,302,530,186.54	71,900,392,182.96
5. SHAREHOLDINGS thereof: in financial institutions EUR 1,986,360.52 (EUR 1,986,360.52)			**171,911,629.99**	**221,455,800.85**
6. HOLDINGS IN AFFILIATED COMPANIES			**17,809,201.00**	**16,309,201.95**
7. FIDUCIARY ASSETS thereof: fiduciary loans EUR 33,456,041.51 (EUR 38,807,798.39)			**33,464,672.32**	**38,849,427.91**
8. INTANGIBLE ASSETS a) purchased licences, industrial property rights and similar rights and assets, and licences to such rights and assets			3,514,383.30	6,095,694.30
9. TANGIBLE ASSETS			**99,982,396.27**	**102,722,064.27**
10. OTHER ASSETS			**84,911,527.15**	**1,770,342,001.62**
11. ACCRUED ITEMS			**955,855,257.65**	**1,019,220,721.03**
TOTAL ASSETS			**70,669,979,254.22**	**75,075,387,094.89**

L-BANK BALANCE SHEET AS AT 31 DECEMBER 2017

LIABILITIES	31.12.2017 EUR	31.12.2017 EUR	31.12.2017 EUR	31.12.2016 EUR
1. LIABILITIES TO BANKS				
a) due on demand		4,978,230.80		6,099,407.39
b) with agreed term or notice period		25,263,754,834.60		24,711,546,521.67
			25,268,733,065.40	**24,717,645,929.06**
2. LIABILITIES TO CUSTOMERS				
a) other liabilities				
aa) due on demand	135,208,977.24			132,164,214.76
ab) with agreed term or notice period	7,873,347,220.23			7,490,811,806.84
		8,008,556,197.47	**8,008,556,197.47**	**7,622,976,021.60**
3. SECURITISED LIABILITIES				
a) notes issued			**30,383,417,388.26**	**36,226,328,455.12**
4. FIDUCIARY LIABILITIES thereof: fiduciary loans EUR 33,456,041.51 (EUR 38,807,798.39)			**33,464,672.32**	**38,849,427.91**
5. OTHER LIABILITIES			**598,896,607.93**	**26,054,759.67**
6. DEFERRED ITEMS			**1,781,055,432.32**	**1,829,016,337.04**
7. PROVISIONS				
a) provisions for pensions and similar obligations		260,248,043.00		236,852,308.00
b) tax provisions		100,000.00		0.00
c) other provisions		366,239,011.98		376,409,570.64
			626,587,054.98	**613,261,878.64**
8. SUBORDINATED LIABILITIES			**193,063,683.07**	**200,084,982.45**
Carried forward			66,893,774,101.75	71,274,217,791.49

LIABILITIES	31.12.2017 EUR	31.12.2017 EUR	31.12.2017 EUR	31.12.2016 EUR
Brought forward			66,893,774,101.75	71,274,217,791.49
9. PROFIT-SHARING RIGHTS OUTSTANDING			**260,975,600.00**	**356,529,800.00**
10. FUND FOR GENERAL BANKING RISKS			**650,000,000.00**	**630,000,000.00**
11. EQUITY				
a) subscribed capital		250,000,000.00		250,000,000.00
b) capital reserve		999,426,789.69		999,426,789.69
c) retained earnings				
ca) other retained earnings		1,565,000,000.00		1,515,000,000.00
d) net profit		50,802,762.78		50,212,713.71
			2,865,229,552.47	**2,814,639,503.40**
TOTAL LIABILITIES			**70,669,979,254.22**	**75,075,387,094.89**

1. CONTINGENT LIABILITIES				
a) liabilities from sureties and guarantee contracts			**1,352,499,036.19**	**2,673,645,686,11**
2. OTHER COMMITMENTS				
a) irrevocable lending commitments			**5,701,505,907.64**	**4,369,142,069,73**

L-BANK STATEMENT OF INCOME FOR THE FISCAL YEAR 1 JANUARY 2017 TO 31 DECEMBER 2017

		2017 EUR	2017 EUR	2017 EUR	2016 EUR
1.	INTEREST INCOME FROM a) lending and money market transactions	1,069,015,276.71			1,050,334,274.52
	b) fixed-interest and book-entry securities	481,153,820.04			551,846,316.01
			1,550,169,096.75		1,602,180,590.53
2.	INTEREST EXPENSES		1,295,917,668.29		1,462,851,661.39
				254,251,428.46	**139,328,929.14**
3.	CURRENT INCOME FROM a) shareholdings			**1,907,244.34**	**5,714,148.42**
4.	COMMISSION INCOME			**41,893,040.85**	**43,602,359.49**
5.	COMMISSION EXPENSES			**5,391,571.18**	**15,160,822.15**
6.	OTHER OPERATING INCOME			**25,586,194.62**	**11,123,366.35**
7.	GENERAL ADMINISTRATIVE EXPENSES a) personnel expenses aa) wages and salaries	76,906,174.16			75,490,051.83
	ab) social security contributions and expenses for pensions and other benefits thereof: for pension provision EUR 7,920,359.63 (EUR 5,740,270.45)	21,005,498.29			17,931,290.43
			97,911,672.45		93,421,342.26
	b) other administrative expenses		70,185,881.19		61,082,193.50
				168,097,553.64	**154,503,535.76**
8.	WRITE-DOWNS AND VALUATION ADJUSTMENTS ON INTANGIBLE ASSETS AND TANGIBLE ASSETS			**16,706,097.95**	**10,868,204.69**
Carried forward				133,442,685.50	19,236,240.80

	2017 EUR	2016 EUR
Brought forward	133,442,685.50	19,236,240.80
9. OTHER OPERATING EXPENSES	30,713,403.41	61,104,929.50
10. INCOME FROM REVALUATION OF RECEIVABLES AND CERTAIN SECURITIES AS WELL AS FROM REVERSALS OF PROVISIONS FOR LOAN LOSSES	8,843,738.29	90,858,032.37
11. WRITE-DOWNS AND VALUATION ADJUSTMENTS ON SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS	40,505,507.29	0.00
12. INCOME FROM REVALUATION OF SHAREHOLDINGS, SHARES IN AFFILIATED COMPANIES AND SECURITIES TREATED AS FIXED ASSETS	0.00	2,007,533.02
13. ADDITIONS TO FUND FOR GENERAL BANKING RISKS	20,000,000.00	0.00
14. INCOME FROM ORDINARY BUSINESS ACTIVITIES	51,067,513.09	50,996,876.69
15. TAXES ON INCOME AND EARNINGS	299,589.72	1,482,580.73
16. OTHER TAXES NOT STATED UNDER ITEM 9	177,874.30	180,140.13
17. NET INCOME	50,590,049.07	49,334,155.83
18. PROFIT CARRIED FORWARD FROM THE PREVIOUS YEAR	212,713.71	878,557.88
	50,802,762.78	50,212,713.71
19. NET PROFIT	50,802,762.78	50,212,713.71

L-BANK CASH FLOW STATEMENT FOR THE FISCAL YEAR FROM 1 JANUARY 2017 TO 31 DECEMBER 2017

	01.01.–31.12.2017 EURk	01.01.–31.12.2016 EURk
Net profit/loss for the period	50,590	49,334
Depreciation, value adjustments and write-ups on receivables including contingent liabilities and securities	27,503	–78,083
Depreciation, value adjustments and write-ups on tangible assets and intangible assets	16,706	10,868
Depreciation, value adjustments and write-ups on financial assets (excluding securities)	52,039	15,796
Change in provisions (excluding loan-loss provisioning)	126,531	211,917
Profit/loss on the sale of tangible assets and intangible assets	–15,402	–436
Profit/loss on the sale of financial assets	–14,456	–16,441
Other adjustments (net)	–120,433	–294,779
Change in receivables from banks	–1,416,590	–1,387,248
Change in receivables from customers	2,692,461	–1,147,573
Change in securities	1,363,981	511,281
Change in other assets from operating activities	1,754,180	335,200
Change in liabilities to banks	551,087	1,654,860
Change in liabilities to customers	385,580	–474,065
Change in securitised liabilities	–5,842,911	642,642
Change in other liabilities from operating activities	330,447	–303,152
Net interest income	–254,251	–139,329
Income taxes paid	300	1,483
Interest payments and dividend payments received	1,694,275	1,680,248
Interest paid	–1,319,591	–1,246,140
Income tax payments	–300	–1,483
Cash flow from operating activities	**61,746**	**24,900**
Proceeds from sales of financial assets	21,049	39,976
Disbursements for investments in financial assets	–10,588	–46,047
Proceeds from sales of tangible assets	17,998	846
Disbursements for investments in tangible assets	–13,138	–3,192
Proceeds from sales of intangible assets	34	7
Disbursements for investments in intangible assets	–876	–1,966
Cash flow from investment activities	**14,479**	**–10,376**
Cash flow from financing activities	**0**	**0**
Cash and cash equivalents at start of period	46,884	32,360
Cash flow from operating activities	61,746	24,900
Cash flow from investment activities	14,479	–10,376
Cash flow from financing activities	0	0
Cash and cash equivalents at end of period	**123,109**	**46,884**

L-BANK STATEMENT OF CHANGES IN EQUITY AS AT 31 DECEMBER 2017

		Reserves				
	Subscribed capital EURk	Capital reserve pursuant to Art. 272 (2) section 4 HGB EURk	Other retained earnings EURk	Total EURk	Net profit EURk	Equity EURk
Balance as at 31.12.2015	**250,000**	**999,427**	**1,465,000**	**2,464,427**	**50,879**	**2,765,306**
Transfer to reserves			50,000		–50,000	0
Net income for the year					**49,334**	**49,334**
Balance as at 31.12.2016	**250,000**	**999,427**	**1,515,000**	**2,514,427**	**50,213**	**2,814,640**
Transfer to reserves			50,000		–50,000	0
Net income for the year					**50,590**	**50,590**
Balance as at 31.12.2017	**250,000**	**999,427**	**1,565,000**	**2,564,427**	**50,803**	**2,865,230**

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

GENERAL PRINCIPLES

L-Bank (Landeskreditbank Baden-Württemberg – Förderbank –) was established by a law passed on 11 November 1998, effective as from 1 December 1998. It is the development bank of the German federal state of Baden-Württemberg. The Bank's business activities are governed by its statutory remit, namely to support the state government of Baden-Württemberg in the fulfilment of its duties, especially in terms of structural, economic and social policy, by implementing development programmes that comply with European Union regulations governing state aid.

The Bank has its head office in Karlsruhe, with a branch office in Stuttgart. It is entered in the commercial register of the City of Mannheim under number HRA 104441. Article 2 (1), sentence 1 of the above-mentioned law sets the share capital of L-Bank at EUR 250 million.

The annual financial statements of L-Bank were prepared in accordance with the provisions of the German Commercial Code (HGB) and the applicable accounting directive for banks and financial services institutions (RechKredV).

The balance sheet and statement of income comply with the standard forms in RechKredV. Starting in the financial statements for 31 December 2017, additions to the fund for general banking risks are now shown in a separate item immediately before the result of ordinary business activities. Previously, these were reported under write-downs and valuation adjustments on receivables and certain securities, as well as transfers to provisions in the lending business. Because the fund for general banking risks was not specifically set up for the above-mentioned transactions, its disclosure in a separate item improves the transparency of the earnings situation. The sub-item in previous reports on interest expenses 'from interest subsidies for loans' has been replaced by details of the Bank's development fund, which now appear in the notes to the annual financial statements.

When taken together, the majority shareholdings reported are of secondary importance. Preparation of a consolidated financial statement was thus waived pursuant to Art. 290 (5) HGB in conjunction with Art. 296 (2) HGB.

The disclosures required pursuant to Art. 26a (1) sentence 2 of the German Banking Act (KWG) (country-by-country reporting) are provided in these notes to the annual financial statements. The other disclosures required pursuant to Art. 26a (1) KWG and Art. 435 et seq. of the CRR (Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) 646/2012) are contained in a separate disclosure report, which is updated annually and published on the L-Bank website shortly thereafter.

ACCOUNTING AND VALUATION METHODS

Assets, liabilities and pending transactions are valued according to the general provisions of Art. 252 et seq. HGB, taking account of the specific provisions applying to financial institutions (Art. 340a et seq. HGB).

FINANCIAL ASSETS AND LIABILITIES

Receivables from banks and customers are always stated at their nominal value, whereas liabilities are stated at repayment value. Differences (premiums and discounts) with respect to receivables and liabilities are stated under accrued or deferred items and written back on a pro rata temporis basis. Administrative charges are collected immediately. Low-interest and zero-interest receivables are discounted. Zero bonds issued and similar liabilities are stated at the offer price plus any prorated interest accrued at the balance sheet date.

Negative interest from financial investments is reported under interest income, while negative interest from borrowing is reported under interest expenses.

The Bank treats loans linked to development programmes for which it subsidises the interest portion as low-interest lending transactions. Such development programme loans are stated at their net present value. Provisions are made for interest subsidies on irrevocable lending commitments related to development programmes. Earnings from interest subsidies carried by the Bank are stated under net interest income.

All identifiable individual lending risks as well as country risks have been adequately provided for by making specific loan-loss allowances or provisions. Portfolio or general loan-loss allowances have been set up for latent lending risks. The loan-loss allowances are offset against assets or stated under provisions.

Securities in the liquidity reserve are stated at the lower of acquisition cost or stock exchange/market price at the balance sheet date, in accordance with the strict 'lower of cost or market' principle. Where possible, stock market quotations have been used to determine market values. Where no active markets are available, model values have been used, based in turn on market data (yield curves, spread curves) and other available information (e.g. probabilities of default).

Securities treated as fixed assets are stated at amortised cost, whereby differences between the book value and the repayment amount are treated as income in proportion to their term. Depreciation on securities in the financial investment portfolio is applied in the event of a loss of value that is likely to be permanent. If the reasons for a permanent loss of value no longer exist, the depreciation is reversed accordingly. A general provision has been set up for latent risks.

Holdings and shares in affiliated companies are stated at acquisition cost or, in the event of a likely permanent loss of value, at the lower fair value as at the balance sheet date, analogous to the rules governing fixed assets. If the reasons for a permanent loss of value no longer exist, the depreciation is reversed accordingly.

TANGIBLE AND INTANGIBLE ASSETS

Intangible assets and tangible assets are valued at acquisition or production cost, less scheduled depreciation and amortisation. Where necessary, i.e. where it is anticipated that a loss in value may be permanent, extraordinary write-downs are made. Minor-value assets are combined in an annual summary item and depreciated over five years.

PROVISIONS

Provisions for pensions and similar obligations are determined according to actuarial principles using Professor Dr. Heubeck's mortality tables (RT 2005 G). The projected unit credit (PUC) method is used for valuation purposes. Future wage and salary adjustments are included in the calculation, based on a projected average increase of 2% p.a.; future pension adjustments are also included, based on increases of 1.6% or 2%. Pursuant to the specifications of Art. 253 (2) sentence 1 HGB, provisions are discounted at the average market interest rate over the last ten fiscal years, assuming a residual term of 15 years. The rate of interest applied is

3.68% (2016: 4.01%). The difference between the recognition of provisions based on the average market interest rate over the last ten fiscal years and their recognition based on the equivalent average market interest rate over the last seven fiscal years came to EUR 35 million as at 31 December 2017 (2016: EUR 28 million). This amount is barred from distribution.

The remaining provisions are stated at the required repayment amount and take into consideration all identifiable risks from doubtful liabilities and anticipated losses from pending transactions. Provisions with a residual term of more than one year are discounted at the average market interest rate over the last seven fiscal years that corresponds to their remaining term.

Expense provisions within the meaning of Art. 249 (1) sentence 3, (2) HGB (old version) are maintained either until they are used for the purpose for which they were set up (i.e. the relevant event occurs), or until they are written back because the original reason for their existence ceases to apply.

Interest accruing on provisions (including provisions for pensions and similar obligations) totalling EUR 22 million (2016: EUR 6 million) is stated under net interest income.

DEVELOPMENT FUNDS

As at 1 January 2017, L-Bank introduced a new development contribution system. The core element is that any development contributions which L-Bank pays out of its own income to subsidise development activities under the Bank's statutory public-service mandate should be paid from income already earned. On 31 December 2016, to cover its obligation to pay out development contributions in fiscal years 2017 and 2018, L-Bank made a provision of EUR 80 million for each of the two years (hereinafter 'development funds').

The development fund for 2017 was utilised in full during the year under review. On 31 December 2017, to cover its obligation to pay out development contributions in fiscal year 2019, L-Bank once again made a provision of EUR 80 million. This means that a development fund of EUR 80 million is available for each of fiscal years 2018 and 2019.

Allocations to these provisions are recognised in the statement of income as follows, taking account of the type of development activity envisaged (interest rate reductions, subsidised sureties or grants):

	EURk
Interest expenses	64,700
Commission expenses	3,500
Other operating expenses	11,800
Total	**80,000**

CURRENCY TRANSLATION

Currency translation has been carried out according to the provisions of Art. 256a in conjunction with Art. 340h HGB, as well as IDW RS BFA Opinion 4. Assets and liabilities denominated in foreign currencies, as well as all pending foreign currency cash transactions, are translated at the mean spot rate on 29 December 2017. In the case of forward currency contracts, the forward rate is separated out into cash and interest portions.

For currency translation purposes, the Bank calculates currency exposure by offsetting the claims and obligations from on-balance sheet and off-balance sheet transactions in the respective currency against each other. These transactions are classified and valued as separately hedged in each currency. Accordingly, all expenses and income from currency translation within the meaning of Art. 340h HGB are included in the statement of income. Any valuation surplus is reported in a balancing item under 'Other liabilities'.

LOSS-FREE VALUATION OF THE NON-TRADING PORTFOLIO (BANK BOOK)

Reviews of the non-trading portfolio (bank book) within the meaning of IDW RS BFA Opinion 3 with the aim of ensuring loss-free valuation are based on a net present value approach. Calculations are based on book values (as in the balance sheet), discounted cash flows and risk costs, plus future administrative expenses incurred by the unwinding of positions.

The valuation of transactions continued to show that there was no need to make provisions.

TREATMENT OF HEDGING TRANSACTIONS

In order to hedge balance sheet risks, the Bank uses derivative hedging transactions and guarantees. The Bank enters into derivative transactions in order to hedge aggregate interest rate risk exposure and/or individual transactions. Any contributions to earnings by derivatives are stated under net interest income.

Where necessary, hedged transactions and hedging instruments have been grouped together to create valuation units (macro hedges) within the meaning of Art. 254 HGB. The parameters used for the valuations underlying these macro hedges match perfectly (perfect hedges). In this case, the accounting treatment is based on the so-called 'freezing method', in which offsetting changes in value (i.e. equal and opposite changes in the fair values attributable to hedged transactions and hedging instruments as a result of the hedged risk) are not taken into consideration in the financial statements.

Hedged transactions in macro hedges within the meaning of Art. 254 HGB are presented in the table below. Where applicable, the stated book values have been translated into EUR at the mean spot rate on 29 December 2017.

HEDGED TRANSACTION IN MACRO HEDGE

	Book value in EURk	of which interest rate risk	of which currency risk	of which price risk
Assets	431,355	–	–	431,355
Liabilities	2,141,565	1,872,696	268,869	–
Total	**2,572,920**	**1,872,696**	**268,869**	**431,355**

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

BREAKDOWN OF SELECTED ITEMS UNDER ASSETS AND LIABILITIES BY TIME TO MATURITY OR CALL	31.12.2017 EURk	31.12.2016 EURk
RECEIVABLES FROM BANKS		
due on demand	392,882	384,069
up to three months	867,815	989,698
more than three months and up to one year	4,786,554	3,629,676
more than one year and up to five years	6,917,378	6,701,271
more than five years	10,907,326	10,749,212
RECEIVABLES FROM CUSTOMERS		
up to three months	1,286,302	625,691
more than three months and up to one year	1,689,249	3,827,790
more than one year and up to five years	3,650,433	4,838,198
more than five years	17,541,539	17,602,667
BONDS, DEBENTURES AND OTHER FIXED-INCOME SECURITIES		
maturing in the following year	673,617	2,944,989
LIABILITIES TO BANKS		
due on demand	4,978	6,099
up to three months	1,391,210	1,198,652
more than three months and up to one year	1,856,099	1,736,534
more than one year and up to five years	7,780,278	7,173,807
more than five years	14,236,168	14,602,554
LIABILITIES TO CUSTOMERS		
due on demand	135,209	132,164
up to three months	898,020	721,258
more than three months and up to one year	75,109	22,459
more than one year and up to five years	504,505	522,409
more than five years	6,395,714	6,224,685
SECURITISED LIABILITIES		
maturing in the following year	15,359,006	17,679,450

EXPLANATIONS OF INDIVIDUAL BALANCE SHEET ITEMS	31.12.2017 EURk	31.12.2016 EURk
RECEIVABLES FROM BANKS		
This item comprises: – receivables from companies in which an equity interest is held	125,652	75,652
RECEIVABLES FROM CUSTOMERS		
This item comprises: – receivables from affiliated companies	66,092	53,169
– receivables from companies in which an equity interest is held	66,381	79,269
– subordinated claims	36	1,739
BONDS, DEBENTURES AND OTHER FIXED-INCOME SECURITIES		
This item comprises: – receivables from companies in which an equity interest is held	2,126,543	2,134,371
The securities in this item eligible for listing break down as follows: – listed	20,794,722	22,086,154
– unlisted	361,322	434,081
Securities with a book value (excluding prorated interest accrued) of EUR 20,724,587,000 are assigned to investment assets. Of these, securities with a book value of EUR 3,079,431,000 have a market value of EUR 2,985,122,000. No depreciation has been applied to these items, as short-term market fluctuations are not taken into account due to the intention to hold these assets on a long-term basis.		
FIDUCIARY ASSETS		
This item breaks down as follows: – receivables from banks	30,785	34,978
– receivables from customers	2,671	3,830
– other assets	9	42
TANGIBLE ASSETS		
This item comprises: – plots and buildings used for the Bank's own activities	72,505	83,476
– plant and office equipment	6,171	7,258

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

EXPLANATIONS OF INDIVIDUAL BALANCE SHEET ITEMS	31.12.2017 EURk	31.12.2016 EURk
OTHER ASSETS		
of which subordinated	7,520	7,520
ACCRUED ITEMS – ASSETS		
– Difference between disbursement amount or acquisition cost and lower nominal value of receivables	749,435	798,503
– Difference between issue price and higher repayable amount of liabilities	45,519	60,782
FIDUCIARY LIABILITIES		
Fiduciary liabilities break down into – liabilities to banks	1,090	1,592
– liabilities to customers	32,366	37,215
– other liabilities	9	42
DEFERRED ITEMS – LIABILITIES		
– Difference between disbursement amount or acquisition cost and higher nominal value of receivables	1,394	2,040
– Difference between issue price and lower repayable amount of liabilities	29,177	12,702
SUBORDINATED LIABILITIES AND PROFIT-SHARING RIGHTS		
– Interest expenses on subordinated liabilities	4,461	9,244
– Interest expenses on profit-sharing rights	15,261	17,563

The following subordinated liabilities exceed 10% of the total value of all subordinated liabilities:

CURRENCY	Amount in EURk	Interest rate in %	Maturity date
JPY	74,069	2.14	24.08.2018
EUR	40,000	2.27	14.11.2023
EUR	20,000	2.27	14.11.2023

EXPLANATIONS OF INDIVIDUAL BALANCE SHEET ITEMS

Profit-sharing rights consist of profit participation certificates and break down as follows:

Amount in EURk	Interestrate in %	Maturity date	Number
10,000	5.000	01.07.2020	2
25,000	5.125	01.07.2020	1
25,000	5.140	01.07.2020	2
5,000	5.160	01.07.2020	2
25,000	5.170	01.07.2020	1
10,000	5.170	01.07.2020	1
3,000	5.170	01.07.2020	1
50,000	5.375	01.07.2025	1
10,000	5.375	01.07.2025	4
5,000	5.375	01.07.2025	3

Under the terms and conditions of the profit participation certificates, the servicing of distribution and repayment claims is linked to the result of the Bank's ordinary business activities.

Subordinated liabilities and profit-sharing rights are intended for use as supplementary capital and comply with the eligibility requirements of the CRR. The important factor here is the subordinated nature of the Bank's liability in these cases in relation to all non-subordinated liabilities towards other creditors. In the event of liquidation, the liabilities of all other creditors would be satisfied in full before any payments were made to subordinated creditors.

A retroactive limitation of the subordination, or of the original term (at least five years) or notice period is not possible.

Under state law, L-Bank is not capable of insolvency.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

INDIVIDUAL AMOUNTS THAT ARE MATERIAL IN ASSESSING THE ANNUAL FINANCIAL STATEMENTS	31.12.2017 EURk	31.12.2016 EURk
OTHER ASSETS		
– Receivables from swaps	57,403	61,964
– Works of art	12,804	14,001
– Profit participation certificates	7,520	7,520
– Balancing item from currency translation	–	1,678,159
PREPAYMENTS AND ACCRUED ITEMS		
– Single payments made in advance for swaps	153,987	154,055
OTHER LIABILITIES		
– Balancing item from currency translation	576,367	–
– Single (bullet) repayments on swaps	11,110	14,316
DEFERRED ITEMS		
– Single payments received in advance for swaps	1,748,424	1,814,105
PROVISIONS		
Under other provisions: – Provisions for development funds	160,000	160,000
– provisions for interest-subsidised loans	90,461	111,100
CONTINGENT LIABILITIES AND OTHER COMMITMENTS		
Liabilities from sureties and guarantee contracts include: – loan guarantees to financial institutions	5,000	166,569
– credit default swaps	991,720	1,869,354
The assessment of utilisation risk is based on the Bank's risk management approach. The overwhelming proportion of contingent liabilities comprise credit risks from borrowers with a first-class credit rating. 92.4% of the total portfolio of contingent liabilities has an investment grade rating. Credit default swaps only oblige L-Bank, in its capacity as protection seller or guarantor, to make compensation payments for default risk within the meaning of IDW RS BFA Opinion 1. The intention is to hold the credit default swaps until maturity or until the credit event occurs.		
INTEREST INCOME		
– Negative interest from financial investments	30,833	24,575
INTEREST EXPENSES		
– Negative interest from borrowing	20,324	18,586
COMMISSION INCOME		
– Income from other services	35,596	35,760
OTHER OPERATING INCOME		
– Income from the disposal of land and buildings	15,404	430

INDIVIDUAL AMOUNTS THAT ARE MATERIAL IN ASSESSING THE ANNUAL FINANCIAL STATEMENTS	31.12.2017 EURk	31.12.2016 EURk
GENERAL ADMINISTRATIVE EXPENSES		
Other administrative expenses include auditor's fees (excluding sales tax): – for year-end auditing services	394	383
– for other auditing services	54	14
– for other services	–	24
OTHER OPERATING EXPENSES		
– Addition to the provision for development funds	11,800	17,411
– Expenses for subsidies granted while processing development programmes for the State of Baden-Württemberg	–	33,919
TOTAL VALUE OF ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES		
– Assets	3,998,198	4,298,448
– Liabilities	20,708,880	24,610,878
The exchange rate risk from foreign exchange balance sheet items is essentially covered by off balance sheet hedging transactions. Currency translation produced: other operating income in the amount of	–	15
other operating expenses in the amount of	43	–

PROVISION OF COLLATERAL

For refinancing purposes, securities in the amount of EUR 6,388 million (2016: EUR 3,773 million) were deposited with Deutsche Bundesbank. Securities in the amount of EUR 304 million (2016: EUR 294 million) were deposited for participation in EUREX (the electronic derivatives exchange).

As collateral for OTC transactions, the Bank posted cash surety bonds totalling EUR 4,143 million (2016: EUR 3,124 million), reported under receivables from banks or customers.

TRANSACTIONS WITH RELATED PARTIES

As at 31 December 2017, transactions with closely associated companies and persons on the basis of conditions that do not conform with market conditions had a reported value of EUR 17 million (2016: EUR 18 million). These transactions consisted of a shareholder loan.

OTHER FINANCIAL COMMITMENTS

By acquiring a shareholding in Landesbank Baden-Württemberg (LBBW) with effect from 1 January 2005, L-Bank became a guarantor of LBBW. Even after withdrawing from its role as LBBW guarantor with effect from midnight on 28 December 2015, L-Bank remains liable to third parties for all LBBW liabilities incurred prior to 18 July 2001. However, in the event of claims against L-Bank, the Bank is entitled to hold any guarantors with inter partes liability jointly and severally liable in full.

As at the balance sheet date, there are no transactions within the meaning of Art. 285, sections 3 and 3a HGB that are significant for the assessment of the Bank's financial position.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

DERIVATIVE TRANSACTIONS

As at the balance sheet date, L-Bank had concluded the derivative transactions (forward transactions within the meaning of Art. 36 RechKredV) listed below. They are used as hedges against interest rate and currency risks. For the purposes of reporting derivative transactions, no netting of the positive and negative market values of contracts with the same counterparty was undertaken. As a general rule, insolvency-proof netting arrangements are in place. Furthermore, L-Bank has entered into collateral agreements with the Bank's main business partners with the aim of reducing any existing mutual risk of default by providing collateral in the form of cash.

Fully hedged derivative structures embedded in underlying transactions are not included in the tables.

The derivative transactions break down as follows:

DERIVATIVE TRANSACTIONS – SUMMARY OF AMOUNTS

in EUR millions	Nominal values 31.12.2017	Nominal values 31.12.2016	Market values positive 31.12.2017	Market values negative 31.12.2017	Market values positive 31.12.2016	Market values negative 31.12.2016
INTEREST RATE RISKS						
Interest rate swaps	75,025	81,556	2,416	–4,972	2,723	–6,311
Other forward transactions	–	1,160	–	–	–	–37
Interest rate risks – total	**75,025**	**82,716**	**2,416**	**–4,972**	**2,723**	**–6,348**
CURRENCY RISKS						
Forward currency contracts/swaps	9,146	7,567	15	–106	342	–1
Currency swaps/cross-currency interest rate swaps	14,139	19,550	192	–1,552	1,413	–1,217
Currency risks – total	**23,285**	**27,117**	**207**	**–1,658**	**1,755**	**–1,218**

On balance, no significant profit or loss on foreign exchange transactions or interest rate valuations is due from interest rate/currency swaps and the corresponding hedged items, especially on bonds or debentures issued in foreign currencies. Market values of interest rate/currency swaps totalling EUR –576 million are due to changes in spot exchange rates. A balancing item from currency translation was set up in this amount on the liabilities side and stated under 'Other liabilities'.

Interest rate swaps in the non-trading portfolio are used primarily to control total interest rate exposure and show a net negative market value of EUR 2,556 million as at year-end 2017. These interest rate swaps are not valued in the balance sheet, because both assets and liabilities contain interest-related hidden reserves that are significantly higher than the negative market values of the interest rate swaps.

DERIVATIVE TRANSACTIONS – BY COUNTERPARTY

in EUR millions	Nominal values 31.12.2017	Nominal values 31.12.2016	Market values positive 31.12.2017	Market values negative 31.12.2017	Market values positive 31.12.2016	Market values negative 31.12.2016
Banks in the OECD	89,089	91,468	2,400	–5,834	3,738	–6,102
Other counterparties (including stock-exchange transactions)	9,221	18,365	223	–796	740	–1,464
Total	**98,310**	**109,833**	**2,623**	**–6,630**	**4,478**	**–7,566**

DERIVATIVE TRANSACTIONS – BY TERM

Nominal values in EUR millions	Interest rate risks 31.12.2017	Interest rate risks 31.12.2016	Currency risks 31.12.2017	Currency risks 31.12.2016
RESIDUAL MATURITIES				
– up to three months	1,713	7,526	8,112	10,548
– more than three months and up to one year	5,589	7,707	5,419	4,590
– more than one year and up to five years	21,915	24,080	5,785	7,848
– more than five years	45,808	43,403	3,969	4,131
Total	**75,025**	**82,716**	**23,285**	**27,117**

There are no trading activities.

VALUING DERIVATIVE FINANCIAL INSTRUMENTS

The market valuation of derivatives is based on market data as at 31 December 2017, including yield curves, exchange rates and CFC, swaption and FX volatilities obtained by the Bank from external providers. The parameters required for our interest rate structure models are, in part, obtained through calibration using historical time series (mean reversion parameters in Hull-White models, as well as correlation parameters).

PRODUCT GROUP	MAIN VALUATION MODEL
Interest rate and currency derivatives	DCF method
Interest rate structures	Interest rate structure models (BGM model, Bachelier model, Hull-White model, modified Hull-White model for multiple currencies)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

INFORMATION ON TAX LIABILITIES

In accordance with the applicable German tax statutes (Art. 5 (1) section 2 KStG and Art. 3, section 2 GewStG), L-Bank is exempt from corporate income tax and trade tax.

COUNTRY-BY-COUNTRY REPORTING PURSUANT TO ARTICLE 26A (1) SENTENCE 2 KWG

All disclosures in the annual financial statements within the meaning of Art. 26a (1) sentence 2 KWG apply exclusively to the Federal Republic of Germany.

L-Bank's turnover for the fiscal year from 1 January to 31 December 2017 breaks down as follows:

in EUR millions	2017	2016
Net interest income (including current income)	256	145
Net commission income	36	28
Other operating income	26	11
Turnover	**318**	**184**

During 2017, L-Bank employed the equivalent of 1,063 full-time salaried employees on average (2016: 1,059).

The Bank's pre-tax profit for fiscal year 2017 was EUR 51 million (2016: EUR 51 million).

After rounding, taxes on income during fiscal year 2017 totalled EUR 0 million (2016: EUR 1 million). These consisted exclusively of non-reimbursable taxes on capital, plus the solidarity surcharge.

The Bank did not receive any public funding (state aid) in the year under review or in the previous year.

HOLDINGS PURSUANT TO ART. 285, SECTION 11 HGB/ART. 340A (4), SECTION 2 HGB

No.	NAME/REGISTERED OFFICE	Direct share-holding in %	Equity* in EURk	Result* in EURk
1	Austria Beteiligungsgesellschaft mbH, Stuttgart	33.34	35,996	173
2	Baden-Württemberg International – Gesellschaft für internationale wirtschaftliche und wissenschaftliche Zusammenarbeit mbH, Stuttgart	24.00	3,335	–5,031
3	BrandMaker GmbH, Karlsruhe	31.92	3,890	–3,470
4	BWK GmbH Unternehmensbeteiligungsgesellschaft, Stuttgart	10.00	260,693	18,107
5	CureVac AG, Tübingen	0.83	123,424	–44,135
6	DBAG Expansion Capital Fund GmbH & Co. KG, Frankfurt	21.77	41,148	1,411
7	European Investment Fund, Luxembourg	0.18	1,878,602	122,072
8	iQuest Holding GmbH, Frankfurt	27.13	2,159	625
9	Landesbeteiligungen Baden-Württemberg GmbH, Stuttgart	12.14	405,755	–36,158
10	LEA Mittelstandspartner GmbH & Co. KG, Karlsruhe	25.00	28,982	–1,968
11	LEA Venturepartner GmbH & Co. KG, Karlsruhe	46.73	**	
12	MBG Mittelständische Beteiligungsgesellschaft Baden-Württemberg GmbH, Stuttgart	26.80	66,948	6,067
13	Micropelt Abwicklungsgesellschaft GmbH, Freiburg	20.10	***	
14	OnSee Holding GmbH, Bruchsal	47.71	10,034	–56
15	ONVENTIS GmbH, Stuttgart	48.91	1,449	–465
16	Selbca Holding GmbH, Berlin	36.55	8,287	–400
17	Staufen.AG Beratung Akademie Beteiligung, Köngen	25.10	8,080	3,253
18	StEP Stuttgarter EngineeringPark GmbH, Stuttgart	100.00	8,968	–255
19	Strohheker Holding GmbH, Pforzheim	49.50	–417	–613
20	Technologiepark Karlsruhe GmbH, Karlsruhe	96.00	20,103	9,198
21	Technologiepark Mannheim GmbH, Mannheim	100.00	442	–58
22	Technologieparks Tübingen-Reutlingen GmbH, Tübingen	100.00	9,244	1,028
23	Wessel-Werk Beteiligungsverwaltung GmbH, Karlsruhe	35.00	***	

* As at the last fiscal year for which annual financial statements are available in each case.

** Newly established, so no annual statements are available as yet.

*** No annual financial statements were prepared due to insolvency.

The Bank opted to apply Art. 286 (3) sentence 1 HGB.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

STATEMENT OF CHANGES IN FIXED ASSETS

Fixed assets Balance sheet items	Acquisition costs 01.01.2017 EURk	Additions EURk	Retire-ments EURk	Transfers EURk	Write-ups, cumulative EURk	Depreciation/ amortisation, cumulative EURk	Book value 31.12.2017 EURk	Depreciation/ amortisation for the year 2017 EURk
Bonds, debentures and other fixed-interest securities	22,686,125	Net change pursuant to Art. 34 (3) sentence 2 RechKredV: −2,109,201					20,724,587	–
Shareholdings	314,850						171,912	−53,139
Holdings in affiliated companies	22,534						17,809	–
Intangible assets	35,164	876	−70	–	–	−32,456	3,514	−3,424
Tangible assets	230,377	13,138	−20,926	–	–	−122,607	99,982	−13,282
Other assets	14,023	44	–	–	–	−1,263	12,804	−1,241

Depreciation/amortisation	01.01.2017	Addition	Write-up	Transfer	Retirement	31.12.2017
Intangible assets	29,068	3,424	–	–	36	32,456
Tangible assets	127,655	13,282	–	–	18,330	122,607
Other assets	22	1,241	–	–	–	1,263

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

Remuneration paid to members of the Board of Management for 2017 in EURk

Name	Membership period	Membership period	Other non-cash benefits	Payments from third parties in relation to Board of Management activities	Total
Dr. Axel Nawrath Chair	01.01.–31.12.	682	24	8	713
Dr. Ulrich Theileis Vice-Chair	01.01.–31.12.	517	27	18	562
Dr. Iris Reinelt	08.05.–31.12.	275	18	3	296
Johannes Heinloth	17.07.–31.12.	195	14	2	210
Total		**1,668**	**83**	**30**	**1,781**

An occupational pension scheme is in place for members of the Board of Management based on the rules applicable to L-Bank employees.

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

Remuneration paid to members of the Supervisory Board for 2017 in EURk

Name	Membership period	Membership period	Membership of committees	Attendance fees	Total
Edith Sitzmann [1)] Chair	01.01.–31.12.	9.0	3.9	2.0	14.9
Thomas Strobl [1)] 1st Vice-Chair	01.01.–31.12.	7.5	3.9	1.7	13.1
Dr. Nicole Hoffmeister-Kraut [1)] 2nd Vice-Chair	01.01.–31.12.	7.5	2.4	0.9	10.8
Dr. Jürgen Bufka	01.01.–31.12.	6.0	–	0.9	6.9
Dr. Maximilian Dietzsch-Doertenbach	01.01.–31.12.	6.0	3.9	1.5	11.4
Martin Gross	16.05.–31.12.	3.8	–	0.3	4.1
Roger Kehle	01.01.–31.12.	6.0	–	0.3	6.3
Gabriele Kellermann	01.01.–31.12.	6.0	3.9	1.4	11.3
Dr. Peter Kulitz	01.01.–31.12.	6.0	2.4	1.1	9.5
Andrea Lindlohr	01.01.–31.12.	6.0	–	0.9	6.9
Klaus-Peter Murawski [1)]	01.01.–31.12.	6.0	2.4	0.8	9.2
Prof. Dr. Wolfgang Reinhart	01.01.–31.12.	6.0	–	0.8	6.8
Dr. Dieter Salomon	01.01.–31.12.	6.0	–	0.5	6.5
Franz Untersteller [1)]	01.01.–31.12.	6.0	2.4	1.1	9.5
Joachim Wohlfeil	01.01.–31.12.	6.0	–	0.9	6.9
Clemens Meister	01.01.–31.12.	6.0	–	0.9	6.9
Tatjana Aster	01.01.–31.05.	2.5	–	0.6	3.1
Barbara Bender-Wieland	01.06.–31.12.	3.5	–	0.3	3.8
Thomas Dörflinger	01.01.–31.12.	6.0	–	0.8	6.8
Total		**111.8**	**25.2**	**17.3**	**154.2**

[1)] Subject to a duty of surrender to the State of Baden-Württemberg.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

REMUNERATION PAID TO MEMBERS OF THE BOARD OF MANAGEMENT AND SUPERVISORY BOARD

	31.12.2017 EURk	31.12.2016 EURk
– Payments to former members of the Board of Management or their surviving dependants	1,701	1,689
– Advisory Board remuneration (including travel costs)	127	130
– Pension provisions for former members of the Board of Management and their surviving dependants	25,528	25,307

AVERAGE NUMBER OF EMPLOYEES IN 2017

	Male	Female	Total
Employees*	505	657	1,162
of whom: full-time employees	471	365	836
part-time employees	34	292	

* Headcount; excluding vocational trainees and interns.

DIRECTORSHIPS HELD BY BOARD OF MANAGEMENT MEMBERS AND L-BANK EMPLOYEES SITTING ON STATUTORY SUPERVISORY BODIES OF LARGE CORPORATIONS PURSUANT TO ART. 340A (4), SECTION 1 HGB

DR. ULRICH THEILEIS, VICE-CHAIR OF THE BOARD OF MANAGEMENT

Hypo Vorarlberg Bank AG, Bregenz, Austria	Member of the Supervisory Board
Sächsische Aufbaubank – Förderbank –, Dresden	Member of the Administrative Council

DR. IRIS REINELT, MEMBER OF THE BOARD OF MANAGEMENT

Investitionsbank Berlin, Berlin	Member of the Supervisory Board

BOARDS OF L-BANK

BOARD OF MANAGEMENT

Dr. Axel Nawrath
Chair

Dr. Ulrich Theileis
Vice-Chair

Dr. Iris Reinelt
since 08.05.2017

Johannes Heinloth
since 17.07.2017

SUPERVISORY BOARD MEMBERS

Regular members

Edith Sitzmann MdL
Minister of Finance
Chair

Thomas Strobl
Deputy State Premier and Minister of the Interior, Digitisation and Migration
1st Vice-Chair

Dr. Nicole Hoffmeister-Kraut MdL
Minister of Economic Affairs, Labour and Housing
2nd Vice-Chair

Dr. Jürgen Bufka
Managing Director, Amber Infrastructure GmbH

Dr. Maximilian Dietzsch-Doertenbach
Managing Director, Doertenbach & Co. GmbH

Martin Gross
Regional Manager, ver.di Baden-Württemberg
since 16.05.2017

Roger Kehle
President, Gemeindetag Baden-Württemberg e.V.

Gabriele Kellermann
Member of the Board, BBBank eG

Dr. Peter Kulitz
President, Ulm Chamber of Industry and Commerce

Andrea Lindlohr MdL
Vice-Chair, Alliance 90/ The Greens parliamentary group, Baden-Württemberg State Parliament

Klaus-Peter Murawski
State Secretary, Baden-Württemberg Ministry of State

Professor Wolfgang Reinhart MdL
Chair, CDU parliamentary group, Baden-Württemberg State Parliament

Dr. Dieter Salomon
President, Städtetag Baden-Württemberg e.V.

Franz Untersteller MdL
Minister of the Environment, Climate and Energy

Joachim Wohlfeil
President, Karlsruhe Chamber of Trades and Crafts

Consulting members

Clemens Meister
Chair, Central Staff Council of L-Bank, Karlsruhe

Tatjana Aster
Chair, Staff Council of L-Bank, Karlsruhe
until 31.05.2017

Barbara Bender-Wieland
Chair, Staff Council of L-Bank, Karlsruhe
since 01.06.2017

Thomas Dörflinger
Chair, Staff Council of L-Bank, Stuttgart

SUPERVISORY BOARD MEMBERS

Alternate members

Helmut Althammer
Former President, Ostwürttemberg Chamber of Industry and Commerce

Catharina Clay
Regional Manager, IG BCE Baden-Württemberg

Dr. Roman Glaser
President, Baden-Württembergischer Genossenschaftsverband e.V.

Helmfried Meinel
Permanent Secretary, Baden-Württemberg Ministry of the Environment, Climate and Energy

Rainer Reichhold
President, Chamber of Trades and Crafts, Stuttgart region

Dr. Florian Stegmann
Assistant Secretary, Baden-Württemberg Ministry of State

Joachim Walter
President, Baden-Württemberg Association of District Councils

Other alternate members

Volker Jochimsen
Assistant Secretary, Baden-Württemberg Ministry of the Interior, Digitisation and Migration

Walter Leibold
Assistant Secretary, Baden-Württemberg Ministry of Finance

Jutta Lück
Assistant Secretary, Baden-Württemberg Ministry of the Environment, Climate and Energy

EVENTS AFTER THE BALANCE SHEET DATE

No incidents or events of particular significance occurred after the fiscal year-end on 31 December 2017.

PROPOSAL BY THE BOARD OF MANAGEMENT FOR THE DISTRIBUTION OF NET PROFIT

The Board of Management hereby proposes to the Supervisory Board that out of the net profit for fiscal year 2017 totalling EUR 50,802,762.78, an amount of EUR 50,000,000.00 should be allocated to other retained earnings and the remaining amount of EUR 802,762.78 carried forward to the current fiscal year.

Karlsruhe, 5 March 2018

L-Bank

Dr. Axel Nawrath Dr. Ulrich Theileis Dr. Iris Reinelt Johannes Heinloth

DECLARATION OF THE BOARD OF MANAGEMENT REGARDING THE FINANCIAL STATEMENTS FOR L-BANK AS AT 31 DECEMBER 2017

To the best of our knowledge, and in accordance with the applicable accounting and reporting principles, we confirm that the annual financial statements give a true and fair view of the Bank's financial position, cash flows and financial performance, and that the Management Report includes a true and fair review of the development and performance of the business and the position of the Bank, together with a description of the principal opportunities and risks associated with the Bank's expected development.

Karlsruhe, 5 March 2018

Dr. Axel Nawrath Dr. Ulrich Theileis Dr. Iris Reinelt Johannes Heinloth

INDEPENDENT AUDITOR'S REPORT

for Landeskreditbank Baden-Württemberg – Förderbank –, Karlsruhe

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND THE MANAGEMENT REPORT

Audit opinions

We have audited the annual financial statements of Landeskreditbank Baden-Württemberg – Förderbank –, Karlsruhe – comprising the balance sheet as at 31 December 2017, income statement, cash flow statement and statement of changes in equity for the fiscal year from 1 January to 31 December 2017, as well as the notes to the accounts – including the descriptions of the accounting and valuation methods applied. We have also audited the management report of Landeskreditbank Baden-Württemberg – Förderbank – for the fiscal year from 1 January to 31 December 2017. In accordance with German statutory provisions, we have not audited the contents of the separate non-financial report pursuant to Art. 289b (3) of the German Commercial Code (Handelsgesetzbuch (HGB)).

In our opinion, based on the findings of the audit,

- the accompanying annual financial statements comply, in all material respects, with German commercial law and, in compliance with German accepted accounting principles, give a true and fair view of the net assets and financial position of the institution as at 31 December 2017, and of the results of its operations for the fiscal year from 1 January to 31 December 2017, and

- in all material respects, this management report conveys a true and fair view of the institution's position, is consistent with the annual financial statements, complies with German statutory provisions and suitably presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the contents of the aforementioned separate non-financial report.

In accordance with Art. 322 (3) sentence 1 HGB, we declare that our audit has not led to any reservations regarding the legal compliance of the annual financial statements and the management report.

Basis for the audit opinions

We conducted our audit of the annual financial statements and the management report in accordance with Art. 317 HGB and EU Audit Regulation 537/2014 (hereinafter 'EU Audit Regulation') and in compliance with German generally accepted standards for the audit of financial statements promulgated by the Institute of Public Auditors in Germany (Institut der Wirtschaftsprüfer (IDW)). Our responsibilities under those provisions and standards are further described in the 'Auditor's responsibilities for the audit of the annual financial statements and the management report' section of our auditor's report. In accordance with European law as well as German commercial law and professional requirements, we are independent of the institution and have fulfilled our other German ethical and professional responsibilities in accordance with these requirements. In addition, in accordance with Art. 10 (2) (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Art. 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and the management report.

Key audit matters in the audit of the annual financial statements

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the annual financial statements for the fiscal year from 1 January to 31 December 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the following was the matter of most significance in our audit:

1. Loan loss provisions in customer lending business

Our presentation of this key audit matter has been structured as follows:

1. Matter and issue

2. Audit approach and findings

3. Reference to further information

We present the key audit matter below:

1. Loan loss provisions in customer lending business

1. Landeskreditbank Baden-Württemberg – Förderbank – is the development bank of the German federal state of Baden-Württemberg. Its business activities are governed by its statutory remit, namely to support the state government of Baden-Württemberg in the fulfilment of its public duties, especially in terms of structural, economic and social policy, by implementing development initiatives in accordance with European Union (EU) rules on state aid. It provides support mainly by issuing low-interest loans and grants. As at 31 December 2017, loan receivables in the amount of EUR 24,168 million (34.2% of total assets) were reported under the balance sheet item 'Receivables from customers' in the institution's annual financial statements.

The measurement of loan loss provisions in customer lending business is determined in particular by the legal representatives' assessment of future credit losses based on the structure and quality of the lending portfolio as well as macroeconomic factors. Specific valuation adjustments for receivables from customers are equal in amount to the difference between the outstanding loan amount and its lower fair value at the reporting date. Portfolio and general valuation adjustments are also made. Valuation adjustments in customer lending business are potentially of major significance for the institution's financial performance and also involve the legal representatives' use of judgement. In light of these facts, this matter was especially important in the context of our audit.

2. In the course of our audit, we first assessed the appropriateness of the design of the controls in the institution's relevant internal control system and tested the effective functioning of the controls, taking into account the organisational procedures, the IT systems and the relevant valuation models. We also assessed the valuation of receivables from customers, including the appropriateness of estimates, by examining individual loan exposures on a random basis. In doing so, we assessed the documents available to the institution regarding financial circumstances and the recoverability of associated collateral, among other things. In the case of real-estate collateral for which the institution presented us with valuation reports, we obtained an understanding of the raw data underlying the reports, the valuation inputs used and assumptions made, critically appraised these and assessed whether they lie within a reasonable range. In addition, in order to evaluate the specific, portfolio and general valuation adjustments, we assessed the calculation methods and the underlying assumptions and parameters. Based on the audit procedures we performed, we were able to satisfy ourselves overall of the appropriateness of the assumptions made by the legal representatives in testing the loan portfolio for impairment and of the appropriateness and effectiveness of the processes implemented by the institution.

3. The institution's disclosures on loan loss provisions in customer lending business are contained in the notes to the annual financial statements, in the section entitled 'Financial assets and liabilities' under 'Accounting and valuation methods'.

Other information

The legal representatives are responsible for the other information provided. The other information includes the separate non-financial report pursuant to Art. 289b (3) HGB.

The other information additionally includes the remaining parts of the annual report – excluding cross-references to external information – with the exception of the audited annual financial statements, the audited management report and our auditor's report.

Our audit opinions on the annual financial statements and the management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

→ is materially inconsistent with the annual financial statements, the management report or the findings we obtained in the course of the audit, or

→ otherwise appears to be materially misstated.

Responsibilities of the legal representatives and Supervisory Board for the annual financial statements and management report

The legal representatives are responsible for the preparation of annual financial statements that comply, in all material respects, with German commercial law, and for ensuring that the annual financial statements give a true and fair view of the institution's net assets, financial position and financial performance in accordance with German accepted accounting principles. The legal representatives are also responsible for such internal controls as they, in accordance with German accepted accounting principles, determine are necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the legal representatives are responsible for assessing the institution's ability to continue as a going concern and disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting on the going-concern basis of accounting unless there is constructive or legal evidence to contradict the assumption.

Furthermore, the legal representatives are responsible for the preparation of a management report that, as a whole, provides a suitable understanding of the position of the institution and is in all material respects consistent with the annual financial statements, complies with German statutory provisions, and suitably presents the opportunities and risks of future development. The legal representatives are also responsible for such arrangements and measures (systems) as they consider necessary to enable the preparation of a management report in accordance with the applicable German statutory provisions and to be able to provide sufficient suitable evidence to support the assertions in the management report.

The Supervisory Board is responsible for overseeing the institution's financial reporting process for the preparation of the annual financial statements and the management report.

Auditor's responsibilities for the audit of the annual financial statements and the management report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report on the whole provides a suitable understanding of the position of the institution and, in all material respects, is consistent with the annual financial statements and the findings obtained in the course of the audit, complies with German statutory provisions and suitably presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the annual financial statements and the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Art. 317 HGB and the EU Audit Regulation and in compliance with German generally accepted standards for the audit of financial statements promulgated by the Institute of Public Auditors in Germany (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic or commercial decisions of users made on the basis of these annual financial statements and this management report.

We exercise our professional judgement and maintain professional scepticism throughout the audit. We also:

→ Identify and assess the risks of material misstatement in the annual financial statements and the management report, whether due to fraud or error, design and perform audit procedures in response to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations or the overriding of internal controls.

→ Obtain an understanding of the internal control system relevant to the audit of the annual financial statements and of the arrangements and measures relevant to the audit of the management report, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems at the institution.

→ Evaluate the appropriateness of accounting policies used and the reasonableness of estimates and related disclosures made by the legal representatives.

→ Conclude on the appropriateness of the legal representatives' use of the going-concern basis of accounting and, based on the audit evidence obtained, on whether a material uncertainty exists related to events or conditions that may cast significant doubt on the institution's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our audit opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the institution to be unable to continue as a going concern.

→ Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in such a way that the annual financial statements give a true and fair view of the net assets, financial position and financial performance of the institution in accordance with German accepted accounting principles.

→ Evaluate the consistency of the management report with the annual financial statements, its conformity with the law, and the understanding of the institution's position that it provides.

→ Perform audit procedures on the prospective information presented by the legal representatives in the management report. On the basis of sufficient appropriate audit evidence, we evaluate, in particular, the significant assumptions used by the legal representatives as a basis for the prospective information and assess whether the prospective information was properly derived from those assumptions. We do not express a separate audit opinion on the prospective information and the assumptions used as a basis for the latter. There is a considerable unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in the internal control system that we identify during our audit.

We provide those charged with governance with a statement that we have complied with the relevant independence requirements, and discuss with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the safeguards that have been put in place.

From the matters discussed with those charged with governance, we determine those matters that were of greatest significance in the audit of the annual financial statements for the current reporting period and are therefore the key audit matters. We describe these matters in the auditor's report unless law or regulation precludes public disclosure about such matters.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further information pursuant to Art. 10 of the EU Audit Regulation

We were appointed statutory auditor by the Supervisory Board on 28 April 2017. We were engaged by the Supervisory Board on 28 September 2017. We have been the statutory auditor of Landeskreditbank Baden-Württemberg – Förderbank –, Karlsruhe, for an uninterrupted period of engagement since fiscal year 2015.

We declare that the audit opinions contained in this auditor's report are consistent with the additional report to the audit committee referred to in Art. 11 of the EU Audit Regulation (long-form audit report).

INDEPENDENT AUDITOR RESPONSIBLE

The German public auditor responsible for the engagement is Stefan Palm.

Stuttgart, 5 March 2017
PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Stefan Palm	pp. Ralf Steffan
Public auditor	Public auditor

INDEPENDENT AUDITOR'S REPORT ON A LIMITED-ASSURANCE ENGAGEMENT RELATED TO THE BANK'S NON-FINANCIAL REPORTING

To Landeskreditbank Baden-Württemberg – Förderbank –, independent public-law institution, Karlsruhe.

We have performed a limited-assurance engagement on the separate non-financial report pursuant to Art. 340a (1a) in conjunction with 289b (3) HGB for the period from 1 January 2017 to 31 December 2017 (hereinafter the 'non-financial report') published by Landeskreditbank Baden-Württemberg – Förderbank –, independent public-law institution, Karlsruhe (hereinafter the 'institution').

RESPONSIBILITIES OF THE LEGAL REPRESENTATIVES

The institution's legal representatives are responsible for the preparation of the non-financial report in accordance with Art. 340a (1a) in conjunction with 289b to 289e HGB.

This responsibility on the part of the institution's legal representatives includes selecting and applying appropriate methods of non-financial reporting as well as making assumptions and estimates related to individual non-financial disclosures that are appropriate in the circumstances. The legal representatives are also responsible for such internal controls as they determine are necessary to enable the preparation of a non-financial report that is free from material misstatement, whether due to fraud or error.

AUDIT FIRM INDEPENDENCE AND QUALITY CONTROL

We have complied with German statutory provisions regarding independence and other ethical requirements.

Our audit firm applies national statutory requirements and the German profession's pronouncements, in particular the by-laws governing the rights and duties of German public auditors and German sworn auditors (Berufssatzung für Wirtschaftsprüfer und vereidigte Buchprüfer (BS WP/vBP)) as well as the IDW Standard on Quality Control 1: Requirements for Quality Control in Audit Firms (IDW Qualitätssicherungsstandard 'Anforderungen an die Qualitätssicherung in der Wirtschaftsprüferpraxis' (IDW QS 1)) and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with requirements for ethical conduct, professional standards and applicable legal and regulatory requirements.

INDEPENDENT AUDITOR'S RESPONSIBILITIES

Our responsibility is to express a limited-assurance conclusion on the disclosures in the non-financial report based on the limited-assurance engagement we have performed.

It is not within the scope of our engagement to assess external documentation sources or expert opinions referred to in the non-financial report.

We conducted our limited-assurance engagement in accordance with the International Standard on Assurance Engagements (ISAE) 3000 (Revised) 'Assurance Engagements other than Audits or Reviews of Historical Financial Information', issued by the IAASB. This Standard requires that we plan and perform the assurance engagement to allow us to obtain limited assurance about whether any matters have come to our attention that cause us to believe that the institution's non-financial report for the period from 1 January 2017 to 31 December 2017 has not been prepared, in all material respects, in accordance with Art. 340a (1a) in conjunction with 289b to 289e HGB.

In a limited-assurance engagement, the assurance procedures performed are less in extent than for a reasonable assurance engagement and therefore a substantially lower level of assurance is obtained. The assurance procedures selected depend on the public auditor's professional judgement.

In the course of our audit, we performed, among others, the following assurance procedures and other activities:

- Obtaining an understanding of the structure of the sustainability organisation
- Inquiries of relevant personnel involved in the preparation of the non-financial report regarding the preparation process, the internal control system relating to this process and disclosures in the non-financial report
- Identification of the likely risks of material misstatement in the non-financial report
- Analytical evaluation of disclosures in the non-financial report
- Comparison of disclosures with corresponding data in the annual financial statements and management report
- Evaluation of the presentation of the disclosures

ASSURANCE CONCLUSION

Based on the assurance procedures performed and assurance evidence obtained, nothing has come to our attention that causes us to believe that the institution's non-financial report for the period from 1 January 2017 to 31 December 2017 has not been prepared, in all material respects, in accordance with Art. 340a (1a) in conjunction with 289b to 289e HGB.

INTENDED USE OF THE ASSURANCE REPORT

We issue this report on the basis of the engagement agreed with the institution. The assurance engagement has been performed for the purposes of the institution and the report is solely intended to inform the institution about the results of the assurance engagement.

The report is not intended to provide third parties with support in making (financial) decisions. Our responsibility is solely towards the institution. We do not assume any responsibility towards third parties.

Frankfurt am Main, 5 March 2018

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

pp. Nicolette Behncke	pp. Jan Dietrich
Public auditor	Public auditor

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