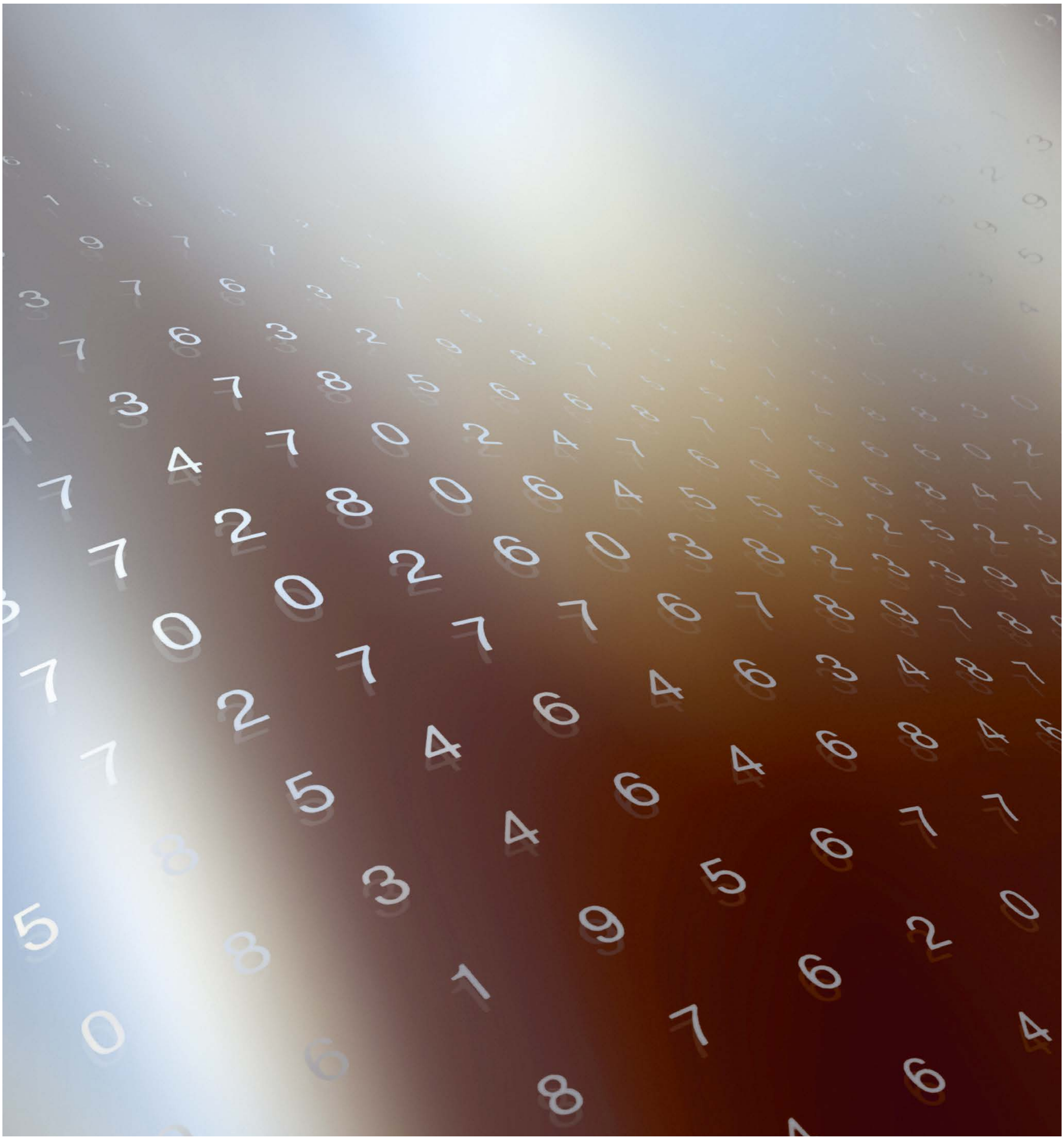
LfA Förderbank Bayern
Beratung. Finanzierung. Erfolg.

Annual Report 2014



LfA Förderbank Bayern at a glance
(EUR million)

	2014	2013
BALANCE SHEET FIGURES		
Total assets / total equity and liabilities	22,138	22,145
Loans and advances to banks	14,619	14,843
Loans and advances to customers	2,022	1,931
Fixed-income securities	4,830	4,740
Liabilities (incl. issues)	19,907	20,000
Equity (excluding net retained profit)	1,004	989
Tier 1 capital ratio (%)	20.9	19.7
Business volume	23,344	23,441
INCOME STATEMENT FIGURES		
Net interest income and net fee and commission income	160	146
Operating result before allowances, provisions and write-downs	113	104
Net reversal of allowances, provisions and write-downs	16	26
Addition to fund for general banking risks (section 340g HGB)	70	70
Net income for the year	59	59
EMPLOYEES		
- Average for the year	322	314
- Full-time equivalents	290	285

	2014	2013
NEW COMMITMENTS		
Loans	**1,978**	**2,272**
by origin		
- Subsidised-interest loans	605	531
- Low-interest loans	1,136	1,422
- Syndicated loans – commercial	153	127
- Syndicated loans – infrastructure	49	67
- Intermediated loans	35	125
by business segment (subsidised-interest and low-interest loans)		
- Start-ups	218	255
- Growth	1,182	1,427
- Innovation	23	8
- Energy and environment	165	98
- Stabilisation	43	67
- Infrastructure	99	89
- Other	11	9
Assumption of risk*	**280**	**355**
- Exemptions from liability	128	137
- Specific guarantees	36	48
- Order guarantees	42	53
- Other assumption of risk	58	93
- General and specific counter-guarantees	16	24
TOTAL DEVELOPMENT VOLUME	**2,258**	**2,627**

*Recognised

1 Annual Financial Statement

1.1 Management report

Legal basis, mandate and areas of activity

Business model

Landesanstalt für Aufbaufinanzierung is a regional development bank operated by the Free State of Bavaria. It trades under the name „LfA Förderbank Bayern" (LfA). The bank is structured as a public-sector agency with legal capacity to hold rights and duties. It has a head office in Munich and a representative office in Nuremberg. Its guarantor is the Free State of Bavaria. The LfA Act specifies that the bank is subject to legal supervision by the Bavarian State Ministry of Finance. The division of the legal supervisory authority referred to in the LfA Act of 2003 as „Bavarian State Ministry of Finance" was renamed „Bavarian State Ministry of Finance, State Development and Home Affairs" as a result of a resolution passed by the Bavarian State Parliament on 10 October 2013.

LfA is a specialist bank dedicated to promoting regional economic development. Its mandate is to safeguard the future success of Bavaria as a location for business and help to generate a positive impact on the labour market. In specific terms, the bank provides financial support for projects initiated by commercial enterprises and for other activities to improve and strengthen the economic, transport and environmental structure of Bavaria. The bank implements its mandate in line with the political objectives set by Bavaria's regional government and in compliance with the regulations on financial assistance laid down by the European Union (EU). The bank's activities are focused on small and medium-sized enterprises (SMEs). The support that LfA provides for these businesses primarily comprises funding for capital investment and for operating resources. This helps to offset the competitive disadvantages suffered by these businesses by virtue of their size.

The critical element in LfA's operating policy is the long-term promotion of the Bavarian economy, implemented by means of an optimum range of development aid products. LfA offers tried and tested development mechanisms, such as loans, risk relief and equity capital, to help provide low-cost funding for as many Bavarian businesses as possible. The bank also offers instruments such as syndicated loans, intermediated loans, general guarantees (Garantien) and specific guarantees (Bürgschaften) for the entire SME sector. In addition, LfA acts as a funding channel for the range of development aid available at federal level from Germany's KfW banking group. This provides businesses with access to particularly favourable terms based on subsidised interest rates. Equity finance completes the range of products available from the bank, although in this case most of the processing is carried out by BayBG Bayerische Beteiligungsgesellschaft mbH, Bayern Kapital GmbH and LfA Gesellschaft für Vermögensverwaltung mbH. The bank's funding activities are complemented by other development activities such as free, comprehensive advisory services for end customers and support services for funding partners and other key players.

The bank generally provides its services through a commercial bank acting as an intermediary. In other words, a business normally applies for the financial assistance, and receives the disbursed funds, through the principal commercial bank generally used by the business for its other banking transactions. This ensures that there is non-competitive collaboration between the commercial bank and LfA in the interests of the SME customer concerned.

In order to meet its mandate, the bank makes use of all standard bank funding instruments. In addition, it holds a portfolio of securities for the purposes of enhancing its development services, investing its own funds and temporarily investing grant and subsidy amounts. The bank's portfolio of long-term equity investments comprises strategic investments in Bavarian companies and holdings in subsidiaries, the purpose of which is to promote the growth of Bavaria as an economic centre.

As the Free State of Bavaria acts as a guarantor, LfA is accorded the same credit rating as the state government. Rating agency Moody's Investors Service gives the bank an Aaa rating (with stable outlook). This investment-grade rating ensures that LfA is a highly sought-after partner in both investment and funding sectors in a challenging market environment.

At European level, the bank has entered into partnerships in the form of funding and general guarantee agreements with the European Investment Bank (EIB) and the European Investment Fund (EIF) with the aim of offering SMEs the best possible financing options.

As in prior years, the bank has decided to make use of the option available under section 290 (5) in conjunction with section 296 (2) German Commercial Code (HGB) and not prepare consolidated financial statements because all its subsidiaries are of minor significance.

New products and processes

None of the new development programmes launched in 2014 were new products as defined by MaRisk. The nature, design and risk structure of the programmes already formed (and remained) part of the LfA product range. The programmes were placed in existing markets.

During the course of 2014, LfA undertook or initiated significant changes to its operational processes and structures:

- The bank introduced the standard „GuV-Planer" software to continue to optimise its strategic and business management planning processes; the use of this software also involved a changeover in the ongoing monthly reporting system and the implementation of the capital planning process required under MaRisk.
- The introduction of a credit portfolio model was completed during the course of the year. The switch to the live production system took place on the reporting date of 30 June 2014. This put in place the prerequisites for a comprehensive solution for measuring credit risk. The further gradual implementation and switch in interfaces to the underlying SAP system are scheduled for the first half of 2015.
- The bank is analysing the various options for action with regard to the issues of „Option components in investing activities" and „Stabilising earnings when interest rates are low"; it is investigating the feasibility of the options before specifying and initiating any implementation measures; the outcomes from these processes are expected to be available in mid-2015.
- Following conclusion of the EMIR project, LfA satisfies all the reporting requirements under the European Market Infrastructure Regulation (transaction register) and is in a position to clear future swaps through BayernLB. LfA also meets the requirements relating to risk mitigation techniques.
- With the SAPHIR project, which is based on the SAP modules FI/CO, GP and CML, the bank has ensured that it meets the fundamental requirements for implementing
  - a new accounting system,
  - a future-proof business partner management system, and
  - a state-of-the-art system covering loan processing as well as loan and guarantee accounting.

These systems were integrated into the LfA system environment at the end of 2014 and beginning of 2015, laying the foundations that will enable the bank to meet future requirements appropriately.

As part of a specific project, LfA addressed the different requirements specified by the Capital Requirements Directive (CRD IV) and the Capital Requirements Regulation (CRR) and pressed ahead with implementation in those areas for which further detailed Basel III requirements became available during the course of 2014. LfA now has the capability to satisfy all the necessary reporting requirements.

Even as it stands at the moment, LfA has already met the capital requirements specified in Basel III, assuming that there is no change in the bank's capital structure for the most part and that the volume of business remains similar to that in 2014.

Using criteria defined specifically for the bank, the technical modifications necessary to enable IT systems to calculate the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) have been implemented. These changes allow the ratios to be calculated automatically by the reporting software.

Economic report

Economic conditions

At the beginning of 2014, the forecast for the German economy was a rising growth trajectory with inflation-adjusted gross domestic product (GDP) of 1.8 per cent. However, the German economy went through a somewhat weaker phase in the middle of the year. Growth in the global economy, primarily in the eurozone, initially turned out to be more sluggish than expected. Furthermore, the crisis involving Ukraine and Russia, together with other conflicts, had an adverse impact on sentiment among business owners and consumers. Following the weaker phase, momentum in the German economy picked up significantly again over extended periods, even before the end of the year. November saw a change in mood among businesses, encouraged by the fall in the value of the euro and the drop in the oil price.

Many of the fundamentals in the German economy remain sound. Business competitiveness, strong public finances, the robust labour market, stable prices and low interest rates all indicate that the German economy will continue to benefit from an economic tailwind in 2015. Over the whole of 2014, the expansion in economic output in Germany was relatively strong at 1.5 per cent (inflation-adjusted), well in excess of the growth achieved in the two preceding years. In view of the brighter economic outlook overall, the forecasts for economic growth in Germany in the current year are also exceptionally positive.

Despite the sharp increase in global industrial output, the underlying pace of growth in the global economy remains subdued. The IMF has reduced its forecast for global GDP growth in 2014 to 3.3 per cent. In addition, the economic performance of France and Italy, major economies in the eurozone, remains a cause for concern. However, the global economy did receive an encouraging boost, primarily from the United States, the United Kingdom and some of the emerging markets in Asia. Overall, further growth is still subject to heightened risk. In terms of international trade, the general conditions for the German economy are therefore less favourable than previously anticipated. In particular, export-led industries are suffering from the stuttering global economic growth and the uncertainty caused by geopolitical crises.

In this environment, consumer spending in Germany is proving to be the most reliable prop for the economy. Although consumer sentiment was affected by some uncertainty in 2014, the appetite for spending nevertheless remained strong. Key prerequisites such as the robust job market, rising incomes and stable prices guarantee a beneficial rise in household consumption.

The employment market continues to be resilient, providing the basis for sound growth in the domestic economy. Despite the tough conditions, employment rose across almost all sectors in 2014 by a total of 317,000, thereby boosting economic activity. In the process, employment figures in Germany hit a record level with 42.7 million people now gainfully employed in the country.

The Bavarian economy has proved itself to be a real pillar of stability, even in the European sovereign debt crisis. Whether on products or services, the „made in Bavaria" label has been, and continues to be, in huge demand throughout the world thanks to the competitiveness of the region at an international level.

With a population of 12.5 million, Bavaria is a dynamic centre of economic activity at the heart of Europe. Furthermore, it is one of the top-ranking German states in terms of economic performance and quality of life. Bavaria's outstanding position is a result of its highly competitive economy, enormous innovative strength, energetic workforce, an environment conducive to business start-ups and the consistent policy pursued by the regional government aimed at promoting the location's economic appeal. The Free State of Bavaria is the undisputed economic leader among all of Germany's federal states and is the engine of growth in the German economy. Between 2008 and 2013, the State achieved growth of 8.5 per cent in real GDP.

By some way, Bavaria is the number one labour market in Germany. Since 2005, unemployment has more than halved and employment is now at a record level. Nowhere else in Germany has created as many new jobs (within the scope of national insurance) as Bavaria. The objective of achieving full employment throughout the whole of Bavaria by 2018 is within reach.

Although economic indicators pointed to a positive growth trend overall, these effects were not evident in the business performance of the bank to the same extent, reflecting the business model of a development bank.

Business performance

Lending business

A key feature of the 2014 financial year at LfA Förderbank Bayern compared with 2013 was the subdued level of demand caused by the macroeconomic environment. Overall loan commitments amounted to EUR 1.98 billion and thus remained below the 2013 level of EUR 2.27 billion. Subsidised-interest and low-interest programme loans continued to account for the largest proportion of the commitment volume at EUR 1.74 billion.

The bank offers SMEs financing solutions for projects in a number of segments, notably start-ups, growth, innovation, stabilisation, energy and environmental protection. It also supports infrastructure projects undertaken by local authorities. The interest-rate subsidies are funded by the bank with grants from the state government budget and some of these grants are derived from profits transferred from the bank. LfA also provides loans with favourable interest rates at the lower end of the scale for market terms.

With these low-interest development loans, LfA helped 5,500 SMEs and 111 towns, cities and other local authorities to invest in their activities to improve competitiveness. Loan commitments were made to businesses in industry and the skilled trades, to retailers and service businesses, and to the liberal professions. Businesses were investing predominantly in premises extensions, state-of-the-art plant and machinery and in energy efficiency. The development loans were used to help fund a capital investment volume of EUR 2.34 billion.

Syndicated loan commitments increased year on year by 4.3 per cent to EUR 201.8 million. LfA only participates in this type of business at the invitation of commercial banks. In the case of intermediated loans, commitments fell from EUR 125.0 million to EUR 35.0 million.

Loan *disbursements* over the entire development business amounted to EUR 2.04 billion compared with EUR 2.28 billion in 2013, broken down as follows:
- subsidised-interest and low-interest loans of EUR 1.77 billion (2013: EUR 1.81 billion),
- syndicated loans of EUR 245.1 million (2013: EUR 368.1 million) and
- intermediated loans of EUR 27.0 million (2013: EUR 105.0 million).

The overall volume of lending business declined by EUR 312.0 million over the year under review to EUR 11.96 billion as at 31 December 2014. Of the total volume of lending business, subsidised-interest and low-interest loans accounted for 60.4 per cent, syndicated and other loans 16.3 per cent, and intermediated loans 23.3 per cent.

Assumption of risk

The demand for LfA to assume risk fell by 21.1 per cent in 2014 to EUR 280.2 million.

The largest proportion of this risk (equating to EUR 128.2 million) was attributable to exemptions from liability (Haftungsfreistellungen), under which LfA arranged to indemnify commercial banks for the credit risk associated with passing through low-interest loans to corporate clients. The bank also assumed risk with a value of EUR 35.9 million as part of its programme of specific guarantees for SMEs.

LfA assumed further risk with a value of EUR 116.1 million. Of this total, EUR 42.5 million was accounted for by short-term general guarantees in domestic and international guarantee business and by general guarantees for order-related or contract-related loans for operating resources; EUR 57.8 million was accounted for by sub-holding liabilities in connection with syndicated loans; the remaining EUR 15.8 million related to the assumption of liability for performance obligations of the Free State of Bavaria.

As at 31 December 2014, the volume of guarantees had decreased by EUR 103.8 million to EUR 1.33 billion.

Equity financing

The SME equity financing business is primarily conducted by two companies: BayBG Bayerische Beteiligungsgesellschaft mbH (LfA shareholding 23.5 per cent) and Bayern Kapital GmbH (LfA shareholding 100.0 per cent).

BayBG deals predominantly with established SMEs and start-ups that have generated some initial sales revenue. In the 2013/14 financial year (balance sheet date 30 September), 74 business owners made use of equity finance amounting to EUR 41.7 million for the joint financing of their capital investment projects, thereby reinforcing their business equity at the same time. BayBG was unable to escape the downward trend in the equity financing market, generating a somewhat lower level of new business compared with 2013.

At the end of 2014, the BayBG portfolio comprised 497 SMEs involving total equity finance of EUR 315.1 million. LfA Förderbank Bayern is involved in the business operated by BayBG in that it is exposed to a risk under general counter-guarantees and general guarantees with a value of around EUR 80.0 million. The losses borne by LfA as a result of this risk were in the low single-digit millions, in line with the average for the last few years.

Bayern Kapital specialises in funding start-up teams and young technology enterprises in Bavaria in the early stages of development. In 2014, Bayern Kapital committed to 25 new long-term equity investments with a volume of EUR 6.5 million, mainly providing seed or start-up capital for small enterprises. Bayern Kapital provides funding primarily in the early years of a business when it is difficult to obtain bank loans. LfA's involvement with this subsidiary is primarily as a service provider for the Free State of Bavaria. However, there is just one area in which it has its own risk exposure in an amount of EUR 3.6 million.

At the end of the financial year, Bayern Kapital held investments in 65 businesses, the total volume being EUR 60.2 million. Bayern Kapital has invested a total of EUR 197 million in 229 businesses since it commenced operations in 1996.

LfA Gesellschaft für Vermögensverwaltung mbH uses equity financing primarily to safeguard jobs in Bavaria and, in special cases, to provide support for structural development. In 2014, it provided mezzanine finance with a value of EUR 2.5 million.

Sales and advisory services

Advisory services represent a further pillar in the range of development services provided by the bank. The advisory and training services offered by LfA are predominantly aimed at corporate client relationship managers in commercial banks, but also at key professionals (such as tax advisers and business consultants) and potential end customers (start-ups, business people, the self-employed and local authorities).

As part of LfA Förderbank Bayern sales activities, employees maintain regular personal contact with commercial bank personnel with the objective of encouraging the banks to pass on more development loans and thereby broaden the impact of SME development in Bavaria. LfA Förderbank Bayern offers corporate client relationship managers at banks special training sessions covering its range of development services. In 2014, LfA recognised the importance of these sales activities by setting up a central services sales management unit for the coordination, management, planning and control of all sales activities.

The bank's general advisory activities similarly cover commercial banks, key professionals and end customers. The range of information services, which includes a large number of events held throughout Bavaria, is tailored to the interests of the target group concerned. These services include the use of mobile branches, which are regularly used for local advisory days. The bank increasingly counts local authorities among its end customers, offering them special capital investment programmes for infrastructure expansion and a range of development services related to energy investment and the expansion of the broadband network.

A particular advisory service is offered by the task force for businesses in financial difficulty. The task force helps these businesses analyse their position and identify weak points, and works together with tax advisers, business consultants, commercial banks and the business owners themselves to highlight a way out of the crisis. The task force is able to draw on proven advisory services, such as „Bavarian Round Table" (Runder Tisch Bayern) and the turnaround advisory service provided by the KfW development bank. The task force focuses on small businesses with up to 20 employees with the aim of providing fast, professional assistance without any distortion of the market, helping the business in question to continue as a going concern on a sustainable basis.

Financial market transactions

FUNDING

LfA Förderbank Bayern primarily uses the capital markets as its source of funding. For more than 20 years, Moody's Investors Service has rated the bank's long-term liabilities at Aaa. This excellent rating is based on the bank's sound financial position and on the fact that the Free State of Bavaria acts as a guarantor.

LfA's high credit rating means that it can obtain particularly favourable terms for its funding. This low funding cost is a major contributing factor in allowing LfA Förderbank Bayern to offer its loans to Bavaria-based businesses and Bavarian local authorities on attractive terms with the aim of promoting Bavaria as a centre of economic activity.

Geopolitical tensions, lower forecasts of global economic growth, a fall in inflation rates in the eurozone and the ECB's expansionary monetary policy all had a significant impact on financial market trends in 2014. These markets were characterised by a high degree of liquidity, narrowing credit spreads and the historically low level of interest rates. LfA Förderbank Bayern was able to meet its funding needs without difficulty in these market conditions.

In 2014, the bank obtained funding of EUR 2.38 billion from capital markets (2013: EUR 2.40 billion). Of the total amount raised, EUR 1.98 billion was derived from bearer bonds and EUR 397.0 million from promissory notes and registered bonds issued by the bank.

A further EUR 1.21 billion of LfA's funding in 2014 was programme-related and obtained through Germany's KfW banking group (2013: EUR 1.23 billion). The objective of this partnership is to integrate development funds from the German federal government into the products and services offered by LfA. The added development value accrues to SMEs and local authorities in Bavaria.

INVESTMENT BUSINESS

LfA Förderbank Bayern also undertakes capital markets business as an investor. LfA's objective is to invest its own funds securely and with favourable margins as well as to generate a sustainable, steady flow of additional income that can then be used to support economic development. Its funds are generally invested in fixed-income bearer or registered bonds, pfandbriefs (covered bonds) or promissory notes. In order to minimise risk, LfA only enters into transactions with issuers and counterparties with investment-grade ratings. The investments continued to be broadly diversified with a focus on pfandbriefs, public-sector bonds and bonds from supranational issuers. LfA has also invested in domestic and international businesses with good credit ratings. Investments are focused on issuers and counterparties located in countries of the European Monetary Union (EMU) excluding southern and eastern Europe. In the reporting period, the invested funds amounted to EUR 1.76 billion (2013: EUR 1.64 billion), of which EUR 1.09 billion (2013: EUR 687.0 million) was invested in promissory notes/registered paper and EUR 673.3 million (2013: EUR 956.0 million) in securities.

In these transactions, LfA pursues a strategy of holding the acquired securities to maturity. Some of the securities are classified as fixed assets (EUR 3.44 billion) and fluctuations in the measurement of the securities in the annual financial statements can thus largely be avoided.

Results of operations, net assets, financial position

Results of operations

LfA Förderbank Bayern generated an overall *net income for the year* of EUR 59.2 million. The income statement breakdown is as follows:

	2014 EUR million	2013 EUR million	Year-on-year change EUR million	 +/- %
Ordinary income				
Net interest income	142.7	128.7	14.0	10.9
Net fee and commission income	17.4	17.6	-0.2	-1.1
Income from long-term equity investments/affiliated companies	0.5	0.4	0.1	25.0
Other operating income	4.1	4.6	-0.5	-10.9
	164.7	**151.3**	13.4	8.9
Ordinary expenses				
Personnel expenses	28.0	26.4	1.6	6.1
Other administrative expenses	17.0	13.8	3.2	23.2
Depreciation and amortisation	3.1	3.4	-0.3	-8.8
Other operating expenses	3.7	4.0	-0.3	-7.5
	51.8	**47.6**	4.2	8.8
Operating result before allowances/ provisions/write-downs and net remeasurement gains/losses	**112.9**	**103.7**	9.2	8.9
Allowances/provisions/write-downs and net remeasurement gains/losses	16.4	25.7	-9.3	-36.2
Operating result after allowances/ provisions/write-downs and net remeasurement gains/losses	**129.3**	**129.4**	-0.1	-0.1
Other taxes	-0.1	-0.1	0.0	0.0
Addition to (-)/reduction of (+) fund for general banking risks in accordance with section 340g HGB	-70.0	-70.0	0.0	0.0
Net income for the year	**59.2**	**59.3**	-0.1	-0.2
Net retained profit	59.5	59.4	0.1	0.2

Despite the persistently low interest rates, *net interest income* rose by EUR 14.0 million to a total of EUR 142.7 million. One of the contributing factors was an increased impact from one-off items, which cushioned the overall negative trend. In addition, LfA was able to reduce funding costs significantly as a result of the further drop in interest rates during the course of the year.

Net fee and commission income, which was derived almost exclusively from guarantees, amounted to EUR 17.4 million, down by EUR 0.2 million year on year, and therefore almost unchanged compared with 2013.

Personnel expenses rose by EUR 1.6 million year on year to EUR 28.0 million. This increase was largely attributable to an increase in collectively agreed salaries and a rise in the number of employees. *Other administrative expenses* (including depreciation and write-downs on property and equipment) increased by EUR 2.9 million to EUR 20.1 million. This change was caused by a rise in building costs. Total administrative expenses were therefore up by EUR 4.5 million to EUR 48.1 million. A factor to be taken into account is that the expense amount of EUR 3.3 million incurred in connection with the switch to SAP was capitalised.

The change in net interest income and net fee and commission income had the effect of improving the cost-income ratio (the ratio of administrative expenses (including depreciation and write-downs on property and equipment) to total net interest income and net fee and commission income), whereas the increase in administrative expenses had the opposite effect. The cost-income ratio calculated for 2014 was almost unchanged year on year at 30.1 per cent (2013: 29.8 per cent). This low figure means that the bank once again had one of the best cost-income ratios among all the regional development banks in Germany.

The bank continues to impose strict standards as regards *loan loss allowances and provisions* in its lending business. In 2014, the write-downs and allowances for losses on loans and advances and on securities, including write-downs of long-term equity investments and shares in affiliated companies, and additions to provisions in the lending business, as well as reversals of such write-downs, allowances and provisions, resulted overall in the recognition of a net reversal of EUR 16.4 million in the income statement.

LfA made use of the operating profit generated for the year to strengthen its regulatory capital and risk-bearing capacity by adding an amount of EUR 70.0 million to the fund for general banking risks as provided for in section 340g HGB.

The outcome was *net income for the year* of EUR 59.2 million (2013: EUR 59.3 million). After including the profit carried forward from 2013, the net retained profit amounted to EUR 59.5 million (2013: EUR 59.4 million). Of this amount, a sum of EUR 14.9 million will be added to the legal reserve pursuant to the LfA Act (the act establishing the Landesanstalt für Aufbaufinanzierung in Bavaria) and EUR 8.2 million will be allocated as guaranteed return for various development institutions. Approximately 75 per cent of the net retained profit will then be transferred to the Free State of Bavaria in accordance with the Management Board’s proposal for the appropriation of profit. Subsequently, the regional government will place EUR 18.0 million from the transferred profit at the disposal of the bank again to be used in support of the bank’s economic development activities.

Net assets

The net asset position is sound. The following table shows the breakdown as at 31 December 2014:

	31 Dec. 2014 EUR million	31 Dec. 2013 EUR million	Change EUR million
Total assets/total equity and liabilities	**22,138.1**	**22,144.9**	**-6.8**
Assets			
Loans and advances to banks	14,618.6	14,843.5	-224.9
Loans and advances to customers	2,022.1	1,930.6	91.5
Bonds and fixed-income securities	4,830.4	4,740.3	90.1
Long-term equity investments, shares in affiliated companies	119.2	115.3	3.9
Other assets	547.8	515.2	32.6
Equity and liabilities			
Liabilities to banks	8,965.6	9,124.6	-159.0
Liabilities to customers	2,958.6	3,161.8	-203.2
Debt instruments	7,982.7	7,713.3	269.4
Provisions	165.9	176.0	-10.1
Subordinated liabilities	100.5	100.5	0.0
Own funds (including fund for general banking risks)	1,463.4	1,378.5	84.9
Other liabilities	501.4	490.2	11.2
Additional information			
Contingent liabilities	1,205.8	1,296.4	-90.6
Business volume	**23,343.9**	**23,441.3**	**-97.4**

As at 31 December 2014, *total assets* (or total equity and liabilities) had contracted to just under EUR 22.14 billion, a decrease of EUR 6.8 million on the equivalent figure as at 31 December 2013. Total assets were therefore virtually unchanged year on year.

In the year under review, *business volume* (total assets and contingent liabilities) contracted by 0.4 per cent or EUR 97.4 million to EUR 23.34 billion. The *contingent liabilities* included in this figure amounted to just under EUR 1.21 billion, down by EUR 90.6 million year on year (EUR 1.30 billion).

The bank issues its loans on a non-competitive basis through other banks. This is reflected in the structure of the assets side of the balance sheet. The proportion of assets accounted for by loans and advances to banks was 66.0 per cent as at 31 December 2014. The equivalent percentages of total assets for loans and advances to customers and for bonds and other fixed-income securities were 9.1 per cent and 21.8 per cent respectively.

Bonds and other fixed-income securities swelled by EUR 90.1 million to EUR 4.83 billion.

The carrying amounts of LfA's *long-term equity investments* and *shares in affiliated companies* remained practically unchanged at EUR 119.2 million.

Expenses of EUR 23.8 million incurred to date in connection with the introduction of SAP were capitalised under *intangible assets*.

Irrevocable loan commitments fell by EUR 95.8 million year on year, the balance at the end of the year being EUR 876.2 million.

The notional amounts of *derivatives* – which are used to hedge the interest-rate risk in connection with individual transactions – fell during the course of the year to an amount of EUR 457.9 million, a decrease of EUR 260.0 million.

Further details on the individual asset items are set out in the risk report section.

LfA has not issued any letters of comfort for other entities. There was no adverse impact on net assets in 2014 from material agreements with affiliated companies or third parties. Furthermore, there are no pending legal disputes or material agreements that could give rise to a substantial prejudicial impact on the net assets of the bank owing to the subject matter or duration of such disputes or agreements or for any other reason.

Financial position

Capital structure

Most of *LfA's funding* is obtained on a long-term basis through the capital market. As at 31 December 2014, liabilities repayable on demand amounted to EUR 317.5 million (31 December 2013: EUR 338.4 million), of which EUR 173.6 million (31 December 2013: EUR 153.5 million) was due to banks. Capital market funding consisted of issued bonds with a value of EUR 7.98 billion (31 December 2013: EUR 7.71 billion) and promissory notes, registered bonds and fixed-term deposits together amounting to EUR 5.83 billion (31 December 2013: EUR 6.40 billion).

Based primarily on a fall in credit risk, total provisions were reduced from an amount of EUR 176.0 million as at 31 December 2013 to EUR 165.9 million at the end of 2014.

The carrying amount of subordinated liabilities remained unchanged at EUR 100.5 million. Intermediated loans from the KfW banking group amounting to EUR 5.67 billion were also used as a source of funding.

The changes in *equity* (including the fund for general banking risks specified by section 340g HGB) were as follows:

	1 Jan. 2014 EUR million	**Reductions** EUR million	**Additions** EUR million	**31 Dec. 2014** EUR million
Equity				
Subscribed capital	368.1			368.1
Capital reserves	42.9			42.9
Revenue reserves	578.0		14.9	592.9
Net retained profit	59.4	59.4	59.5	59.5
Fund for general banking risks	330.0		70.0	400.0
	1,378.4	59.4	144.4	1,463.4

Overall, *Tier 1 capital* (including the additions to the fund for general banking risks in accordance with section 340g HGB) increased to EUR 1.38 billion compared with EUR 1.21 billion as at 31 December 2013. The Tier 1 capital ratio rose from 19.7 per cent to 20.9 per cent. Total *balance sheet equity* (as defined by HGB) also grew by EUR 15.0 million to EUR 1.06 billion. As at 31 December 2014, the modified balance sheet equity ratio (leverage ratio) as defined by the German Banking Act (KWG) was 4.39 per cent.

Capital adequacy is calculated in accordance with the German Solvency Regulation (SolvV). During the year under review, the bank complied with regulatory capital requirements at all times.

Capital expenditure

In 2012, the bank launched the SAPHIR project to replace the existing BS2000-based accounting system as well as the business partner management and lending processing system (KRED) with SAP modules. The project will also introduce a new correspondence system. The technical migration and live implementation of the SAP modules was successfully carried out with integration into the IT system environment at the end of 2014 and beginning of 2015. LfA is planning to carry out reconstruction work on one of its buildings in 2015.

The net assets, financial position and results of operations are all sound.

Liquidity

LfA generally has adequate sources of funding at its disposal in the marketplace based on its excellent credit rating and its status as a development bank under public law backed by guarantees from a public-sector body that will assume responsibility for the bank's liabilities if required to do so.

One of the features of LfA's cash flows is the significant degree of certainty in terms of maturities. Other factors also mean that the cash flows are only subject to minimal fluctuations, largely fixed in terms of scheduling and can be reliably planned. These factors include the principle of maturity-matching applied in funding activities, the buy-and-hold strategy applied in investing activities and the funding commitments given by the KfW development bank.

All funding is obtained through money and capital markets. The bank was involved in three open market operations in 2014. Further potential funding is also available through the operational safe custody account that the bank maintains with the European Central Bank at adequate levels. The bank can use this account at any time to obtain liquidity at short notice. The *liquidity buffer* that publicly listed companies are required to hold is also maintained by the bank. Regular re-deposits ensure that the buffer is kept at an adequate level.

The *liquidity* of the bank was maintained at all times during the entire financial year without limitation. As at 31 December 2014, the regulatory liquidity ratio was 2.38 (the minimum required ratio being 1.0). The breakdown of cash and cash equivalents and payment obligations as specified by the German Liquidity Regulation (LiqV) was as follows as at 31 December 2014:

	Maturity breakdown			
Cash and cash equivalents, payment obligations	**Payable on demand up to 1 month** EUR thousand	**> 1 month up to 3 months** EUR thousand	**> 3 months up to 6 months** EUR thousand	**> 6 months up to 1 year** EUR thousand
A. Cash and cash equivalents	1,577,785	346,216	793,550	1,412,165
B. Payment obligations	662,878	371,071	1,135,653	1,692,871
Maturity mismatch	914,907	-24,855	-342,103	-280,706
Positive maturity mismatch	914,907			
Adjusted maturity mismatch		1,261,123	793,550	1,412,165
Liquidity ratio	**2.38**			

Financial and non-financial performance indicators

The two main aspects of LfA's operating activities are its development mandate and its direct business as a bank. This two-way orientation largely determines the performance indicators used for managing the bank. However, the critical point is that, although LfA operates in accordance with commercial principles, the priority is not to generate profits and achieve the greatest possible return on equity, but to focus on the bank's special role of promoting Bavaria as a centre of economic activity.

To fulfil its structural policy mandate, the bank creates, refines and provides needs-based products. This applies in particular to the ‚Startkredit' and ‚Investivkredit' products that form part of the Bavarian SME lending programme, which is optimised in close consultation with the Bavarian Ministry of Economic Affairs and Media, Energy and Technology.

The business management of the bank is gradually being adjusted in line with the changing regulatory framework. In terms of key performance indicators, the focus is shifting to risk-bearing capacity, the capital ratios (Tier 1 capital ratio and total capital ratio) and the cost-income ratio.

Non-financial performance indicators are becoming increasingly important for the long-term successful performance of the bank, as is the issue of sustainability with all its environmental, economic and social facets. Sustainability is enshrined in the LfA business model, in that the bank finances capital investment over the long term, thereby achieving a sustainable development impact. The development activities are also largely focused on compensating for the structural competitive disadvantages experienced by SMEs and thus ensuring that there is equality of opportunity. The notion of sustainability (with its environmental, economic and social components) forms an integral part of LfA's strategic objectives. It is reflected in the way the bank approaches its commercial operations, from business policy decisions on the design of products and services through to the provision of individual financing deals or advisory services.

Sustainability is a cornerstone of the bank's activities as a responsible employer, both in the structure of internal banking operations and in its corporate social responsibility. LfA's sustainability performance and sustainability-related services are regularly analysed and rated by specialist rating agencies.

In particular, the bank's HR policy is influenced by the principles of sustainability and corporate social responsibility. New trends and developments, increasingly complex regulations, different expectations and requirements, and demographic change constantly require the bank to adapt and remain flexible. Up-to-date expertise and continuous professional development are key requirements if the bank is to successfully meet these challenges. Within the framework of an annual professional development programme, the bank therefore invests in the continuous development of its employees, giving them the skills and expertise they need to cope with future challenges. Expenditure on training and development amounted to more than EUR 460,000 in 2014, equating to an average investment of more than EUR 1,400 in the capabilities of each and every employee. In addition, LfA held comprehensive, user-specific SAP training sessions in 2014 to introduce employees to the SAP applications and processes. In 2014, almost all employees took part in at least one professional development activity.

In addition to using performance indicators reflecting an internal analysis, the bank measures and validates external indicators such as customer satisfaction and brand awareness.

Over and above its specific development mandate, the bank also supports other activities to foster an entrepreneurial spirit and enhance the appeal of Bavaria as a business location.

One example is the Junior project, which is run in Bavaria by Bildungswerk der Bayerischen Wirtschaft e. V. (bbw) in conjunction with Cologne Institute for Economic Research. LfA sponsors the project with the aim of improving the environment for business start-ups, communicating the idea of start-ups in schools and presenting LfA to a wider public. It also sponsors business plan competitions, providing start-ups and the people involved with a range of support from individual coaching to the creation of a business plan. This gives young entrepreneurs the tools to approach investors and provides them with the foundation they need to launch themselves into economic independence.

The bank's broadly-based commitment to the arts also aims to enhance the appeal of Bavaria as a location for business. Rather like the bank's support for business start-ups, its arts commitment is aimed at the next generation of artists, focusing on music and the visual arts.

One of the most important performance indicators in 2015 will be how employees handle the challenge presented by the new core banking system in the SAP environment. The yardstick is the bank's declared aim of maintaining the current levels of quality and service for customers and commercial banks, particularly in the start-up period following the technical changeover.

Summary of target/actual comparison

LfA was not able to achieve all its stated forecasts regarding business and earnings performance in 2014. The following table shows a summary of the forecasts together with an indication of the level of target attainment in the form of the year-on-year change or absolute values:

Criterion	Forecast	Target attainment (+/- YOY / Absolute)
New business volume	Stable trend overall	-10.5 %
- Lending volume I + II	Volume of EUR 2.0 – 2.1 billion	EUR 1.8 billion
- Lending volume III + IV	Volume up to EUR 500 million	EUR 272.1 million
Total assets	Slight growth in volume	EUR -6.8 million
Net interest income and net fee and commission income	Significant fall; target range EUR 120 – 130 million	9.4 % / EUR 160.1 million
Administrative expenses	Increase of EUR 3.0 million	EUR 4.5 million
Cost/income ratio	Target corridor 35.0 % – 40.0 %	30.1 %
Net income for the year/net retained profit	At prior-year level of EUR 59.4 million	EUR 59.5 million
Risk-bearing capacity	Addition to fund for gen. banking risk (s. 340g HGB) of EUR 70.0 million	EUR 70.0 million

Some of the variances compared with the forecasts were attributable to the fact that assumptions and expectations in the planning only partially materialised or did not materialise at all.

Overall, the results achieved are still at a level that enables LfA to report net retained profits for 2014 in an amount similar to that for 2013 and to carry out further reinforcement of its capital adequacy in addition to recognising appropriate loan loss allowances and provisions for all identifiable risks.

Events after the balance sheet date

After the end of the financial year, there were no events of particular significance with an impact on the presentation of the net assets, financial position and results of operations.

Outlook, opportunities and risks

Outlook

The outlook includes forward-looking statements relating to macroeconomic trends, business performance and the net assets, financial position and results of operations of LfA. The statements relate to expectations and assumptions based on the information available as at the date on which the report is prepared. The statements are subject to risks and uncertainties outside the control of the bank. These risks and uncertainties include, in particular, economic trends and developments in financial markets. Changes in interest rates and also in economic conditions play a key role in the demand for development loans.

The predictions made by LfA are largely based on the Annual Economic Report published by the German government and on generally available publications and studies relating to economic trends. In the projections for the year published by economic research institutes, the forecasts for economic growth in 2015 range from 1.2 per cent to 1.9 per cent; the German government's Annual Economic Report predicts a growth rate of 1.5 per cent, which is in the middle of this range.

The German economy appears to be in good shape. Despite the continued geopolitical risks, a recovery took hold in the last few months of 2014, driven by a strong labour market and significant consumer spending. Overall, this recovery was also reflected in improved business sentiment. Although the foreign trade environment continues to be seen as challenging because of the ongoing tensions and the persistently weak growth in the eurozone, forecasts do reflect a degree of confidence. There is expected to be a boost from public-sector investment to maintain and enhance infrastructure because an additional budget of EUR 1.5 billion has been made available for this purpose. The low price of oil and the fall in the value of the euro are also likely to stimulate growth.

Key assumptions in these projections are that the financial sector remains stable overall and that there are no negative trends in the eurozone or the global economy that could lead to a marked rise in uncertainty. As for trends in interest rates, there is not expected to be any major shift in the yield curve, which is likely to remain at a low level overall.

Even though a package of economic support measures has been initiated, economic stimulus from the eurozone will probably remain weak over the forecast period. Market conditions will continue to be heavily influenced by the activities of the ECB. In 2015, the banks will have to cope with enhanced regulatory requirements.

However, once again, LfA does not expect to encounter any difficulty in covering its funding and investment needs this year because of its investment-grade credit rating and the manageable extent of its requirements.

For many years, growth rates for Bavaria have been consistently better than the average for Germany as a whole. The local economy – with its significant SME sector – has shown itself to be stable during phases of weak growth, especially as SMEs are well able to exploit growth opportunities effectively. In view of the positive sentiment in the economy, full order books, low interest rates (which stimulate capital investment) and encouraging trends in the labour market (which boost consumer spending), it is reasonable to expect further growth in 2015 and more improvement in employment figures.

LfA – based on its sound business model in conjunction with its triple-A rating – believes that it will be able to continue to stabilise its position as a development bank for Bavaria over the coming years. It also plans to continue to optimise its range of development instruments in view of the structural policy challenges, for example in relation to the switch to renewable energy sources. Particular attention will be focused in 2015 on assistance and support for the state government start-ups initiative using bank funding, for improving the access of technology-based businesses to development loans and for developing sales approaches in the areas of energy efficiency, broadband and digitisation.

LfA's priorities over the next year will include process optimisation, digitisation of the development business and the provision of effective support for the start-ups initiative. In addition, it will have to take into account the impact from the persistently low interest rates.

In order to forecast the future net assets, financial position and results of operations, the bank prepares annual budgets which are updated on a rolling basis. These budgets include portfolio and income planning, including cost budgets.

In the context of key target planning, LfA has set itself an ambitious target for new development business of more than EUR 2.0 billion. Overall, this will result in a stable trend in development business with the level of total assets remaining unchanged. The performance of the business in 2015 to date, which has been shaped by the current low level of interest rates and the macroeconomic environment, has been in line with this ambitious approach.

The bank's options for investing and obtaining funding will continue to be affected by the consequences of the sovereign debt crisis in the eurozone. It plans to continue with the process of optimising its investment portfolio, the objective being to diversify the risk and stabilise income.

Given the period of persistently low interest rates, LfA expects to see a significant fall in net interest income and net fee and commission income in the coming year to a figure approximately in the range EUR 130.0 million to EUR 140.0 million. Net interest income will continue to be closely linked to changes in the level of interest rates. In contrast, net fee and commission income will be heavily influenced by the pace of economic growth.

According to the planning carried out by the bank, administrative expenses are likely to be subject to a further increase of up to EUR 20.0 million because of the necessary investment in IT, the multitude of regulatory changes and, in particular, the first-time contributions to the resolution financing mechanism for banks (bank levy). At the moment, LfA is assuming that the number of employees will increase slightly.

The forecast changes in net interest income, net fee and commission income and in administrative expenses will have an adverse impact on the cost-income ratio, a KPI used for business management purposes. The bank predicts that this value will be around 50.0 per cent for the 2015 financial year.

According to the latest assessments, trends in financial markets will be a major feature of 2015. As a consequence, LfA intends to continue with the consolidation of its risk-bearing capacity. In addition to recognising appropriate loan loss allowances and provisions for all identifiable risks (which are expected to continue to diminish), the bank is planning to bolster its capital adequacy by adding further sums to the fund for general banking risks. Despite the substantial contraction in income components and the anticipated rise in administrative expenses, the bank is still forecasting that the outcome will be net income for the year of around EUR 50 million.

Risk report

Strategic guidelines

The two main aspects of LfA's operating activities are its *development mandate* and its d*irect business as a bank*.

LfA Förderbank Bayern is a regional development bank operated by the Free State of Bavaria. Its legal structure is that of a public-sector agency and the bank therefore has a special responsibility to the general public. It has a mandate from the regional government – as part of financial, economic, transport, environmental and labour market policy and in compliance with the regulations on financial assistance laid down by the EU – to provide financial support for projects initiated by commercial enterprises and for other activities to improve and strengthen the economic, transport and environmental structure of Bavaria.

LfA operates in accordance with commercial principles; however, its priority is not to generate profits and achieve the greatest possible return on equity, but to focus on its special role of developing Bavaria as a location for business. To this end, LfA provides a considerable number of additional services to the detriment of its net retained profit. These services primarily comprise low-interest lending programmes financed by the bank itself and the assumption of risk by the bank. The critical targets and KPIs in the management of the bank are a *high level of development funding* and the maintenance of the bank's *risk-bearing capacity*.

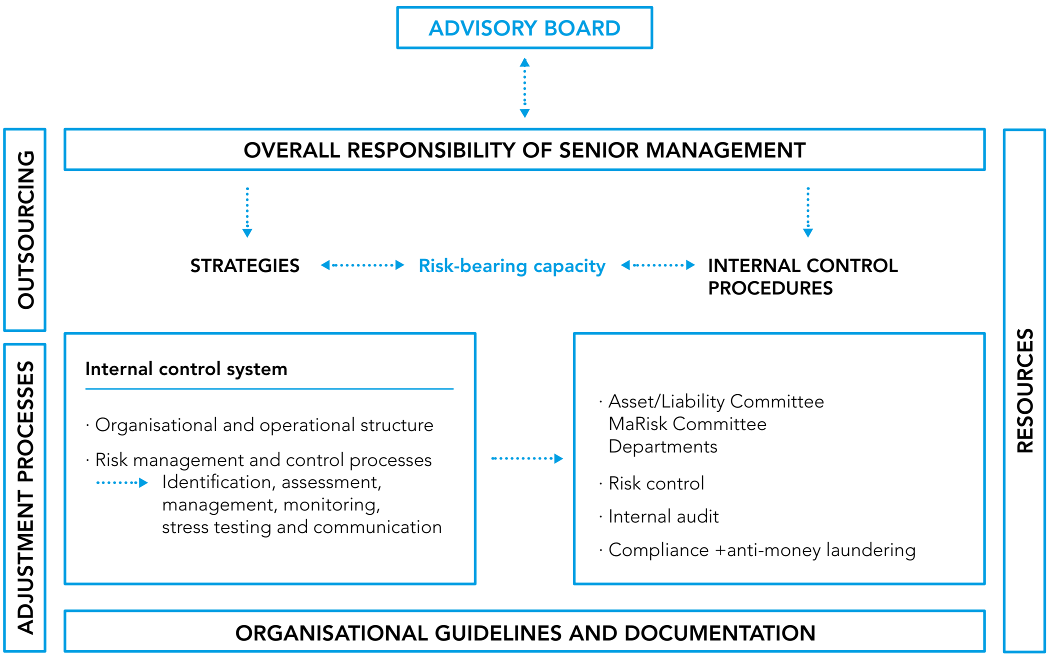
In terms of a long-term framework for the *management of quality and risk*, LfA follows a quality- and risk-based management approach that creates appropriate strategies, flexible structures and effective processes using the same principles.

Risk management system

LfA is a specialist bank backed by an unlimited guarantee from the Free State of Bavaria. As a development bank, LfA is subject to all standards imposed by banking regulators. The standards include, in particular, the *Minimum Requirements for Risk Management (MaRisk)* specified by Germany's Federal Financial Supervisory Authority (BaFin). An interdepartmental committee has been set up to coordinate the bank's activities to implement and comply with MaRisk.

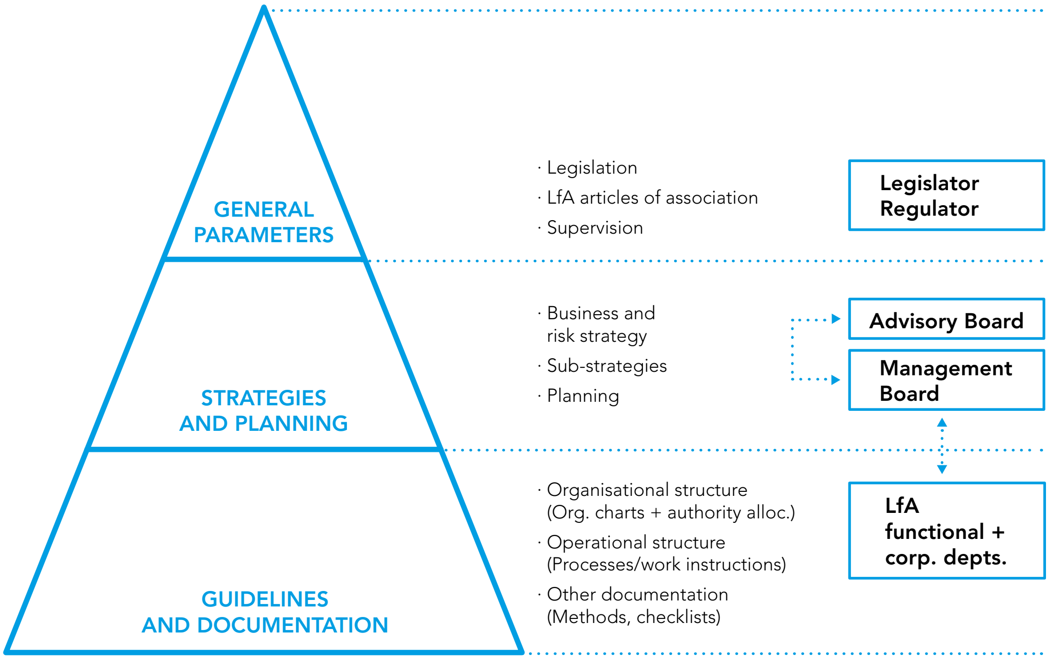
The risk management system encompasses all activities involved in identifying, analysing and assessing business risk and in implementing subsequent action to ensure that corporate objectives are achieved.

The following diagram outlines LfA's risk management system (in accordance with MaRisk):



The bank's *risk policy* is determined by the framework set out by statutory provisions and the bank's articles of association; responsibility for this policy lies with the Management Board. This policy specifies a corporate strategy and a consistent risk strategy, which together form the basis for the bank's risk management system. The corporate and risk strategies are updated on an ongoing basis. The updating process includes an annual risk inventory check in which the bank reviews whether, and to what extent, new risks need to be included in the risk management and control process. The corporate and risk strategies are complemented by an IT strategy, which is derived from the corporate objectives. The IT strategy sets out the requirements for designing, organising and optimising IT processes, for using the existing information technology and for introducing new applications.

The following diagram shows the interrelationship between the parties involved in LfA's risk management system in the context of the existing structure:



Given the bank's statutory function as a regional development bank, LfA's activities are limited and it is not active in all the usual areas of banking business, with the result that many of the risks to which banks are typically exposed are not relevant. The following risks are relevant to LfA:

- Credit risk
- Country risk
- Counterparty/issuer risk
- Interest-rate risk
- Other market risk
- Liquidity risk
- Group risk
- Operational risk
- Performance risk

An *overall risk management approach for the bank* is used to manage risk. At the core of the risk management system is a *risk-bearing capacity strategy*, ensuring that all the material risks relevant to the bank can be absorbed using the bank's own resources. The risks deemed to be material for the bank are credit risk, interest-rate risk and operational risk. Spread risk is also included in the risk-bearing capacity strategy. On the other hand, liquidity risk (which has to be classified as material under the MaRisk requirements) and material performance risk are not included in the risk-bearing capacity strategy because most of these risks cannot be usefully limited by means of aggregate risk cover. All the risks included in the risk-bearing capacity calculation, together with liquidity risk, are deemed to be risks relevant to the management of the bank in the analysis below. Each of the risks is classified as part of the risk inventory check carried out each year.

The regular *analysis of risk-bearing capacity* and the calculation and *specification of potential risk cover* (PRC) form the basis for the quantitative management and monitoring of the bank's risks.

Risk-bearing capacity

As part of the risk-bearing capacity strategy, LfA has specified the *gone concern approach* (liquidation approach) as the lead management method. A management method is defined as all the associated management-relevant procedures aimed at ensuring that the risks aggregated at overall bank level are covered by the available potential risk cover (PRC). The aggregate risk cover is currently determined on the basis of the income statement and balance sheet. The potential risk cover (= economic capital) comprises equity and the funds for general banking risks (in accordance with section 340f and section 340g HGB). Hidden charges under long-term securities are deducted in the calculation.

The figures are predominantly measured on the basis of value-at-risk with a confidence level of 99.9 per cent and a uniform risk analysis horizon of one year.

However, this management approach by itself may only illustrate risk-bearing capacity from one particular perspective. In a comprehensive risk management system, it is important to be aware of the limitations of the management method used and apply corrective action, where required. The bank therefore also uses the *going concern approach* as an accompanying method. With this risk management approach, LfA aims to achieve a balance between expected income and the risk of loss.

Stress tests

Stress scenarios add a further dimension to the risk management and control processes. The bank's entire design for stress tests was completely revised following the introduction of the credit portfolio model in 2014.The first reports under the new approach (described below) were prepared for the reporting date of 31 December 2014.

Typical stress factors in the case of credit risk are a deterioration in ratings (increase in probability of default, PD) and an increase in loss rates (rise in loss given default, LGD). For interest-rate risk, the bank calculates potential interest-rate risk in overall bank cash flows using a variety of stress scenarios. The scenarios assume extreme changes in interest rates with potential for higher losses; the data is derived from historical returns on money and capital markets. The scenario involving a parallel shift of +200/-200 basis points (BaFin interest-rate shock) produced a change of 15.1 per cent in the present value of regulatory own funds based on the liable equity as at the balance sheet date. The bank also complied at all times during the course of the year with BaFin's requirements in relation to extreme changes in interest rates. It can therefore be concluded that LfA is not a bank subject to heightened interest-rate risk. In the case of spread risk and operational risk, a flat-rate approach is used in the stress test analysis.

The bank makes a distinction between two types of scenario. In the first type, quantitative analyses are carried out at overall bank level. In these analyses, all types of risk relevant to risk management are subjected to a suitable test. An example of this type of scenario is a historical scenario in which a unique outlier in a sub-portfolio that has actually occurred in LfA's past experience of credit risk is extrapolated over the entire portfolio.

In the second type of scenario, the bank carries out qualitative investigations into individual cases, in most instances based on ad hoc occurrences and information.

To complement these procedures, the bank also carries out inverse stress tests to investigate whether there are any events that could jeopardise the survival of a bank as a going concern. The scenarios that have been applied are reviewed each year to ensure that they are up to date. This review takes into account a number of factors including the findings from the risk inventory check, new areas of business, changes in the market and other information.

Processes

Within the risk management system, risks relevant to the management of the bank are identified and quantified. When a decision is made to take on such risk relevant to the management of the bank, the risk is limited and continuously monitored. The key principle to be observed in this process is compliance with risk-bearing capacity. Under this principle, the bank's overall risk must be covered at all times by the available potential risk cover.

LfA's risk management process at overall bank level falls largely within the remit of the asset/liability management committee (asset/liability committee), which is responsible for managing the risk, and the central services risk control unit, which is responsible for monitoring the risk. The two units are segregated from each other in terms of both organisation and function. Among other things, the asset/liability committee addresses the issues as to whether certain risks should be consciously assumed, avoided or restricted. The committee submits proposals to the Management Board for decisions in this regard or comes to its own decisions within the limits of authority specified for the committee. In addition, the MaRisk committee ensures that LfA's processes are structured in accordance with MaRisk. The bank management team within the business management/accounting department carries out the groundwork for the asset/liability committee and the MaRisk committee.

Risk control is responsible for monitoring the risks on an ongoing basis, stress testing, backtesting the risk measurement procedures and monitoring compliance with the specified limits in the form of the allocated potential coverage for each risk category. This unit also carries out a comprehensive analysis of LfA's credit risk, liquidity risk and interest-rate risk every six months as part of stress tests. The risk reports to the Management Board and Advisory Board are the responsibility of risk control. The Management Board appoints an officer from the organisation and administration department to be responsible for monitoring and reporting operational risk.

Overall bank management of credit risk includes an analysis of both the entire portfolio and relevant sub-portfolios. In addition, the bank applies breakdowns based on ratings and size categories in addition to investigating any concentrations. These analyses are also used as the basis for corrective action to manage credit risk.

In addition to management at portfolio level, case-by-case risk assessment is a key component of the management system for credit risk. The units responsible for these activities are the three lending departments and, in the case of bank counterparties, the bank commitments team within the business management/accounting department. The level of detail in the risk analysis carried out in connection with lending decisions and lending monitoring depends on the extent of risk involved. Decision-making authority and the group of recipients for monitoring reports are specified at team, departmental, Management Board or Advisory Board levels depending on the risk concerned. Non-performing loans may be subject to workout procedures and the recognition of a specific loan loss allowance depending on changes in the credit quality of the borrower.

To satisfy MaRisk requirements relating to risk management at group level, the bank carries out a quarterly analysis in which it assesses the extent to which material risks arise from entities that form part of the group. LfA restricts this analysis to the particularly material credit risk arising in connection with subordinated entities in the group.

The task of the compliance function (MaRisk) set up as part of the risk management system is to counter the risks that could arise from non-compliance with legal provisions and requirements and to introduce an effective internal system to avoid problems caused by gaps in provisions, particularly in areas such as banking supervision. The compliance officer (MaRisk) entrusted with this task participates in the meetings of the MaRisk committee. In coordination with the relevant departments, the officer determines the legal provisions and requirements that are material to LfA and carries out a risk analysis at regular intervals. LfA has set up a process to monitor, evaluate and implement future legal requirements, particularly those in relation to banking supervision. The compliance function (MaRisk) monitors pending changes, the departments assess the possible implications for LfA, and the MaRisk committee decides on the implementation requirement, the responsibility for implementation and deadlines: the objective is to ensure that all new regulatory and other requirements are implemented by LfA comprehensively and in good time. The responsibility of the Management Board and the departments for compliance with legal requirements is not affected by the tasks of the compliance function (MaRisk).

On behalf of the Management Board, LfA's internal audit department independently and autonomously audits and assesses the effectiveness and appropriateness of the risk management system on a continuous basis.

Internal control system and risk management system in relation to the accounting process

The *internal control system (ICS)* supports the effectiveness and efficiency of operating activities, ensures that financial reporting is reliable and that the bank complies with relevant statutory provisions as well as internal management requirements, and helps to protect the assets of the bank.

The *risk management system (RMS)* encompasses all activities involved in identifying, analysing and assessing business risk and in implementing subsequent action to prevent risks from adversely impacting the achievement of corporate objectives. The objectives of the accounting-related ICS/RMS are to ensure that the bank complies with the associated standards and regulations and adheres to generally accepted accounting principles.

The accounting process includes all activities from posting and processing a transaction to preparing the annual financial statements. The business management/accounting department is responsible from an organisational perspective for setting up and effectively maintaining the ICS and RMS (in relation to the accounting process) at a level commensurate with the circumstances and risks faced by the bank. There is a clear segregation of functions between the main units involved in the accounting process (business management/accounting, risk control and IT departments) and areas of responsibility are clearly assigned.

The accounting process has been fixed and specified in writing with suitable instruction documents. The relevant units carry out regular monitoring and make adjustments in line with statutory and regulatory changes where required. The accounting process is supported both by standard software applications and by software developed in-house. The bank protects systems against unauthorised access by issuing employees with authorisations appropriate to their level of authority. The principle of doublechecking by a second person is applied in all accounting-relevant processes. Automated validation checks within systems, standardised reconciliation routines and target/actual comparisons all help to ensure that accounting records are complete, that errors are discovered or prevented, and at the same time that assets and liabilities are accurately recognised and measured.

The business management/accounting and organisation & administration departments are involved in the new product process so that new products are correctly recognised in accounting systems. There were no material changes affecting the accounting process in 2014. Fundamental modifications are only expected with the introduction of SAP, which was carried out at the end of 2014 and beginning of 2015.

The accounting process is documented using a structure that is clear for suitably qualified persons. The corresponding documents are archived for the periods specified in statutory provisions.

The internal audit department carries out regular audits to monitor the accounting-related internal control system/risk management system and ensure that the systems are fully functioning.

Reports are submitted promptly to the Management Board as part of the overall reporting system. The Management Board regularly provides the Advisory Board with the latest information on the performance of the bank.

Risks

Subject to appropriate coverage from the potential risk cover and taking into account the corporate and risk strategies, the Management Board set an *overall risk ceiling* for 2014 on the basis of which the individual types of risk were also limited. The bank continuously monitors the limits and the adequacy of the assigned cover assets for the risk types described below.

The effects of correlations across the risk types and/or diversification are not factored into these risk analyses.

CREDIT RISK

Credit risk is defined as the risk that a business partner will not be able to meet some or all of its contractual obligations to LfA. As a consequence, there is a risk of a loss or lost profits as a result of the partial or complete default of the business partner concerned. Credit risk encompasses not only credit risk itself but also counterparty, issuer, country and equity risk.

Credit risk forms the largest group of risks to which the bank is exposed. Approximately 76.0 per cent of total assets are accounted for by *loans and advances to banks* and fixed-income securities issued by banks. The vast majority of these assets are in the form of pass-through loans and intermediated loans with reduced risk. Furthermore, in the case of financial assets, the bank imposes strict requirements in respect of the counterparty's credit rating. Credit risk in relation to loans and advances to banks is managed by using individual and group limits, which are set on the basis of external ratings and the bank's own analysis of annual reports and further information.

The bank also regularly reviews the strategic requirements for *interbank transactions* because of the changes in market conditions caused by the recent financial crisis and persistent sovereign debt crisis and because of the precarious situation in which some banks find themselves. As a consequence, various action plans have been initiated and implemented to mitigate risk. These have included reducing or withdrawing lines of credit, increasing internal credit quality requirements and improving the collateral requirements for exposures.

Credit risk is measured by using a credit portfolio model. This is based on the standard mathematical model, CreditMetrics; risk is quantified in the default mode. The risk measure is credit value at risk (CVaR), which is determined using a Monte Carlo simulation. Risk is quantified based on a confidence level of 99.9 per cent and a risk analysis horizon of one year. A critical determining factor in the model is the size of the exposure in each case. In the case of the lending and guarantee business, the amount at risk includes any binding undrawn commitments; in securities business, the exposure is the nominal amount, and for derivatives, it is the credit equivalent amount. The probability of default for the partner also plays a key role. This can be determined directly from an internal or external rating based on a master rating scale. Last but not least, the loss rate also represents a further factor in the measurement of the risk. This rate reflects the available collateral in each case; alternatively, it can be determined on the basis of rates obtained from external data sources. Hedging structures that are typical in development business are also taken into account, thereby mitigating the risk.

The following table shows a breakdown of LfA's overall portfolio by risk class and includes the assigned probability of default in each case.

CREDIT RISK BY RISK CLASS

Risk class	Range	Amount at risk	Proportion
Class 1	0.0000 % – 0.0230 %	3,422,874,554.19	14.2 %
Class 2	0.0231 % – 0.0340 %	867,500,000.00	3.6 %
Class 3	0.0341 % – 0.0510 %	4,091,311,868.43	16.9 %
Class 4	0.0511 % – 0.0770 %	6,090,420,547.46	25.2 %
Class 5	0.0771 % – 0.1160 %	1,788,355,174.78	7.4 %
Class 6	0.1161 % – 0.1800 %	4,062,991,608.16	16.8 %
Class 7	0.1801 % – 0.2600 %	309,884,939.34	1.3 %
Class 8	0.2601 % – 0.3900 %	775,435,562.16	3.2 %
Class 9	0.3901 % – 0.5850 %	958,490,760.46	4.0 %
Class 10	0.5851 % – 0.8780 %	875,805,282.10	3.6 %
Class 11	0.8781 % – 1.3170 %	301,213,425.76	1.2 %
Class 12	1.3171 % – 1.9750 %	136,479,506.95	0.6 %
Class 13	1.9751 % – 2.9630 %	211,931,025.29	0.9 %
Class 14	2.9631 % – 4.4440 %	17,133,915.31	0.1 %
Class 15	4.4441 % – 6.6670 %	46,049,755.45	0.2 %
Class 16	6.6671 % – 10.0000 %	20,823,708.75	0.1 %
Class 17	10.0001 % – 15.0000 %	4,446,217.79	0.0 %
Class 18	15.0001 % – 99.9999 %	2,733,550.59	0.0 %
Class 19	100 %	193,657,111.94	0.8 %

Credit risk arising from long-term equity investments and from shares in affiliated companies is of minor significance at LfA. This risk is included in the credit portfolio model and therefore forms part of the reported credit risk.

Country risk is a type of credit risk that materialises if, in a particular country, a partner or the country itself is unable to meet payment obligations on time or at all as a result of an act by the country's government or authorities or because there are economic problems within the country concerned. In the annual risk inventory check, there was no change in respect of country risk, which continued to be classified as not material. The main reason for this is that LfA has for the most part invested only in neighbouring countries within the eurozone. A further point with regard to the lending business is that, even in the case of exposures to foreign commercial banks, the ultimate borrowers are German companies. These risk exposures are therefore for the most part related to risk arising from the counterparty credit quality. In addition, the information obtained during country analyses carried out by the bank did not point to any heightened country risks. At the moment, LfA is therefore not exposed to any material country risk. The existing foreign risk exposures are included in the credit risk on the basis of the borrower credit ratings.

Counterparty and issuer risk is the risk that a contractually agreed service in a pending trading transaction may not be performed by the counterparty and it may therefore be necessary to enter into a replacement transaction on terms that are worse than in the original transaction. This risk is managed by issuing special limits. Compliance with these limits is continuously monitored by the financial markets service team, which is segregated organisationally from the trading units. This risk is also already included in the reported credit risk.

The bank also carries out a *risk analysis at group level* covering the entire LfA Group. In an initial stage, detailed information is consolidated at specified intervals for the group members by the relevant department. Using predefined criteria, the risks are then assessed both at individual and group levels.

MARKET RISK

The most significant market risks faced by the bank are interest-rate risk and spread risk on securities. Both of these risk types are included in the risk management and monitoring process. The bank is also exposed to other pricing risk to the extent described below. Currently, the bank is not exposed to any currency risk at all. LfA is a bank without a trading book and it does not undertake any own-account trading as defined by section 1a (1) KWG.

Interest-rate risk is the potential risk of a loss in the fair value of an interest-rate risk exposure if there is an unfavourable change in interest rates. This type of risk is assessed and managed exclusively for the bank as a whole. A value-at-risk (VaR) is determined for this risk on a continuous basis. This VaR is quantified for the total bank cash flows using a modern historical simulation with a confidence level of 99.9 per cent and a holding period and analysis period of 250 days. When investing its own funds, LfA pursues a benchmark strategy focusing on the generation of stable contributions to earnings over the long term. The predictive quality of the VaR model is reviewed at least annually with a backtesting procedure.

LfA believes that spread risk is primarily influenced by the credit rating of the borrower and by the impact of the market on the credit spread environment. These two factors are for the most part already covered within credit risk. For this reason, and also because LfA adopts a buy-and-hold strategy, the bank believes it is sufficient to measure spread risk using a flat-rate method. This approach should also be seen against the background that LfA focuses new business on borrowers or issuers with good investment-grade ratings. If a rating is downgraded at a later point below a defined threshold, the bank then decides on a case-by-case basis whether it is going to continue to hold or sell the security with the weaker rating.

LfA is also exposed to other non-material market risks that are not included in the analysis of risk-bearing capacity. These risks relate to one long-term equity investment held by the bank. The value of this long-term equity investment depends on the share price performance for a listed company. The risk is quantified monthly using a VaR model for a liquidation period of 250 trading days (i.e. one year) and a confidence level of 99.9 per cent based on the current market share price.

LIQUIDITY RISK

Liquidity risk in the actual sense of the term refers to the risk that it may not be possible to satisfy some or all payment obligations in accordance with agreed contractual terms. In a broader sense, it refers to the risk that it may only be possible to obtain funding on terms that are worse than those expected. Detailed financial planning is used to manage the bank's ongoing ability to meet its payment obligations. The main features of the bank's liquidity position are as follows: funding is largely arranged on the basis of matching maturities; the majority of the bank's cash flows have fixed maturities and can therefore be budgeted with a high degree of accuracy; as a result of LfA's excellent credit rating, the bank also has at its disposal extensive money market trading lines with a variety of banks.

LfA has been able to obtain funding from money markets without any restriction. Furthermore, the bank also has on its balance sheet fixed-income securities with a value of EUR 4.8 billion that for the most part could be used as collateral to obtain funding from the European Central Bank if required. The bank would therefore have no problem in turning at any time to the funding facilities provided by the European Central Bank if the need for additional funding arose.

Given the circumstances described above, the bank believes that its liquidity risk is low and can be easily managed despite the fact that it is difficult at the moment to predict how trends on the money and capital markets will develop. As regulatory requirements specify that liquidity risk must be classified as a material risk, and as LfA is deemed to be equivalent to a publicly listed bank, the bank has structured its risk management system for liquidity risk accordingly. LfA generates a funding matrix that aggregates liquidity-relevant cash flows into year segments over an analysis period of ten years and that also breaks down the details for the next two years month by month. The bank also carries out stress tests and produces regular reports. As at 31 December 2014, a measured volume of EUR 1.4 billion had been allocated to the liquidity buffer required by MaRisk. The utilisation of the liquidity buffer was calculated at 32.6 per cent as at the reporting date based on an analysis period of 30 days.

Liquidity continues to be monitored using the liquidity ratio specified by LiqV. For the purposes of determining this ratio, the expected receipts over a 30-day period must be compared against the expected payments over the same period, whereby the receipts in the analysis period must be greater than the payments. As at 31 December 2014, this liquidity ratio was 2.38, i.e. it was greater than the minimum value of 1. Over the course of the year, this ratio fluctuated in the range 1.35 to 2.76. The open lending commitments all resulted from the standard business activities of a development bank.

OPERATIONAL RISK

Operational risk refers to the risk of losses arising as a consequence of the inappropriateness or failure of internal processes, people or systems or as a consequence of external events. This definition includes legal risk, but excludes strategic risk and reputational risk.

The bank assigns responsibility for recording, assessing and monitoring this risk to an officer from the organisation department. All the departments affected are regularly involved in the processes.

A system originally produced by the Association of German Public Sector Banks (VÖB) known as Operational Risk Center is used to record possible risks. The bank carries out an annual risk inventory check in which it analyses all possible risk events and losses incurred to establish the causes of the event or loss concerned. This is carried out regardless of the size of the loss or potential risk to enable the bank to initiate suitable corrective action at an early stage should circumstances with similar characteristics arise.

The individual risks that are identified are broken down into risk classes (I to IV) depending on the possible amount of the loss and the probability that the risk will materialise. Action is initiated for each individual risk in classes I and II. The action is specified by the operational risk officer in consultation with the relevant department. The officer documents the agreed action and monitors its implementation. The risks in classes III and IV are subject to acceptance of the risk. No separate action is documented or taken for these risks other than the normal banking precautionary measures. Regardless of the risk class involved, the bank also takes out insurance policies (taking into account cost-benefit issues) to pass on the risk in conventional areas of risk such as fire, vehicle damage, etc.

Since 2004, LfA has been using a central database to collect information on losses and loss-free risk events. In 2014, neither the identified losses nor the loss-free risk events highlighted risks that could jeopardise the bank as a going concern. A significant loss event is defined as one in which the gross loss is EUR 15 thousand or more. If this threshold is exceeded, an ad hoc report is submitted to the member of the Management Board responsible for managing operational risk. If a loss exceeds EUR 100 thousand, an ad hoc report is sent by email to all the members of the Management Board. In the year under review, six ad hoc reports were submitted to the member of the Management Board responsible for operational risk and one further ad hoc report was sent to the entire Management Board. The gross loss arising from loss events in 2014 amounted to EUR 402 thousand.

The risk officer submits regular reports to the Management Board on the overall risk position from an operational perspective. These reports are prepared on the basis of the risk portfolio broken down by risk classes and the data captured in the loss database.

The Basic Indicator Approach in accordance with Basel II is used as the basis for quantifying operational risk within the risk-bearing capacity strategy. This risk measurement is fed into risk reports and used in the calculation of risk-bearing capacity. The economic capital for operational risk is determined annually using a method similar to that in the regulatory Basic Indicator Approach.

LfA has also appointed officers with responsibility for specific risk issues. This provides a further dimension to the risk management system to ensure that it is appropriate and effective, and also serves as a precautionary measure to ensure that the bank complies with existing legal requirements. An anti-money laundering officer and a deputy have been appointed to combat money laundering and the financing of terrorism and to prevent other criminal offences. The securities compliance officer monitors the bank's compliance with the legal requirements under the German Securities Trading Act (WpHG) relevant to LfA on the basis of its business activities; in particular, this involves monitoring compliance with the prohibition on insider trading, monitoring employee transactions and ensuring that the bank satisfies the WpHG reporting obligations. The compliance function (MaRisk), which is a mandatory requirement as part of proper business organisation, is the responsibility of the compliance officer (MaRisk). The objective is to counter risks that could arise from non-compliance with statutory, regulatory or voluntary internal requirements and to work towards avoiding gaps in requirements and implementation omissions. The data protection officer monitors compliance with data protection requirements. All officers are answerable directly to the Management Board for their respective areas of responsibility and therefore report directly to the Management Board.

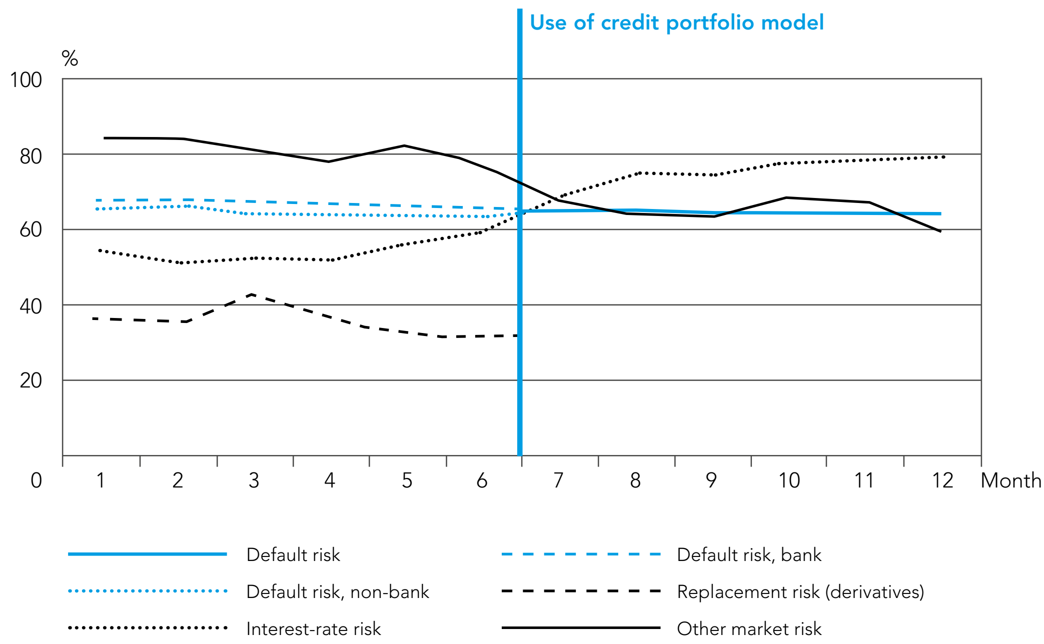
OVERALL RISK POSITION

LfA's *overall risk position* continues to be positive.

The following table shows the overall risk ceilings specified by the Management Board for the main types of risk, together with the quantification of the risk and the utilisation of the limits as at 31 December 2014:

31 December 2014	**Limit** EUR million	**Amount used** EUR million	**Util. rate**
Credit risk	1,200.0	801.1	66.8 %
Interest-rate risk	150.0	118.6	79.1 %
Market risk	40.0	23.7	59.3 %
Operational risk	30.0	23.7	79.0 %
Risk ceiling (limit)	1,420.0	967.1	68.1 %

The following chart shows the change in the utilisation of limits (in per cent) for the main types of risk over the course of the year:



On 30 June 2014, a credit portfolio model for determining the credit risk was put into live operation; from this date, limits that had previously been disclosed separately (banks, non-banks, replacement risk (derivatives) and currency risk) were aggregated under „default risk“.

The increase in the limit-utilisation under interest-rate risk was largely the result of further flattening in yield curves over the course of the year.

The calculation for operational risk is carried out once a year. As this value is therefore constant over the year, this type of risk is not included in the chart.

Over the course of 2014, all risk exposures fluctuated within their respective limits.

Alongside the long-term liquidation approach, a short-term earnings-based model (going concern approach) is used to monitor the bank's ***compliance with its risk-bearing capacity*** at all times.

The bank ensured that its full risk-bearing capacity was in place at all times. It has initiated appropriate action plans to address possible future challenges and the tighter capital requirements resulting from Basel III.

LfA is complying with the regulatory requirements under CRD IV/CRR with a Common Equity Tier 1 (CET1) ratio of 20.9.

Opportunities

LfA takes on risk to a clearly defined extent, limited by general parameters derived from its mandate as a special bank for regional economic development and from the defined business and risk strategies. Opportunities for unexpected developments or events that could lead to a positive outcome and variance from targets are therefore also only available to a very limited degree. Generally speaking, forecast opportunities associated with future business developments emerging from the business model are included in the annual strategic planning process.

For example, LfA sees potential opportunities in an improvement in the ratings for exposures, which would lead overall to the recognition of a lower level of ratings-based potential credit risk cover.

As the collaboration with the European Investment Fund (EIF) is stepped up, this is expanding the activities aimed at generating more growth in the Bavarian economy: LfA is placing a total of EUR 75.0 million in an EIF umbrella fund to make more venture capital available for start-ups; it is also continuing to build a default guarantee into its development loans. With these two initiatives, the EIF and LfA intend to mobilise capital investment of EUR 525 million.

The objective of asset/liability management is to generate a fixed interest and fee and commission margin. Opportunities in the investment portfolio are therefore limited. The greatest opportunities for profits are therefore in the differing trends in realised cost rates on the assets and liabilities sides and not in additional gains on open interest-rate positions. As a consequence, opportunities for achieving additional income from market risk exposures are not a priority.

LfA continues to enjoy high demand from investors because of its status. This is reflected in a favourable funding environment for the bank. The bank sees additional opportunities in the coverage of short-term liquidity requirements. This funding can be obtained from different money market segments, depending on the financial markets. It is therefore possible to obtain a very favourable supply of liquidity; in some cases, this could even generate income because of negative interest rates.

There are some potential opportunities from strengthening sales at all levels. An important lever for effectiveness in this regard is ongoing optimisation of the lending process chain to ensure that standardized business transactions are processed as efficiently as possible. From a business management perspective, continuous improvement and streamlining in the processing of transactions with commercial banks can have a beneficial impact on unit costs for both partners. From a sales perspective, it enhances the appeal of products and services, which can ultimately help to create a broader demand base. One of the components that the bank is planning to implement in the medium term in this regard is the development of a web-based system for the submission and processing of applications.

LfA supports the development of the Free State of Bavaria by pursuing its development mandate systematically and on a sustainable basis in a wide variety of ways. Based on optimisation of the range of development products and services offered, particularly in view of the structural policy challenges such as the switch to renewable sources of energy, LfA believes there is further potential for continuing to expand its development mandate in line with future requirements. This is what LfA Förderbank Bayern stands for; this is what „working for Bavaria" means.

Munich, 24 March 2015

LfA Förderbank Bayern
The Management Board

Dr. Beierl | Dr. Claussen | Göttler | Stolle

Figures in the tables and charts are rounded and this may give rise to discrepancies of +/- one unit (euro, per cent, etc.).

1.2 Balance sheet of LfA Förderbank Bayern, Munich, as at 31 December 2014

Assets	2014			As at 31 December 2013		
	EUR	EUR	EUR	EUR	EUR	EUR
1. Cash reserve						
a) Cash on hand		10,637.08			11,183.75	
b) Balances at central banks		19,403,587.92			21,075,242.18	
of which: at Deutsche Bundesbank EUR 19,403,587.92 (31 Dec. 2013: EUR 21,075,242.18)						
c) Post office bank balances		0.00	19,414,225.00		0.00	21,086,425.93
2. Public-sector debt instruments and bills eligible as collateral for central bank funding						
a) Treasury bills, non-interest-bearing treasury notes and similar public-sector debt instruments		0.00			0.00	
of which: eligible as collateral at Deutsche Bundesbank EUR 0.00 (31 Dec. 2013: EUR 0.00)						
b) Bills of exchange		0.00	0.00		0.00	0.00
3. Loans and advances to banks						
a) Repayable on demand		9,883,087.79			19,334,563.69	
b) Other loans and advances		14,608,719,334.50	14,618,602,422.29		14,824,150,993.47	14,843,485,557.16
4. Loans and advances to customers			2,022,137,872.03			1,930,630,485.50
of which: secured by mortgages EUR 4,812,441.07 (31 Dec. 2013: EUR 5,485,328.19)						
of which: local authority loans EUR 1,037,660,290.05 (31 Dec. 2013: EUR 965,177,656.93)						
5. Bonds and other fixed-income securities						
a) Money market instruments						
aa) issued by the public sector	0.00			0.00		
of which: eligible as collateral at Deutsche Bundesbank EUR 0.00 (31 Dec. 2013: EUR 0.00)						
ab) issued by others	0.00	0.00		0.00	0.00	
of which: eligible as collateral at Deutsche Bundesbank EUR 0.00 (31 Dec. 2013: EUR 0.00)						
b) Bonds						
ba) issued by the public sector	726,856,631.23			603,890,606.34		
of which: eligible as collateral at Deutsche Bundesbank EUR 726,856,631.23 (31 Dec. 2013: EUR 603,890,606.34)						
bb) issued by others	4,099,754,826.41	4,826,611,457.64		4,132,740,338.97	4,736,630,945.31	
of which: eligible as collateral at Deutsche Bundesbank EUR 4,015,730,429.83 (31 Dec. 2013: EUR 4,048,982,112.79)						
c) Own bonds		3,766,154.75	4,830,377,612.39		3,668,400.52	4,740,299,345.83
Nominal amount: EUR 3,643,000.00 (31 Dec. 2013: EUR 3,544,000.00)						
		CARRIED FORWARD:	**21,490,532,131.71**		**CARRIED FORWARD:**	**21,535,501,814.42**

1.2 Balance sheet of LfA Förderbank Bayern, Munich, as at 31 December 2014

Assets	2014 EUR	2014 EUR	2014 EUR	As at 31 December 2013 EUR	As at 31 December 2013 EUR	As at 31 December 2013 EUR
			Carried forward: 21,490,532,131.71			Carried forward: 21,535,501,814.42
6. Equities and other variable-yield securities			3.00			3.00
6a. Trading assets			0.00			0.00
7. Long-term equity investments			47,195,131.10			45,671,420.90
of which: in banks EUR 72,850.00 (31 Dec. 2013: EUR 72,850.00) in financial services institutions EUR 0.00 (31 Dec. 2013: EUR 0.00)						
8. Shares in affiliated companies			71,991,459.20			69,551,578.03
of which: in banks EUR 0.00 (31 Dec. 2013: EUR 0.00) in financial services institutions EUR 0.00 (31 Dec. 2013: EUR 0.00)						
9. Trust assets			243,591,597.93			248,822,451.40
of which: trust loans EUR 243,591,597.93 (31 Dec. 2013: EUR 248,822,451.40)						
10. Intangible assets						
a) Internally generated industrial and similar rights and assets		0.00			0.00	
b) Purchased concessions, industrial and similar rights and assets, including licences in such rights and assets		662,056.56			814,151.90	
c) Goodwill		0.00			0.00	
d) Prepayments		23,758,727.35	24,420,783.91		22,224,285.82	23,038,437.72
11. Property and equipment			45,303,619.22			46,917,160.63
12. Unpaid contributions called up			0.00			0.00
13. Other assets			12,017,846.95			20,875,161.57
14. Prepaid expenses			203,022,504.29			154,495,881.83
TOTAL ASSETS			**22,138,075,077.31**			**22,144,873,909.50**

1.2 Balance sheet of LfA Förderbank Bayern, Munich, as at 31 December 2014

Equity and liabilities	2014 EUR	2014 EUR	2014 EUR	As at 31 December 2013 EUR	As at 31 December 2013 EUR	As at 31 December 2013 EUR
1. Liabilities to banks						
a) Repayable on demand		173,557,442.80			153,496,001.26	
b) With agreed term or period of notice		8,792,012,266.47	8,965,569,709.27		8,971,064,823.24	9,124,560,824.50
2. Liabilities to customers						
a) Savings liabilities		0.00			0.00	
b) Other liabilities						
ba) Repayable on demand	143,985,008.34			184,943,442.05		
bb) With agreed term or period of notice	2,814,649,277.94	2,958,634,286.28	2,958,634,286.28	2,976,894,540.18	3,161,837,982.23	3,161,837,982.23
3. Debt instruments						
a) Bonds issued		7,982,724,735.40			7,713,312,497.34	
b) Other debt instruments		0.00	7,982,724,735.40		0.00	7,713,312,497.34
of which: money market instruments EUR 0.00 (31 Dec. 2013: EUR 0.00) own acceptances and promissory notes outstanding EUR 0.00 (31 Dec. 2013: EUR 0.00)						
3a. Trading liabilities			0.00			0.00
4. Trust liabilities			243,591,597.93			248,822,451.40
of which: trust loans EUR 243,591,597.93 (31 Dec. 2013: EUR 248,822,451.40)						
5. Other liabilities			11,243,830.59			11,438,468.83
6. Deferred income			246,408,666.28			229,913,678.73
7. Provisions						
a) Provisions for pensions and similar obligations		22,424,358.00			20,660,779.00	
b) Tax provisions		0.00			0.00	
c) Other provisions		143,507,529.61	165,931,887.61		155,301,842.94	175,962,621.94
8. Subordinated liabilities			100,523,315.07			100,523,315.07
			CARRIED FORWARD: 20,674,628,028.43			**CARRIED FORWARD: 20,766,371,840.04**

1.2 Balance sheet of LfA Förderbank Bayern, Munich, as at 31 December 2014

Equity and liabilities (continued)	2014 EUR	2014 EUR	2014 EUR	As at 31 December 2013 EUR	As at 31 December 2013 EUR	As at 31 December 2013 EUR
			Carried forward: 20,674,628,028.43			Carried forward: 20,766,371,840.04
9. Fund for general banking risks			400,000,000.00			330,000,000.00
10. Equity						
a) Capital called up						
Subscribed capital	368,130,154.46			368,130,154.46		
minus unpaid contributions not yet called up	0.00	368,130,154.46		0.00	368,130,154.46	
b) Capital reserves		42,948,518.02			42,948,518.02	
c) Revenue reserves						
ca) Legal reserve	307,700,000.00			292,800,000.00		
cb) Reserve for shares in a controlling company or company holding a majority interest	0.00			0.00		
cc) Reserves provided for by the statutes	0.00			0.00		
cd) Other revenue reserves	285,181,631.55	592,881,631.55		285,181,631.55	577,981,631.55	
d) Net retained profit		59,486,744.85	1,063,447,048.88		59,441,765.43	1,048,502,069.46
TOTAL EQUITY AND LIABILITIES			**22,138,075,077.31**			**22,144,873,909.50**

1. Contingent liabilities						
a) Contingent liabilities from forwarded, negotiated bills of exchange	0.00			0.00		
b) Liabilities from specific guarantees and indemnity agreements	1,205,829,198.02			1,296,412,600.09		
c) Liabilities from assets pledged as collateral for third-party obligations	0.00	1,205,829,198.02		0.00	1,296,412,600.09	
2. Other commitments						
a) Repurchasing obligations under non-genuine repos	0.00			0.00		
b) Placement and underwriting commitments	0.00			0.00		
c) Irrevocable loan commitments	876,156,390.31	876,156,390.31		971,970,773.77	971,970,773.77	

1.3 Income statement of LfA Förderbank Bayern, Munich, for the period 01/01/2014 to 31/12/2014

	2014			2013		
	EUR	EUR	EUR	EUR	EUR	EUR
1. Interest income from						
a) loans and money market transactions	426,090,398.27			477,132,278.94		
b) fixed-income securities and book-entry securities	147,554,946.26	573,645,344.53		156,485,889.23	633,618,168.17	
of which: from discounting provisions EUR 5,053,497.26 (2013: EUR 6,239,942.58)						
2. Interest expenses		-430,965,106.04	142,680,238.49		-504,949,461.25	128,668,706.92
of which: from unwinding the discount on provisions EUR 6,350,222.08 (2013: EUR 8,022,742.93)						
3. Current income from						
a) equities and other variable-yield securities		0.00			0.00	
b) long-term equity investments		509,744.50			377,318.62	
c) shares in affiliated companies		7,271.25	517,015.75		0.00	377,318.62
4. Income from profit pooling, profit transfer or partial profit transfer agreements			0.00			0.00
5. Fee and commission income		18,448,327.01			18,724,470.11	
6. Fee and commission expenses		-1,063,878.48	17,384,448.53		-1,153,548.07	17,570,922.04
7. Net gains or losses on trading activities			0.00			0.00
8. Other operating income			4,141,020.49			4,586,241.40
of which: from discounting provisions EUR 2,860.91 (2013: EUR 4,297.56)						
9. General and administrative expenses						
a) Personnel expenses						
aa) Wages and salaries	-20,049,191.62			-18,809,823.25		
ab) Social security, post-employment and other employee benefit costs	-7,928,053.13	-27,977,244.75		-7,599,760.27	-26,409,583.52	
of which: in respect of retirement pensions EUR 4,191,293.83 (2013: EUR 4,135,798.64)						
b) Other administrative expenses		-16,982,572.64	-44,959,817.39		-13,821,571.74	-40,231,155.26
			CARRIED FORWARD: 119,762,905.87			**CARRIED FORWARD: 110,972,033.72**

1.3 Income statement of LfA Förderbank Bayern, Munich, for the period 01/01/2014 to 31/12/2014

(continued)	2014 EUR	2014 EUR	2014 EUR	2013 EUR	2013 EUR	2013 EUR
			Carried forward: 119,762,905.87			Carried forward: 110,972,033.72
10. Amortisation and write-downs of intangible assets and depreciation and write-downs of property and equipment			-3,141,110.29			-3,338,049.60
11. Other operating expenses			-3,678,768.22			-4,000,512.79
of which: from unwinding the discount on provisions EUR 1,374,193.50 (2013: EUR 1,341,274.85)						
12. Write-downs and allowances for losses on loans and advances and on specific securities, and additions to provisions in the lending business		0.00			0.00	
13. Income from the reversal of write-downs and allowances for losses on loans and advances and on specific securities and from the reversal of provisions in the lending business		16,398,752.61	16,398,752.61		23,889,857.40	23,889,857.40
14. Write-downs of long-term equity investments, shares in affiliated companies and of securities classified as fixed assets		0.00			0.00	
15. Income from the reversal of write-downs of long-term equity investments, shares in affiliated companies and of securities classified as fixed assets		0.00	0.00		1,830,310.05	1,830,310.05
16. Additions to the fund for general banking risks		-70,000,000.00			-70,000,000.00	
17. Reductions in the fund for general banking risks		0.00	-70,000,000.00		0.00	-70,000,000.00
18. Expenses from the transfer of losses			0.00			0.00
19. Result from ordinary activities			59,341,779.97			59,353,638.78
20. Extraordinary income		0.00			0.00	
21. Extraordinary expense		0.00			0.00	
22. Extraordinary result		0.00	0.00		0.00	0.00
			CARRIED FORWARD: 59,341,779.97			CARRIED FORWARD: 59,353,638.78

1.3 Income statement of LfA Förderbank Bayern, Munich, for the period 01/01/2014 to 31/12/2014

(continued)	2014			2013		
	EUR	EUR	EUR	EUR	EUR	EUR
			Carried forward: 59,341,779.97			Carried forward: 59,353,638.78
23. Income taxes		0.00			0.00	
24. Other taxes not reported under item 11		-96,800.55	-96,800.55		-97,070.16	-97,070.16
25. Income from transfer of losses			0.00			0.00
26. Profits transferred under profit pooling, profit transfer agreement or partial profit transfer agreement			0.00			0.00
27. Net income for the year			59,244,979.42			59,256,568.62
28. Profit brought forward from 2013			241,765.43			185,196.81
			59,486,744.85			59,441,765.43
29. Reductions in capital reserves			0.00			0.00
			59,486,744.85			59,441,765.43
30. Reductions in revenue reserves						
a) In legal reserve		0.00			0.00	
b) In reserve for shares in a controlling company or company holding a majority interest		0.00			0.00	
c) In reserves provided for by the statutes		0.00			0.00	
d) In other revenue reserves		0.00	0.00		0.00	0.00
			59,486,744.85			59,441,765.43
31. Additions to revenue reserves						
a) To legal reserve		0.00			0.00	
b) To reserve for shares in a controlling company or company holding a majority interest		0.00			0.00	
c) To reserves provided for by the statutes		0.00			0.00	
d) To other revenue reserves		0.00	0.00		0.00	0.00
32. NET RETAINED PROFIT			**59,486,744.85**			**59,441,765.43**

1.4 Notes to the annual financial statements for the year ended 31 December 2014

A. Accounting policies

Assets and liabilities are recognised and measured in accordance with the provisions in section 246 et seq. German Commercial Code (HGB) and the special regulations for banks specified in section 340a et seq. HGB in conjunction with the German Regulation on the Accounts of Banks and Financial Services Institutions (RechKredV).

Loans and advances are carried at their principal amounts. Discounts and premiums are posted under prepaid expenses or deferred income and recognised in the income statement on a pro rata basis over the term of the loan or advance concerned. The measurement of loans and advances is dictated by prudent business practice and specific loan loss allowances in an appropriate amount are recognised for all identifiable credit risks. Portfolio loan loss allowances are recognised to cover latent credit risk. Loans and advances with below-market rates of interest are measured at present value.

Trust assets are measured at the amortised cost of the relevant loan or advance.

Securities in the liquidity reserve are measured strictly at the lower of cost and market. *Long-term securities* are measured at amortised cost, differences between the carrying amount and the repayment amount being recognised in the income statement on a pro rata basis over the maturity of the security concerned. Such securities are only written down to a lower fair value if they are permanently impaired.

Shares in affiliated companies and other *long-term equity investments* are reported at cost but are written down if the fair value is a lower amount.

Property and equipment is carried at cost and reduced by depreciation on a straight-line basis over the useful life determined for the asset concerned; *intangible assets* are carried at cost and reduced by amortisation on a straight-line basis over the useful life determined for the asset concerned. Low-value assets, i.e. assets with a cost value of no more than EUR 900.00, are written off in full in the year of acquisition. Capitalisable expenses incurred in connection with the switch to SAP have been recognised under intangible assets.

Liabilities are carried at the settlement amount. Any difference between the notional amount and settlement amount of a liability is recognised in the income statement on a pro rata basis over the maturity of the liability.

Provisions are recognised in an appropriate amount for all identifiable credit risks in relation to specific guarantees and issued exemptions from liability. Provisions are measured in the amount required to settle the obligation. The same also applies to the ‚Other provisions' item, which is used to recognise amounts covering other identifiable risks. Provisions with a residual maturity of more than one year are discounted using a maturity-matched average market discount rate over the past seven years in accordance with the requirements of section 253 (2) HGB and the German Provisions Discounting Rate Regulation (RückAbzinsV).

Effects from changes in the discount rate for provisions that relate to the lending business are recognised under net interest income. Effects from changes in the discount rate for other provisions are recognised in other net operating income.

The portfolio provision in relation to specific guarantees and issued exemptions from liability is determined as part of a group assessment based on an average default rate and an average residual maturity. This provision is discounted with an appropriate market discount rate.

Irrevocable loan commitments are also subject to the recognition of a portfolio loan loss allowance. This loan loss allowance is calculated in the same way as other portfolio loan loss allowances using an average default rate.

LfA has elected to make use of the implied HGB option not to discount provisions with a residual maturity of less than one year. For the purposes of the calculations it is assumed that changes in the amount of an obligation are only applied at the end of the calculation period; in other words, the amount of an obligation is not subject to any change during the course of the year.

Pension obligations are measured in accordance with recognised actuarial principles using the projected unit credit method. The Heubeck 2005 G mortality tables are used as the biometric basis for the calculations. The following assumptions are also used in the calculation of the pension obligations:

- Annual discount rate: 4.58 %
- Annual growth rate in entitlement (e.g. salary): 2.75 %
- Annual growth rate in pension: 2.50 %

The provision for widows'/widowers' pensions is calculated using the collective method, which is based on a probability of marriage derived from the other parameters used in the calculation. The contractual pension age is used as the age at which funding comes to an end.

A present-value approach is used for the ‚loss-free' measurement applicable to the interest-rate-related transactions in the *non-trading portfolio* (all interest-bearing items in which the bank is involved). The present value for the transactions is determined by discounting the overall bank cash flows using maturity-matched discount rates. Risk and administrative costs in connection with these interest-rate-related transactions are factored into the calculation. In 2014, there was no excess liability, so there was no requirement to recognise a provision for an anticipated loss in accordance with section 340a HGB in conjunction with section 249 (1) sentence 1 no. 2 HGB.

Off-balance-sheet derivatives entered into by the bank to hedge interest-rate and currency risks arising in connection with individual balance sheet items are combined with the associated underlying transactions as economic hedges. The bank does not form valuation units for hedge accounting purposes.

LfA is exempt from the payment of corporation tax and trade tax. As a consequence, there is no requirement to determine or recognise *deferred taxes*.

Given the minor significance of the other entities in the group in terms of their financial circumstances, the bank elects not to prepare *consolidated financial statements* as permitted by section 290 (5) HGB.

B. Balance sheet disclosures
(Figures as at 31 December 2013 in parentheses)

	Maturity structure					
Maturity structure for selected balance sheet items (excluding pro rata interest) – EUR million –	**Up to 3 months**	**More than 3 months up to 1 year**	**Due in the following year**	**More than 1 year up to 5 years**	**More than 5 years**	**Indefinite**
Loans and advances to banks						
- Other loans and advances	**401.8** (480.0)	**2,011.5** (1,855.1)		**7,844.8** (8,405.2)	**4,267.1** (3,990.3)	
Loans and advances to customers	**25.9** (15.5)	**111.8** (177.1)		**904.4** (850.5)	**952.3** (858.8)	**5.6** (5.5)
Bonds held			**529.9** (587.1)			
Liabilities to banks						
- With agreed term or period of notice	**266.1** (280.4)	**977.5** (1,093.6)		**3,846.9** (4,109.9)	**3,650.8** (3,421.1)	
Liabilities to customers						
- Savings liabilities	**0.0** (0.0)	**0.0** (0.0)		**0.0** (0.0)	**0.0** (0.0)	
- Other liabilities with agreed term or period of notice	**302.8** (297.3)	**161.5** (152.5)		**1,136.0** (1,129.2)	**1,311.9** (1,533.6)	
Debt instruments						
- Bonds issued			**1,806.2** (1,705.0)			
- Other debt instruments	**0.0** (0.0)	**0.0** (0.0)		**0.0** (0.0)	**0.0** (0.0)	

Loans and advances and liabilities to affiliated companies and other long-term investees and investors	**Affiliated companies** EUR million	**Other long-term investees and investors** EUR million
Loans and advances to banks	**0.0** (0.0)	**1.8** (1.9)
Loans and advances to customers	**102.9** (104.8)	**86.0** (88.5)
Bonds and other fixed-income securities	**0.0** (0.0)	**0.0** (0.0)
Liabilities to banks	**0.0** (0.0)	**0.0** (0.0)
Liabilities to customers	**50.5** (63.7)	**0.6** (0.8)
Debt instruments	**0.0** (0.0)	**2.3** (2.3)

Subordinated assets	EUR million
Loans and advances to banks	**0.0** (1.5)
Loans and advances to customers	**4.1** (4.1)
Bonds and other fixed-income securities	**7.1** (6.9)

Marketable securities and shares

The asset items „Bonds and other fixed-income securities" and „Equities and other variable-yield securities" consist exclusively of marketable securities, of which securities with a value of EUR 7.1 million (carrying amount) are not listed on a stock exchange.

Changes in fixed assets

Financial assets EUR million	As at 31 Dec. 2013	Change in 2014	Carrying amount 31 Dec. 2014
Securities classified as fixed assets	3,051.5	393.2	3,444.7
Long-term equity investments	45.7	1.5	47.2
Shares in affiliated companies	69.6	2.4	72.0

Please refer to section A for information on the valuation of long-term securities.

Securities classified as fixed assets include bearer securities with a carrying amount of EUR 29.11 million, but for which the fair value was EUR 29.05 million. Short-term fluctuations in fair value caused by changes in market prices are not recognised because it is intended to hold the securities to maturity and because the issuers are all banks or prestigious industrial concerns with investment-grade ratings or are public-sector issuers. Write-downs to a fair value below the repayment amount were therefore not required. The increase in the value of the portfolio of long-term securities was attributable exclusively to new business.

	Cost	Additions 2014	Disposals 2014	Reclassi-fications 2014	Reversals of write-downs 2014	Amortisation and write-downs			Carrying amount 31 Dec. 2014	Carrying amount 31 Dec. 2013
						Prior years	2014	Total		
Intangible assets	27.4	1.9	-0.4	0.0	0.0	4.0	0.5	4.5	24.4	23.0

	Cost	Additions 2014	Disposals 2014	Reclassi-fications 2014	Reversals of write-downs 2014	Depreciation and write-downs			Carrying amount 31 Dec. 2014	Carrying amount 31 Dec. 2013
						Prior years	2014	Total		
Property and equipment	85.5	1.0	-1.0	0.0	0.0	37.6	2.6	40.2	45.3	46.9

Of the total for property and equipment, EUR 2.1 million relates to office furniture and equipment and EUR 25.3 million to land and buildings used by the bank for its own operating activities.

Shareholdings

List of entities in which LfA Förderbank Bayern holds an interest of 20 per cent or more and all LfA's long-term equity investments in major corporations that represent a holding of more than 5 per cent of the voting rights. The disclosures for equity and net income relate to the last financial year for which annual financial statements are available (section 285 no. 11 HGB).

Name and registered office of the company	Equity EUR million	Direct and indirect shareholding %	Net income EUR million
Affiliated companies – direct investments			
1. LfA Gesellschaft für Vermögensverwaltung mbH (LfA GV), Munich	77.4	100.00	- 5.9
2. Bayern Innovativ Bayer. Gesellschaft für Innovation und Wissenstransfer mbH, Nuremberg	0.5	100.00	- 0.2
3. Bayern Kapital GmbH, Landshut	72.7	100.00	+ 0.4
4. Technologie Beteiligungsfonds Bayern GmbH & Co. KG, Landshut	2.1	69.53	+ 0.3
5. Technologie Beteiligungsfonds Bayern Verwaltungs GmbH, Landshut	0.04	75.00	1)
6. Technologie Seed-Beteiligungsfonds Bayern GmbH & Co. KG, Landshut	8.0	88.82	- 0.7
7. Technologie Beteiligungsfonds Bayern II GmbH & Co. KG, Landshut	6.9	50.48	- 1.4
8. Technologie Beteiligungsfonds Bayern III GmbH & Co. KG, Landshut	4.7	100.00	- 1.0
9. Clusterfonds Bayern Verwaltungs GmbH, Landshut	0.03	100.00	1)
10. Clusterfonds Start-Up! GmbH & Co. KG, Landshut	5.1	100.00	- 0.8
11. Clusterfonds Innovation GmbH & Co. KG, Landshut	20.5	100.00	- 3.1
12. Clusterfonds EFRE Bayern GmbH & Co. KG, Landshut	7.5	100.00	- 0.4
13. Clusterfonds Seed GmbH & Co. KG, Landshut	5.5	100.00	- 0.4
14. Bayerische Filmhallen GmbH, Grünwald	- 1.4 *)	100.00	- 0.3

Name and registered office of the company	Equity EUR million	Direct and indirect shareholding %	Net income EUR million
Other long-term equity investments – direct investments			
15. BGG-Bayerische Garantiegesellschaft mbH für mittelständische Beteiligungen, Munich	42.1	18.73	+ 1.6
16. Kreditgarantiegemeinschaft des Hotel- und Gaststättengewerbes in Bayern GmbH, Munich	4.3	21.44	0.0
17. BayBG Bayerische Beteiligungsgesellschaft mbH, Munich	193.6	23.48	+ 7.4
18. Garchinger Technologie- und Gründerzentrum GmbH, Garching	0.06	20.00	1)
19. Automobiltechnikum Bayern GmbH, Hof	1.2	40.00	+ 0.2
20. EPS Ethylen-Pipeline-Süd Geschäftsführungs GmbH (EPS-GmbH), Munich	0.03	25.20	2)
21. ForTISS GmbH, Garching	0.9	33.33	+ 0.7
Other long-term equity investments – indirect investments through LfA-GV			
22. Bavaria Film GmbH, Munich	63.3	16.67	+ 4.6

1) Profit was less than EUR 100,000.00
2) Loss was less than EUR 100,000.00
*) Loss not covered by equity

The company numbered 15 in the list is a bank as defined by section 1 (1) sentence 2 no. 8 German Banking Act (KWG).

Trust assets and trust liabilities

The reported trust assets of EUR 243.6 million are accounted for entirely by loans and advances to customers.

The trust liabilities of EUR 243.6 million are due entirely to customers.

Prepaid expenses and deferred income

The prepaid expenses include discounts (section 250 (3) HGB) of EUR 38.3 million (31 December 2013: EUR 46.8 million) and premiums (section 340e (2) HGB) of EUR 162.9 million (31 December 2013: EUR 105.9 million).

Of the total deferred income, EUR 26.2 million (31 December 2013: EUR 42.7 million) is accounted for by discounts (section 340e (2) HGB) and EUR 75.3 million (31 December 2013: EUR 43.6 million) by premiums.

Subordinated liabilities

The subordinated liabilities comprise three promissory note loans with the following contractually agreed terms:

	EUR million	Interest rate	Maturity
Funds raised	25	3.95 %	10 Nov.16
Funds raised	25	3.98 %	14 Nov.16
Funds raised	50	4.00 %	14 Nov.16
+ pro rata interest	0.5		
	100.5		

In the event of insolvency or liquidation of the bank, these liabilities will only be settled after all amounts due to non-subordinated creditors have first been paid. It is not possible for an early repayment obligation to arise at the request of the creditor. There are no plans to convert this debt into equity or any other form of debt.

Interest expenses amounting to EUR 2.1 million were incurred in 2014 in respect of subordinated liabilities.

Equity, revenue reserves

The other revenue reserves reported on the balance sheet are „other reserves“ as defined by section 18 no. 2 LfA Act.

Assets and liabilities denominated in foreign currency

As at 31 December 2014, there were no assets, liabilities or guarantee obligations denominated in foreign currency.

Other assets

Other assets include net interest receivables from swap transactions amounting to EUR 8.1 million.

Other liabilities

This item includes liabilities of EUR 10.3 million due to a guarantee fund of the Free State of Bavaria related to loans as part of the SME lending programme.

Assets transferred as collateral

In connection with liabilities of EUR 62.3 million to banks (with an agreed maturity or notice period), LfA has transferred assets with the same value to these banks as collateral.

Genuine sale and repurchase agreements (repos)

As at the balance sheet date, the bank had not entered into any repos.

Contingent liabilities, other obligations

The reported liabilities in connection with specific guarantees and indemnification agreements predominantly relate to the assumption of specific guarantees as part of LfA's various specific guarantee programmes and exemptions from liability given to commercial banks, in respect of which an amount of EUR 686.2 million is already included in the loans and advances to banks. In accordance with the requirements specified by MaRisk, the bank processes its guarantee obligations in the same way as loans. These obligations are subject to continuous credit rating checks. For risk management purposes, the risk of a call under the guarantees is estimated on the basis of the average default rate. Of the exposures of EUR 250 thousand or more classified using an internal rating system, 29.5 per cent of the volume falls in the top investment-grade category. At the lower end of the rating scale, 4.8 per cent of the guarantee volume meets the criteria for intensive support.

The reported irrevocable loan commitments largely relate to as yet undrawn loans under LfA's various lending programmes; the figure includes an amount of EUR 67.0 million relating to open guarantee commitments. For reasons related to credit quality, a portfolio loan loss allowance of EUR 4.8 million has been recognised in respect of the irrevocable loan commitments.

Derivative transactions

Volume of derivative transactions – EUR million –	Notional amounts 31 Dec. 2014	 31 Dec. 2013	Fair values Positive 31 Dec. 2014	 Negative 31 Dec. 2014
Interest-rate risks				
Interest-rate swaps	458	718	45	-1
Caps, floors	0	0	0	0
Total	**458**	**718**	**45**	**-1**
Currency risks				
Currency swaps	0	0	0	0
Interest-rate/currency swaps	0	0	0	0
Currency forward contracts	0	0	0	0
Total	**0**	**0**	**0**	**0**

Derivative transactions - Maturity structure -

Notional amounts – EUR million –	Interest-rate risks 31 Dec. 2014	 31 Dec. 2013	Currency risks 31 Dec. 2014	 31 Dec. 2013
Residual maturity				
- up to 3 months	0	35	0	0
- 3 months to 1 year	125	225	0	0
- up to 5 years	297	347	0	0
- over 5 years	36	111	0	0
Total	**458**	**718**	**0**	**0**

LfA is not involved in any forward contracts with currency or other price risks. The transactions are exclusively derivatives that are not recognised at fair value on the balance sheet.

These derivatives comprise solely over-the-counter (OTC) transactions. Generally, their purpose is to serve as an economic hedge to minimise the risk associated with an underlying transaction reported on the balance sheet or to achieve the desired interest-rate structure. However, the bank does not form valuation units for hedge accounting purposes.

All the contracts are with banks based in OECD member countries.

Contracts are measured using the mark-to-market method. The fair value of the derivatives is based on market data as at 30 December 2014. As at the balance sheet date, the portfolio only consisted of interest-rate swaps, which were measured using the DCF method.

C. Income statement disclosures

Regional breakdown of income

Most of the interest income (79 per cent) was generated in the Federal Republic of Germany. The breakdown of the remaining interest income from countries other than Germany (21 per cent) was as follows: 18 per cent from EMU countries, 3 per cent from other European countries. There was no interest income from non-European countries in 2014.

Auditor fees

In 2014, the invoiced fees for auditing services related to financial statements pursuant to section 285 no. 17a HGB amounted to a net sum of EUR 268.5 thousand. This included an additional auditing expense of EUR 4.1 thousand related to 2013 for which insufficient provisions had been recognised. Expenses of EUR 10 thousand were incurred in respect of other attestation services as defined by section 285 no. 17b HGB.

D. Other disclosures

Employees	Average for the year		
	Male	Female	Total
Full-time:	145	102	247
Part-time:	13	91	104
	158	193	351

The average number of employees excluding those with temporary leave of absence was 322. This equates to 290 full-time equivalents (FTEs).

Disclosure pursuant to section 26a (1) sentence 2 KWG

LfA Förderbank Bayern, whose registered office is situated in Munich, has no branches located outside the Federal Republic of Germany that are involved in banking activities. LfA has not made use of any public sector aid available under EU state aid procedures. The other disclosures required by section 26a (1) sentence 2 KWG can be found directly in these annual financial statements.

Remuneration paid to the Management Board and the Advisory Board

Management Board remuneration (excl. retirement pension)	TEUR
Chief Executive Officer and Chairman of the Management Board	**306**
Deputy Chairman of the Management Board	**247**
Member of the Management Board	**216**

The value of additional benefits in kind received by the Management Board amounted to EUR 23 thousand; other benefits amounted to EUR 15 thousand. In 2014, a net addition of EUR 884 thousand was recognised under the pension provisions for active members of the Management Board.

As at 31 December 2014, the pension obligations to former members of the Management Board and their surviving dependants were recognised in full with a provision of EUR 13,130 thousand (following a net addition of EUR 448 thousand). Retirement pensions and payments to surviving dependants amounted to EUR 1,138 thousand in 2014.

The total remuneration paid to members of the Advisory Board amounted to EUR 61 thousand in 2014.

Loans and advances to members of the Management Board and Advisory Board

As at 31 December 2014, there were no loans or advances to members of the Management Board or Advisory Board.

LfA Advisory Board and Management Board

As a bank as defined by the German Banking Act (KWG), LfA Förderbank Bayern is subject to supervision by the German Federal Financial Supervisory Authority (BaFin).

Advisory Board

Full members	Deputy members
Ilse Aigner (Chair) State Minister Bavarian State Ministry of Economics and Media, Energy and Technology	**Franz Josef Pschierer** (Deputy Chairman) State Secretary Bavarian State Ministry of Economics and Media, Energy and Technology
Johannes Hintersberger State Secretary Bavarian State Ministry of Finance, State Development and Home Affairs	**Judith Steiner** Assistant Head of Department Bavarian State Ministry of Finance, State Development and Home Affairs (since 1 November 2014)
	Dr. Ulrich Klein Assistant Head of Department Bavarian State Ministry of Finance, State Development and Home Affairs (until 31 October 2014)
Emilia Müller State Minister Bavarian State Ministry for Labour, Social Affairs, Family and Integration	**Michael Höhenberger** Head of State Department Bavarian State Ministry for Labour, Social Affairs, Family and Integration
Peter Driessen General Manager Chamber of Industry and Commerce for Munich and Upper Bavaria	**Dr. Lothar Semper** General Manager Chamber of Skilled Trades for Munich and Upper Bavaria
Dieter Seehofer Chairman of the Management Board Sparkasse Ingolstadt	**Josef Bittscheidt** Chairman of the Management Board, Kreissparkasse München Starnberg Ebersberg (since 1 June 2014)
	Roland Schmautz Vice-President Sparkassenverband Bayern (until 30 April 2014)
Dr. Ulrich Schürenkrämer Member of the Management Committee Germany and Chairman of the Regional Management, Deutsche Bank AG (since 1 May 2014)	**Klaus Greger** Division Head GRM Group Intensive Care, Head of Frankfurt Office Commerzbank AG
Sandra Bindler Division Head Strategy & Business Development UniCredit Bank AG (until 30 April 2014)	

Guest members pursuant to section 12 (2) LfA Act	Deputy guest members
Konrad Irtel Spokesman of the Management Board VR Bank Rosenheim-Chiemsee eG	**Dr. Alexander Büchel** Member of the Management Board Genossenschaftsverband Bayern e.V.

Management Board

Dr. Otto Beierl Chief Executive Officer and Chairman of the Management Board	**Dr. Thies Claussen** Deputy Chairman of the Management Board
Albrecht Stolle Member of the Management Board	**Hans Peter Göttler** Member of the Management Board (since 1 January 2015)

To the best of our knowledge, and in accordance with the applicable reporting principles, the annual financial statements of LfA Förderbank Bayern give a true and fair view of the assets, liabilities, financial position, and profit or loss of the bank, and the management report of LfA Förderbank Bayern includes a 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 expected development of the bank.

Munich, 24 March 2015

LfA Förderbank Bayern
The Management Board

Dr. Beierl   Dr. Claussen   Göttler   Stolle

1.5 Cash flow statement, LfA Förderbank Bayern, Munich for the period 1 January 2014 to 31 December 2014

Classification item no.			Description	Amount as at 31 Dec. 2014 EUR	Amount as at 31 Dec. 2013 EUR
1.			**Net income for the period before extraordinary items** Non-cash items included in net income and reconciliation to cash flows from operating activities	**59,244,979.42**	**59,256,568.62**
	2.	+ / -	Allowances for losses on loans and advances, write-downs of financial assets, depreciation and write-downs of property and equipment, amortisation and write-downs of intangible assets, and reversals of such allowances and write-downs	-10,674,259.14	-35,562,052.50
	3.	+ / -	Increase/decrease in provisions	11,551,347.93	20,334,493.60
	4.	+ / -	Other non-cash income and expenses	65,127,412.76	69,330,131.00
	5.	+ / -	Gain/loss on disposal of financial assets and property and equipment	-22,403.18	-256,079.94
	6.	+ / -	Other adjustments (net)	-139,760,058.21	-138,130,097.93
7.		**=**	**Sub-total** Change in assets and liabilities from operating activities	**-14,532,980.42**	**-25,027,037.15**
	8.		Loans and advances		
	8a.	+ / -	- to banks	224,167,502.40	538,953,177.53
	8b.	+ / -	- to customers	-79,120,770.49	10,153,915.85
	9.	+ / -	Securities (not classified as long-term financial assets)	294,393,168.17	52,158,725.00
	10.	+ / -	Other assets from operating activities	-41,546,344.69	9,975,897.89
	11.		Liabilities		
	11a.	+ / -	- to banks	-143,724,638.97	-549,468,596.84
	11b.	+ / -	- to customers	-196,351,822.76	-38,256,810.12
	12.	+ / -	Debt instruments	275,819,000.00	53,546,000.00
	13.	+ / -	Other liabilities from operating activities	-10,509,390.38	-44,983,560.68
	14.	+	Interest and dividends received	515,300,980.39	563,226,865.16
	15.	-	Interest paid	-373,519,526.76	-422,904,753.94
	16.	+	Receipts from extraordinary items	0.00	0.00
	17.	-	Payments for extraordinary items	0.00	0.00
	18.	+ / -	Income tax payments	0.00	0.00
19.		**=**	**Cash flows from operating activities (operating result)**	**450,375,176.49**	**147,373,822.70**
	20.		Proceeds from disposal of		
	20a.	+	- long-term financial assets	178,894,583.57	367,846,585.51
	20b.	+	- property and equipment	52,244.16	115,659.07
	21.		Purchase of		
	21a.	-	- long-term financial assets	-581,640,207.44	-706,070,375.57
	21b.	-	- property and equipment	-1,023,432.41	-597,069.59
	22.	+	Receipts from disposal of consolidated subsidiaries and other business units	0.00	0.00
	23.	-	Purchase of consolidated subsidiaries and other business units	0.00	0.00
	24.	+ / -	Changes in cash from other investing activities (net)	-1,916,323.64	-12,984,186.85
25.		**=**	**Cash flows from investing activities**	**-405,633,135.76**	**-351,689,387.43**

Classification item no.			Description	Amount as at 31 Dec. 2014 EUR	Amount as at 31 Dec. 2013 EUR
	26.	+	Cash receipts from issue of capital (capital increases, additions to reserves, etc.)	0.00	0.00
	27.		Cash payments to owners and other capital providers		
	27a.	-	- Dividends	0.00	0.00
	27b.	-	- Other payments	-46,414,241.66	-46,399,983.34
	28.	+ / -	Changes in cash from other financing activities (net)	0.00	0.00
29.		**=**	**Cash flows from financing activities**	**-46,414,241.66**	**-46,399,983.34**
	30.		Net change in cash and cash equivalents (sum of 19, 25, 29)	-1,672,200.93	-250,715,548.07
	31.	+ / -	Effect on cash and cash equivalents of exchange rate movements, changes in reporting entity structure and re-measurement Reconciliation differences	0.00	0.00
32.		**+**	**Cash and cash equivalents at the start of the period**	**21,086,425.93**	**271,801,974.00**
33.		**=**	**Cash and cash equivalents at the end of the period**	**19,414,225.00**	**21,086,425.93**

Under section 264 (1) HGB, publicly listed corporations that are not under any obligation to prepare consolidated financial statements must include a cash flow statement with their annual financial statements.

The cash flow statement shows the changes in cash and cash equivalents during the financial year. For this purpose, three separate cash flow categories are reported: cash flows from operating activities, cash flows from investing activities and cash flows from financing activities. The indirect method is used to determine the cash flows from operating activities.

Cash and cash equivalents comprise the cash reserve balance sheet item, which in turn consists of cash on hand and the credit balance with Deutsche Bundesbank.

The „other adjustments" item mainly comprises reclassifications of items that are shown separately in the cash flow statement. These items largely relate to cash interest, fees and commission received and paid during the year.

The year-on-year increase in cash flows from operating activities (operating result) was attributable to both the decline in the volume of securities and the rise in the volume of debt instruments issued.

The change in cash flows from investing activities mainly arose from the increased volume of long-term securities.

The meaningfulness of the cash flow statement should be considered limited as far as LfA is concerned. The cash flow statement replaces neither liquidity nor financial planning, nor is it used as a management tool.

1.6 Statement of changes in equity, LfA Förderbank Bayern, 31 December 2012 to 31 December 2014

Statement of changes in equity (EUR)	Subscribed capital	Capital reserves	Revenue reserves		Net retained profit	Equity
			Legal reserve	Other revenue reserves		
As at 31 December 2012	**368,130,154.46**	**42,948,518.02**	**277,900,000.00**	**285,181,631.55**	**59,385,196.81**	**1,033,545,500.84**
Additions to revenue reserves from net retained profit 2012			14,900,000.00		-14,900,000.00	
Distribution from net retained profit 2012					-44,300,000.00	
Capital increases 2013	0.00					
Net income 2013					59,256,568.62	
As at 31 December 2013	**368,130,154.46**	**42,948,518.02**	**292,800,000.00**	**285,181,631.55**	**59,441,765.43**	**1,048,502,069.46**
Additions to revenue reserves from net retained profit 2013			14,900,000.00		-14,900,000.00	
Distribution from net retained profit 2013					-44,300,000.00	
Capital increases 2014	0.00					
Net income 2014					59,244,979.42	
As at 31 December 2014	**368,130,154.46**	**42,948,518.02**	**307,700,000.00**	**285,181,631.55**	**59,486,744.85**	**1,063,447,048.88**

1.7 Independent Auditors' Report

We have audited the annual financial statements – comprising the balance sheet, the income statement, the cash flow statement, the statement of changes in equity and the notes to the financial statements – together with the bookkeeping system, and the management report of LfA Förderbank Bayern rechtsfähige Anstalt des öffentlichen Rechts, Munich, for the business year from 1 January to 31 December 2014. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law and supplementary provisions of the LfA statute are the responsibility of the bank's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and on the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § 317 HGB („German Commercial Code") and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer. Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with German principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservation.

In our opinion, based on the findings of our audit, the annual financial statements of LfA Förderbank Bayern rechtsfähige Anstalt des öffentlichen Rechts, Munich, comply with the legal requirements and supplementary provisions of the LfA statute and give a true and fair view of the net assets, financial position and results of operations of the bank in accordance with German principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the bank's position and suitably presents the opportunities and risks of future development.

Munich, 25 March 2015

Deloitte & Touche GmbH
Wirtschaftsprüfungsgesellschaft

(Mayer)	(Müller)
German Public Auditor	German Public Auditor

2 Report of the Advisory Board

The Advisory Board decides on the policies governing the operating activities of the bank and monitors the management of the bank in accordance with the powers it has been assigned.

In 2014, the Advisory Board held seven meetings and conducted four procedures in writing during which it discussed and passed a large number of resolutions relating to reports presented in accordance with the statutes and submissions concerning lending. For example, it noted and approved the regular reports on intended business policy and corporate planning, risk strategy, main findings of audits conducted by the internal audit department, long-term equity investments, business performance, results of operations and the risk position. It also approved a range of larger lending exposures (in which the bank's own risk was more than EUR 5 million).

On 18 May 2015, the Advisory Board adopted the annual financial statements for the year ended 31 December 2014, approved the management report and formally approved the acts of the Management Board for 2014. Based on a proposal submitted by the Management Board, the Advisory Board passed the following resolution on the appropriation of the net retained profit:

„Of the net retained profit for 2014 amounting to EUR 59,486,744.85, EUR 14,900,000.00 shall be allocated to the legal reserve, EUR 44,300,000.00 shall be transferred to the Free State of Bavaria and EUR 286,744.85 shall be carried forward to the next financial year."

Munich, 18 May 2015

Chair of the Advisory Board
State Minister Ilse Aigner

3 Report for 2014 on LfA Förderbank Bayern's compliance

with its principles of good corporate governance

LfA Förderbank Bayern's principles of good corporate governance, documentation
LfA Förderbank Bayern has a number of objectives in documenting its principles of good corporate governance.

As the development bank for the Free State of Bavaria, LfA Förderbank Bayern has a special responsibility to the region and the people who live there. Conscious of this responsibility, the bank aims to create transparency and make sure that its practices in terms of corporate governance and monitoring are communicated outside its own organisation. Sustainability issues, such as the environment and corporate social responsibility, form a very important component of corporate governance.

The standards laid down by the act that established the Bavarian Landesanstalt für Aufbaufinanzierung (LfA Act) and by the LfA's statutes are reflected in LfA Förderbank Bayern's principles of good corporate governance.

Management and monitoring of LfA Förderbank Bayern by the Management Board and the Advisory Board
In 2014, the Management Board and the Advisory Board managed the bank in compliance with the principles of good corporate governance laid down by LfA Förderbank Bayern.

The Management Board agreed LfA Förderbank Bayern's corporate strategy with the Advisory Board within the framework of the mandate from the Free State of Bavaria. In addition, the Management Board managed the business of the bank independently in compliance with statutory requirements, stipulations in the bank statutes and internal policies, and – where specified in the LfA statutes – obtained the consent of the Advisory Board. The Management Board informed the Advisory Board of transactions that were of considerable importance for the results of operations or liquidity of the bank; the Chief Executive Officer also informed the Chair of the Advisory Board and the representative of the Bavarian State Ministry of Finance, State Development and Home Affairs of any special events, circumstances or incidents.

Remuneration and D&O insurance
The remuneration received by the members of the Management Board in 2014 did not include any variable components. The amount of the remuneration is published in the notes to the 2014 annual financial statements with a breakdown by the amounts paid to the Chief Executive Officer, Deputy Chairman of the Management Board and the other member of the Management Board.

LfA Förderbank Bayern has taken out a D&O insurance policy for the members of the Management Board. This policy includes an excess in the amount of 10 per cent of the loss subject to a maximum of one-and-a-half times the fixed annual remuneration of the member of the Management Board concerned.

The remuneration received by the members of the Advisory Board in 2014 did not include any variable components. The aggregate amount of remuneration paid to all the members of the Advisory Board is published in the notes to the 2014 annual financial statements.

For the members of the Advisory Board, LfA Förderbank Bayern has taken out a D&O insurance policy that does not include any excess. It was decided not to include an excess in this policy in view of the negligible amounts of allowances paid to the members for their activities in connection with the Advisory Board of LfA Förderbank Bayern.

Avoiding conflicts of interest

In fulfilling their duties, the members of the Management Board and the Advisory Board are particularly bound by the mandate from the Free State of Bavaria. In this regard, there were no conflicts of interest in 2014 affecting the members of the Management Board or the Advisory Board. The members of the Management Board and the Advisory Board have each declared that, in 2014, neither they nor any of their close family members were involved in any business relationship with LfA Förderbank Bayern or with any of its investee or investor entities.

Accounting and auditing of financial statements

The annual financial statements and management report for the year ended 31 December 2014 have been prepared in accordance with the requirements of the German Commercial Code (HGB). The Advisory Board has adopted the annual financial statements for the year ended 31 December 2014, approved the management report and formally approved the acts of the Management Board for 2014. The annual financial statements and management report for the year ended 31 December 2014 are published in the electronic version of the German Federal Gazette.

The independent auditors were appointed by the Advisory Board with the agreement of the Bavarian State Ministry of Finance, State Development and Home Affairs. Prior to the engagement, the designated auditors declared that there were no business, financial, personal or other relationships between the auditors, their decision-making bodies or audit managers on one side and LfA Förderbank Bayern or the members of the bank's decision-making bodies on the other side that could cast doubt on the independence of the auditors. The Chair of the Advisory Board issued the audit engagement. The audited annual financial statements, the management report and the audit report were submitted without delay to the Advisory Board and the Bavarian State Ministry of Finance, State Development and Home Affairs.

PUBLISHING DETAILS

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