



Deutsche Genossenschafts-Hypothekenbank AG
ANNUAL REPORT 2005



Member of the
Cooperative Financial Services Network



OVERVIEW

Business Development	2005	2004	2003	2002
	€ mn	€ mn	€ mn	€ mn
New business	16,157	15,363	11,704	8,206
– Real estate lending including: loan extensions	4,177	3,334	3,817	3,167
– Portfolio investment	1,767	965	932	780
– Public-sector lending* including: loan extensions	10,213	11,064	6,955	4,259
<i>Pfandbrief</i> sales and other refinancing sources	13,228	13,085	9,881	6,527
Balance Sheet	2005	2004	2003	2002
	€ mn	€ mn	€ mn	€ mn
Total assets	79,140	73,813	69,097	67,781
Real estate lending	24,790	24,809	24,779	25,163
MBS	3,396	2,216	1,865	1,530
Public-sector lending	41,833	39,379	37,584	37,791
Covered bonds (<i>Pfandbriefe</i>) and other debt securities	66,789	60,477	55,071	57,305
Liabile capital	2,197	1,977	1,953	1,854
Profit and Loss Account	2005	2004	2003	2002
	€ mn	€ mn	€ mn	€ mn
Gross profit	290	334	295	325
Administrative expenses	178	180	186	186
Risk provisioning/revaluation results	– 56	– 72	– 91	– 57
Operating profit	51	79	16	81
Profit transfer	–	18	18	30
Employees	2005	2004	2003	2002
	Number	Number	Number	Number
Annual average (full-time equivalent)	582	581	593	575
Vocational trainees	22	21	18	20

* Comprises originated loans to local authorities, plus securities and promissory note loans eligible as cover assets for public-sector covered securities

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Ladies and Gentlemen, dear business associates,

The ongoing consolidation process within the sector, as well as intense competition in real estate financing, continued to dominate the real estate banks during 2005. With the introduction of the new *Pfandbrief Act (Pfandbriefgesetz)*, German legislators have provided additional momentum for structural change, a move that we consider positive. The Act strengthens the German *Pfandbrief* as a top-quality capital market funding product for real estate and public sector lending. Additionally, the abolition of special bank privileges offers the former mortgage banks more flexibility to further develop their business.

One of DG HYP's key objectives in the 2005 financial year was to further enhance the bank's market position in real estate financing, and also in local authority lending. In the face of a persistently difficult real estate finance market, we therefore welcome our success in significantly increasing new business and loan extensions in residential real estate finance by 40.2 per cent, and in commercial real estate finance by 14.4 per cent, over the previous year. Due to the continued high level of local authority finance requirements, the aggregate volume of new business and loan extensions in local authority lending was up by as much as 54.4 per cent.

DG HYP is firmly enshrined in the German cooperative banking sector; the extensive presence of some 1,300 cooperative banks (*Volksbanken und Raiffeisenbanken*) throughout Germany, with more than 30 million customers, continues to represent the fundamental basis of our success. This applies above all to the retail and commercial real estate finance and local authority lending business brokered to DG HYP through partners in the German cooperative banking sector. We see this

as being a crucial factor to our success, offering us attractive business potential in a competitive marketplace.

We have established DG HYP in recent years as a modern real estate bank. Issuing *Pfandbriefe* is one part of a broad product range we employ in our funding mix: using structures such as MBS transactions and portfolio transfers, we access new investor groups – predominantly via the capital markets – to open up growth potential for lending business, whilst optimising our own loan portfolio. Furthermore, we increasingly leverage our in-depth knowledge of the capital market and the real estate sector in order to offer a range of real estate and portfolio management advisory services to third parties. This has allowed us to position DG HYP as an intermediary in structured real estate financing. In our view, this is another prerequisite for a modern real estate bank to gain a competitive advantage for the German cooperative banking sector in the business with real estate investors and local authorities.

Our objective is therefore to focus our future activities increasingly on innovative products, competitive prices, and a high quality of service in order to provide our partners within the cooperative banking sector, the real estate industry, and the public sector, with an attractive service range. As a modern real estate bank, we are fast becoming one of the most active and creative players in the sector.

The Management Board of DG HYP, Hamburg, April 2006

CONVERGENCE OF CREDIT AND CAPITAL MARKETS

The role of real estate banks as intermediaries and advisors, linking the capital markets and the real estate industry

The German market for real estate finance has been subject to fundamental change for some years now. The banks' real estate credit management operations are facing new challenges resulting from structural changes to the real estate markets, intensive competition between the banks and – not least – the changed regulatory environment brought about by the implementation of the Basel II accord. Against this background, the transfer of credit risks and credit portfolios – predominately via the capital markets – has meanwhile established itself as a key element of the portfolio management activities of real estate banks.

At the same time, Germany remains Europe's largest real estate market. The German real estate industry remains a key sector, and a source of economic growth, income and employment. As a more recent development, companies and public-sector authorities are increasingly disposing of significant real estate holdings, or are restructuring real estate portfolios – predominantly to reduce costs. At present, demand is driven mainly by US and Anglo-Saxon investors, who have recognised the potential of the German real estate market. The traditional real estate investment strategy, whereby investments were held for a long period of time, is becoming increasingly uncommon: real estate is becoming a mobile asset class, requiring active real estate portfolio management and structured financing solutions tailored to investors' specific needs.

The changed environment offers banks specialising in real estate and public finance the opportunity to provide new solutions for the German real estate industry, developing and providing innovative financial services. Against this backdrop, DG HYP had already realigned its strategic focus in recent years and established itself as a modern real estate bank. The new German *Pfandbrief Act (Pfandbriefgesetz)* that came into effect mid-2005 is an additional catalyst, offering the potential for targeted expansion of the service range offered by the former mortgage banks.

The key role of modern real estate banking is in fact threefold: to act as a financier, intermediary, and advisor – in order to explore as wide a range of financing sources as possible. In this way, real estate banks enable both the industry and the investors to fully exploit the vast potential of the German real estate market, at attractive terms.

Active management of real estate loan portfolios – from “buy-and-hold” to “buy-and-sell”

The risk structure of real estate finance in Germany has undergone fundamental change in recent years. Whilst the real estate markets were still defined by relatively continuous growth up to the mid 90s, both in terms of new construction and real estate prices, demographic development and a more pronounced economic differentiation of Germany into prosperous and structurally weak regions brought about fundamental change. In recent years, this development was accompanied by a sharp increase in insolvencies amongst private households and companies. Since then, the markets have undergone fundamental consolidation.

Additionally, the introduction of Basel II as of 2007 will require the banks to comply with new capital adequacy requirements for credit risks. This involves, above all, a greater orientation of the weighting of the risk assets relative to individual default risk. For banks, this has brought about new requirements, forcing them to actively manage risks and equity.

Like other banks, DG HYP has increasingly shifted its method of managing real estate finance exposure, from a pure “buy-and-hold” strategy, to a “buy-and-sell” approach. This means that loan exposures are no longer held in the bank's own books until maturity, but are placed with third parties via securitisation, or portfolio sales. The principal objective here is to optimise the risk/return profile of the loan portfolio, and hence the necessary capital adequacy requirements for credit risks, through targeted diversification achieved by buying and selling credit risks.

MBS link the credit and capital markets – dynamic growth of securitisation markets

Real estate loan portfolios are securitised in the form of residential mortgage backed securities (RMBS) and commercial mortgage backed securities (CMBS). Conceptually, this means that real estate financings are ‘repackaged’ into investment products that can be placed on the capital markets. Banks placing credit risks in the market in this manner gain relief in terms of their capital adequacy requirements, and hence additional scope for growth in the lending business. Securitisation is therefore an important capital market tool for mobilising investment capital on behalf of the real estate sector.

The European market for credit securitisation has already grown substantially in recent years, and provides the banks with a favourable environment in which to expand their portfolio management operations. Real estate finance asset classes account for a considerable share of the market. Transferring risks and portfolios via the capital markets has meanwhile become an integral part of real estate lending in Europe – both for the banks that are placing the risk, as well as for the capital market investors.

Securitisation platform for the German cooperative banking sector – innovation through multi-seller transactions

DG HYP actively used the market opportunities offered in this environment at an early stage. It launched a first RMBS pilot transaction in 2000 – the € 1 billion *Bauhaus Securities* deal. This was followed by an innovative platform for multi-seller RMBS transactions. Developed in conjunction with DZ BANK and KfW Banking Group, the platform is used to group DG HYP's real estate loan portfolios together with portfolios contributed by cooperative banks, then placed on the market by way of synthetic securitisation.

Residential real estate loans totalling € 1.5 billion were securitised in this form within the scope of a total of three *PROVIDE-VR* transactions. Furthermore, an innovative multi-seller CMBS transaction – *PROSCORE-VR 2005-1* – was issued in the 2005 financial year which, by virtue of the granularity and geographical diversification of the underlying portfolio, was a novelty on the German market for securitised transactions.

DG HYP, up until now, has securitised lending volume totalling € 3.3 billion. In this way, it has transferred credit risks onto the capital market, and provided access to the capital market for all institutions within the German cooperative banking sector. For them, tapping the market would not be feasible on a stand-alone basis. At the same time, DG HYP is optimising its own loan portfolio by investing in real estate finance portfolios on the international capital markets and as individually structured transactions.

Efficient data management central to the success of securitisation transactions

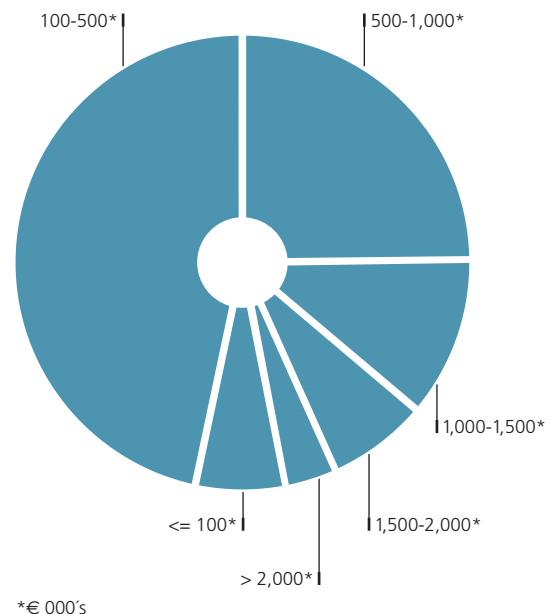
The structuring effort required to realise securitisation transactions is only the tip of the iceberg. One inconspicuous

FIRST CMBS OF THE GERMAN COOPERATIVE BANKING SECTOR COMPRISING SMALL-SIZED COMMERCIAL REAL ESTATE LOANS

Size categories (€ 000's)	Share (%)
<= 100	6.3
100 - 500	46.7
500 - 1,000	24.8
1,000 - 1,500	11.4
1,500 - 2,000	7.1
> 2,000	3.7
TOTAL	100.0

	Share in assets pool € mn	%
Cooperative banks**	45	6.2
Deutsche Genossenschafts-Hypothekenbank AG	690	93.8
TOTAL	735	100.0

** Volksbank Weinheim eG
 Volksbank Wetzlar-Weilburg eG
 Bremische Volksbank eG
 Vereinigte Volksbank AG
 Raiffeisenbank Oberschleißheim eG
 Vereinigte Volksbank
 Griesheim-Weiterstadt eG



ous critical success factor is efficient data management. Data management creates the basis for structuring credit risks with regard to the specification of tranches, and for rating and pricing – as well as for the continuous transaction reporting to rating agencies and investors. To ensure the eligibility of loans for securitisation, it is crucially important that all data is available in the bank's systems – for the initial processing of individual exposures through to ongoing credit processing. Being able to process an attractively priced transaction as quickly as possible requires the right systems to prepare and provide the requisite data. This can be quite a challenge, especially with securitisations involving a large number of small-sized individual loans.

The answer to this challenge is TXSuite ("TXS"), an innovative software solution developed by TXS Financial Products, in which DG HYP holds a stake, together with agens, an IT service provider. TXS offers all of the important functions required for the integrated management of complex securitisation transactions involving the most diverse asset classes: from database management, through port-

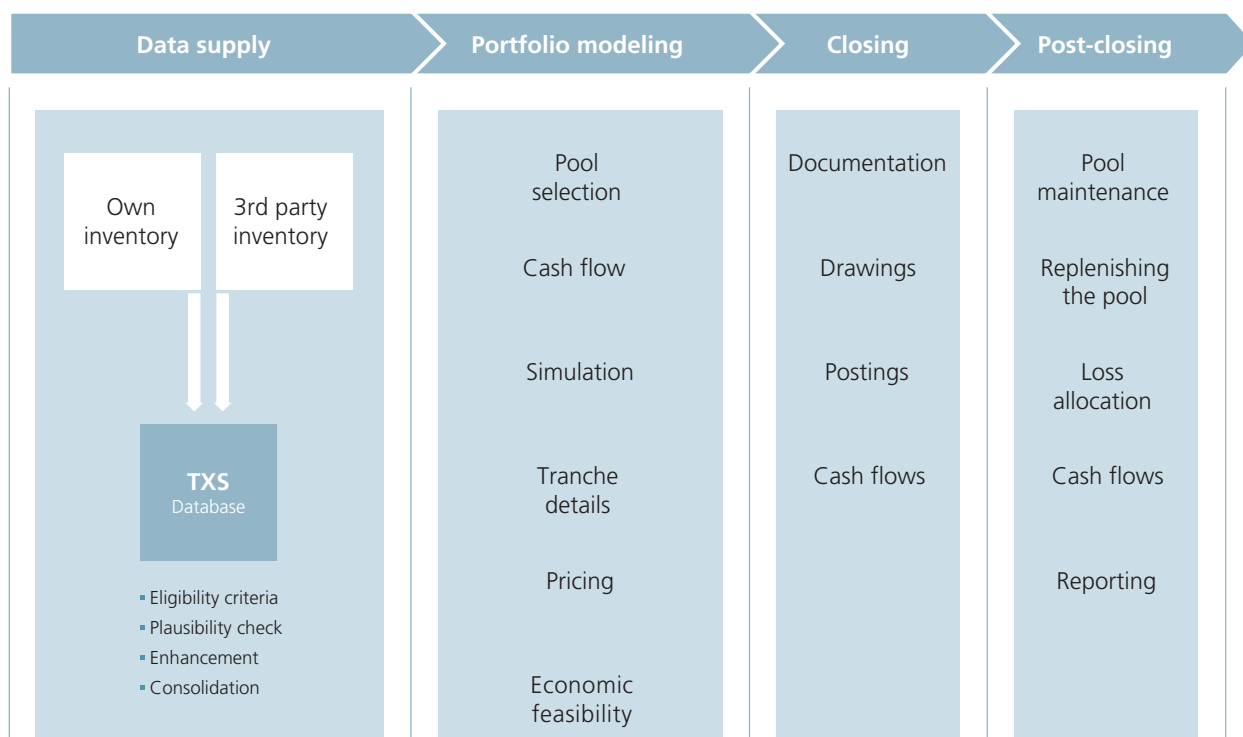
folio modelling (pool selection, cash flow analyses, tranche details, pricing etc.) documentation, disbursement and booking, to continuous reporting of all key functions.

DG HYP used TXS for the first time within the scope of *PROSCORE-VR-2005-1*; this represents considerable progress for further developing the bank's active portfolio management operations. As a key benefit of this platform, it offers a standardised gateway to securitisations, which especially facilitates the participation of smaller issuers in multi-seller transactions. This creates a multitude of possibilities for further expansion of the business.

NPL transfers – a growth segment

In the wake of the write-downs that were necessary in the entire banking sector within the course of the recent weak performance of the German economy as a whole, and the German real estate markets, the sale of non-performing loans (NPL) is becoming increasingly important in addition to the securitisation of "sound" exposures. Assuming that the share of NPLs relative to the overall loan

PROCESSING FACILITY FOR SECURITISATION MANAGEMENT



portfolios of German banks ranges between five and eight per cent, the total volume of NPLs on the German market is estimated at € 200 billion to 300 billion, of which loans collateralised by real estate account for at least € 70 billion to 80 billion.

The sale of NPLs is interesting to banks, not only regarding the risk structure of their credit portfolios, but also with respect to managing problem loans more efficiently. On the demand side, international investors have discovered the German market for non-performing real estate loans as an interesting investment opportunity. Against this background, we are seeing strong growth in the NPL market in Germany at present, with transaction volume having reached a record high of € 20 billion in 2005.

DG HYP makes use of its experience in real estate financing, and in active risk management of real estate loan portfolios, to act as both seller and service provider in this attractive growth market. Within this context, DG HYP arranged the sale of a portfolio of receivables by DZ BANK in 2005. It also successfully placed an NPL portfolio of its own on the market.

Additionally, DG HYP launched IMMOFORI Gesellschaft für Immobilien Forderungsinkasso mbH, a specialist NPL portfolio management advisor and servicer, at the beginning of 2005. Within a short period of time, this wholly-owned subsidiary successfully positioned itself in its target segment.

***Pfandbrief* Act offers new opportunities in active portfolio management**

The introduction of the new German *Pfandbrief* Act has presented the former mortgage banks with new opportunities in active portfolio management since mid-2005. The German Mortgage Bank Act, the predecessor of the *Pfandbrief* Act, did not permit the use of derivatives for hedging loan portfolios. DG HYP multi-seller transactions therefore required special synthetic securitisation structures that offered only a limited degree of flexibility.

The abolition of the previous legal restrictions has opened up new opportunities for compiling multi-seller portfolios, with added flexibility in terms of portfolio structure, less dependence on the timing of placement needs of participant banks, and enhanced scope for customised structures when placing these portfolios on the market. Special solutions can therefore be found for the banks

placing the risk – in particular, the primary institutions of the German cooperative banking sector and other banks that do not have direct access to the capital market – as well as for the investors, thus creating added value for all participants. DG HYP intends to increasingly take advantage of these opportunities in the future, in order to continuously enhance the bank's portfolio management capability and status as a service provider for third parties.

Unlocking the value of real estate portfolios

The challenges faced by banks in trying to strike a balance between risk and return in loan portfolio management are similar to those faced by companies with regard to the return and cost-conscious management of their real estate holdings. From this perspective, public-sector entities and private companies are placing their real estate holdings under increasing scrutiny. Similar to the structuring of loan portfolio transactions, this requires complex cash flow and risk analyses of real estate investments or portfolios.

Private companies and the public sector alike have recently been selling substantial real estate assets, mainly to international investors. In 2004 alone, some 300,000 residential units changed hands within the scope of portfolio sales, further increasing to over 400,000 units in 2005. Further transaction growth is expected in the next few years, taking the number close to 1 million units – with an approximate value of € 60 billion.

Whilst the privatisation of public-sector real estate holdings is driven primarily by budgetary constraints, most corporate entities with a capital market presence are focused, above all, on meeting the market's return requirements. Target returns of 12 to 15 per cent are generally not achievable on existing residential real estate. Moreover, as real estate management is frequently a non-core activity for industrial manufacturers and services companies, specialised real estate investors can often manage real estate holdings and portfolios more efficiently.

This development has considerably heightened the momentum of real estate portfolio transfers. Against this background, the introduction of real estate investment trusts (REITs) is currently being discussed in Germany. These are a special form of internationally established, exchange-listed real estate company that offers an interesting investment alternative to investors. The introduction of REITs could provide further potential for unlocking real estate value on a larger scale.

DG HYP has established itself in this market, above all as a service provider and arranger of real estate portfolio transactions. In its role as a service provider for potential sellers, DG HYP structures, analyses and arranges the company's entire real estate portfolio. This entails establishing data transparency, conducting data management and carrying out valuation. DG HYP actively supports negotiations with potential buyers of the real estate portfolios, paving the way for the subsequent transfer of those parts of the portfolio that are not essential for the company's operations. If and when required, a refinancing concept can be drawn up for the portion retained by the company. DG HYP offers real estate portfolio investors solutions for structuring and implementing the financing.

Structured financing solutions for real estate investors

Traditional forms of real estate finance, secured by charges on the property and with a standardised proportion of borrower equity committed, is subject to restrictions

when large-sized commercial real estate lending is envisaged – even more so, when transferring real estate portfolios. Instead, these types of transaction require a combination of different financing products, reflecting the special risk/return structure of real estate investment. This is where capital market-oriented financing solutions are becoming increasingly important – including the syndication of large-volume loans to diversify risks, investment banking instruments such as mezzanine financings, and various solutions for equity investors.

Leveraging its capital market experience and expertise in the real estate sector, DG HYP can offer an extensive range of services related to structured financing solutions to real estate investors, companies and the public sector.

Public/private partnerships as a solution for the public sector

The structuring of public/private partnerships (also known as “PPP” structures) is an example of how various

REAL ESTATE STRUCTURED FINANCE AT DG HYP – NEW FLEXIBILITY FOR UNLOCKING REAL ESTATE ASSETS

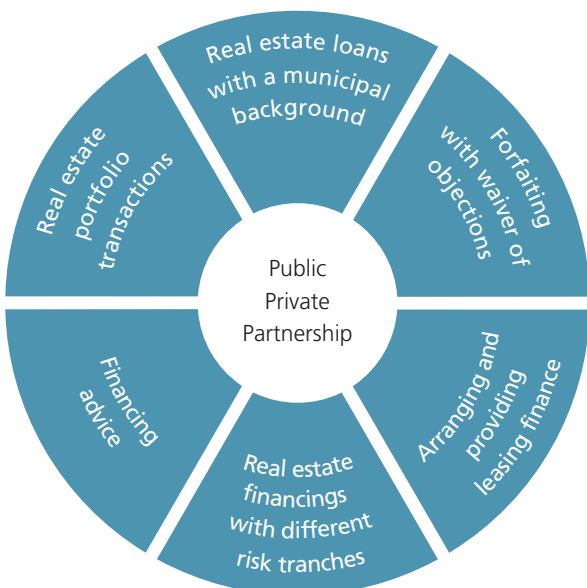


financing tools can be combined within the scope of complex real estate transactions. Such arrangements involve a long-term, contractually-agreed partnership between public-sector entities and private enterprises over the entire life-cycle of a public-sector investment project.

In Germany, the public authorities are faced with declining tax revenue in conjunction with a gradual rise in public expenditure – leading to an increasingly tight budgetary situation. To compound matters, the continuous reduction in local authority investment over recent years has resulted in pent-up investment requirements officially estimated at around € 690 billion up to 2009.

In light of this, cooperation between private enterprises, project developers and investors represents a sensible alternative to the classic approach to financing local authority investment projects. PPP schemes offer local authorities the opportunity to utilise their tight financial resources more efficiently, to concentrate consistently on their core sovereign duties and to increase the use of private capital and expertise for necessary infrastructural projects. Areas of potential PPP application comprise diverse projects such as public administration buildings, schools, hospitals, airports and retirement homes.

PPP – PRIVATE-SECTOR CAPITAL AND EXPERTISE FOR PUBLIC-SECTOR INFRASTRUCTURAL PROJECTS



There are a multitude of possibilities for financing PPP projects. Depending on the scope and risk structure of the project, and the investors' anticipated return, various tools can be used. These might comprise traditional local authority loans, project financing, or the provision of private investor equity financing.

Building on its experience in traditional local authority lending as well as in complex commercial real estate finance, DG HYP has established a PPP centre of competence. This allows us to offer an extensive advisory service as well as structuring financing models, in order to meet all of the requirements of local authority infrastructural projects.

DG HYP – a modern real estate bank

Real estate finance has turned into an ever more complex and demanding business. This trend is set to continue during the years to come. The banks and their clients face the same challenge: they need to structure real estate financings attractively and transparently, with a suitable risk/return profile. This is essential in order to secure all options for raising capital. Against this background, DG HYP is consistently pursuing its development as a service provider for structuring real estate financings and real estate loan portfolios. Nowadays, the bank no longer restricts itself to the role of lender and manager of its own credit risks on its own books: rather, it is increasingly acting as a partner and intermediary between real estate market participants.

In its targeted development from a classic mortgage bank to a modern real estate bank, DG HYP is well positioned to successfully manage the challenges it faces in an ever-changing market for real estate financing – and to exploit the new business opportunities that arise, in a targeted manner.

DG HYP – A PARTNER FOR THE GERMAN COOPERATIVE BANKING SECTOR, AND A MEMBER OF THE DZ BANK GROUP

With total assets of € 79 billion and a real estate lending portfolio of € 25 billion, DG HYP – established 1921 – is one of Germany's leading real estate banks. As the largest issuer of *Pfandbriefe* – German covered bonds – within the German cooperative banking sector, DG HYP offers attractive financing solutions to retail customers, commercial investors, and public-sector entities. In addition, the bank's scope of activity includes loan portfolio deals placed on the capital markets, syndicated loans, and structured financing solutions. With roughly € 60 billion in securities outstanding, DG HYP is one of Germany's regular issuers of mortgage bonds and public-sector covered securities.

As a member of the DZ BANK Group, DG HYP is affiliated with Bausparkasse Schwäbisch Hall, DZ BANK International, DZ PRIVATBANK Switzerland, norisbank, R+V Insurance, Union Asset Management Holding, VR LEASING, and various other specialist financial services providers. The various DZ BANK Group entities are the cornerstones of a comprehensive range of financial services offered to (and through) the German cooperative banking sector. Within this strong network, DZ BANK Group entities work together to optimise the products and services delivered to cooperative banks and their roughly 30 million customers.

DZ BANK Group is a part of the German cooperative banking sector, which comprises approximately 1,300 individual cooperative banks. In terms of aggregate total assets, the cooperative banking sector ranks among the largest financial services organisations in Germany. Within this sector, DZ BANK AG acts as the central institution for around 1,100 credit cooperatives with a total of 12,000 outlets – at the same time however, it is a commercial bank with international reach, having a particular focus on Europe.

Combining banking services with insurance products and asset management has a long tradition within the German cooperative banking sector. Thanks to the competitive, top-quality products offered by all the specialist financial services providers within the DZ BANK Group, German cooperative banks are in a strong position, being able to offer their customers a full range of outstanding financial services.

MANAGEMENT REPORT

STRATEGIC MILESTONES ACHIEVED IN 2005

- Strong growth in new business
- Expansion of active portfolio management
- Cost-cutting by transforming IT systems
- Refining credit risk management
- Strengthening the capital base

ECONOMIC ENVIRONMENT AND STRATEGIC DEVELOPMENT

Moderate development of the economic environment and real estate markets

During 2005, the moderate upside trend in German economic performance continued, with modest growth posted in gross domestic product. However, the domestic real estate markets benefited only partially from this development, as there is evidence of recovering demand in attractive locations, and in growth sectors. Another positive signal is the lively interest in German real estate shown by international financial investors, who believe the market has the potential to rise again in the years ahead.

Overall, domestic demand for real estate remained muted in 2005, despite historically low interest rates. The difficult prevailing labour market environment, together with rising energy prices, continues to burden private household consumption and investment; this is also reflected in the residential real estate market. There is no evidence yet of a recovery in commercial real estate in areas of considerable surplus. Accordingly, we saw a slight decline in construction investment in 2005.

Consolidation continues in the real estate banking market

The ongoing consolidation process in the banking industry was such that the real estate financing environment was defined by extensive competition during the period under review. On the one hand, the withdrawal of some competitors from the market continued, whilst on the other hand a number of real estate banks that had meanwhile focused their operations solely on international business returned to the German market. Competition, especially in the retail business, is determined to a great extent by the direct banks and internet-based providers. This limited the potential for increasing margins in new business. An increase in new business commitments requires greater effort in terms of product development and distribution.

Introduction of a general German *Pfandbrief* Act

The German Mortgage Bank Act and Public-Sector Mortgage Bond Act were replaced by a general German *Pfandbrief* Act (*Pfandbriefgesetz – PfandBG*) in July 2005. The new Act abolished the status of mortgage banks as specialist institutions, which coincided with the abolition of state guarantees for public-sector banks. DG HYP welcomes this development.

The German *Pfandbrief* Act strengthens the German covered bond concept of *Pfandbriefe* – especially in the competitive international environment – as a transparent and stable instrument to be employed in refinancing real estate and public finance on the capital market. It requires a high level of professionalism in risk management, and data transparency of the cover assets pool.

The former German mortgage banks were already subject to stringent rules in their management of cover assets under the previous legislation. Their know-how, acquired over many years, together with their management systems, should translate into a competitive advantage vis-à-vis new *Pfandbrief* issuers as well as covered bond issuers from other countries. Additionally, the abolition of the special bank privileges gives rise to new business opportunities that were not previously available to the mortgage banks under the Mortgage Bank Act. We will exploit these opportunities in the future, within the scope of real estate and public finance, in a targeted manner.

DG HYP's strategic position

During the 2005 financial year, DG HYP consistently pursued its strategic repositioning within the framework of the VR-Immobilien AG ('VR IMMO') business model. The primary objective of the strategic position is to develop DG HYP into a lean and innovative real estate bank. This will form the basis on which we will consistently improve the bank's profitability. The key points for achieving these objectives are as follows:

- concentrating on the bank's strategic business and optimising processes in order to further enhance efficiency of its core business activities throughout the four divisions – Residential Real Estate Finance, Commercial Real Estate Finance, Credit Treasury and Treasury;
- improving the risk/return profile of the loan portfolio by generating new business with a strong focus on credit quality, combined with risk-adjusted loan pricing, and active portfolio management;
- optimising the cost structure further, by upgrading the IT system environment as well as streamlining the organisational structure; and
- optimising the capital structure, also with regard to meeting the demands of the capital market.

Within the scope of this process, we achieved important milestones in 2005, by taking an active and creative

approach to meeting the challenges presented by a changing market environment.

Important strategic milestones achieved in 2005

Intensifying marketing activities. A key factor in DG HYP's success in defending its market position (and even advancing market share, despite the difficult economic environment) was the targeted intensification of our marketing activities in the German cooperative banking sector as well as in direct business. We succeeded in substantially increasing new business in residential and commercial real estate financing, as well as in originated local authority lending.

Expanding active portfolio management. During the period under review, DG HYP concluded a series of innovative portfolio transactions, which considerably expanded the scope of risk/return-oriented portfolio management in Credit Treasury. This includes securitisations and sales from the bank's own loan inventory, as well as portfolio investments.

Refining credit risk management. Consistent portfolio adjustment and refinement of the credit processes within the scope of implementing the Basel II accord was on the credit risk management agenda in 2005. During the period under review, we undertook important steps towards implementing the Foundation Internal Rating Based Approach (FIRB) as of 1 January 2007. We also extended and optimised the back office infrastructure for our retail business. In a further step, we strengthened the Credit Treasury back office, to bring it into line with the business development in this division. The objective of this development is to establish a state-of-the-art risk management process, and to optimise the efficiency of credit processes and risk costs across all business divisions.

Cost-cutting by transforming IT systems. The ongoing restructuring of our IT systems enabled us to reduce costs further in this area during the 2005 financial year. This was facilitated above all by the increased use of standard software, as well as by reducing the complexity in the system environment. We have thus largely completed our investments in transforming our IT environment.

Strengthening the capital base. In order to safeguard growth in the bank's lending business, and in view

of meeting the demands of the capital market, we had achieved a sustained strengthening of DG HYP's capital base by allocating € 30 million to the capital reserves, and through € 180 million in perpetual silent partnership contributions. Having implemented its plans, DG HYP increased its core capital (Tier I) to 7.0 per cent as at 31 December 2005 (31 Dec 2004: 6.3 per cent).

DG HYP rating upgrade. The favourable rating development further strengthened DG HYP's position as a real estate bank focused on the capital market. The rating agency Standard & Poor's upgraded DZ BANK's long-term and short-term rating; consequently, DG HYP's rating was upgraded from A-/A-2 to A/A-1 with outlook stable. Additionally, Fitch Ratings awarded an overall rating for the first time to the entire cooperative banking sector, which also applies to DG HYP. This represents a further upgrade of the bank's long term rating from A to A+ with outlook stable. The two rating agencies upheld their AAA ratings for DG HYP public-sector covered securities (*Öffentliche Pfandbriefe*) and mortgage bonds (*Hypothekendarlehen*).

RESIDENTIAL REAL ESTATE FINANCE

Buyers of residential real estate in Germany benefited from a benign environment during 2005, thanks to interest rates at long-term lows and a slight decline of real estate prices on average. Yet this did not trigger a recovery of the German market for residential real estate financing. While the market volume for purchasing and modernisation of residential real estate remained stable compared with the previous year, the volume of new buildings declined by 8.3 per cent.

Market potential in retail business

Current studies show that Germany still offers growth potential. Accordingly, some 1.3 million households are fundamentally interested and would also be in a position to finance the purchase of a house or apartment. However, uncertainty prevails amongst these private households with regard to the poor performance of the labour market and rising ancillary costs, so that they are tending to postpone planned expenditure on residential real estate.

Turnaround in new business and loan extensions

Notwithstanding the difficult market environment and increasing competitive pressure in residential real estate financing, DG HYP succeeded in expanding new business and loan extensions by 40.2 per cent, to € 2 billion during the period under review.

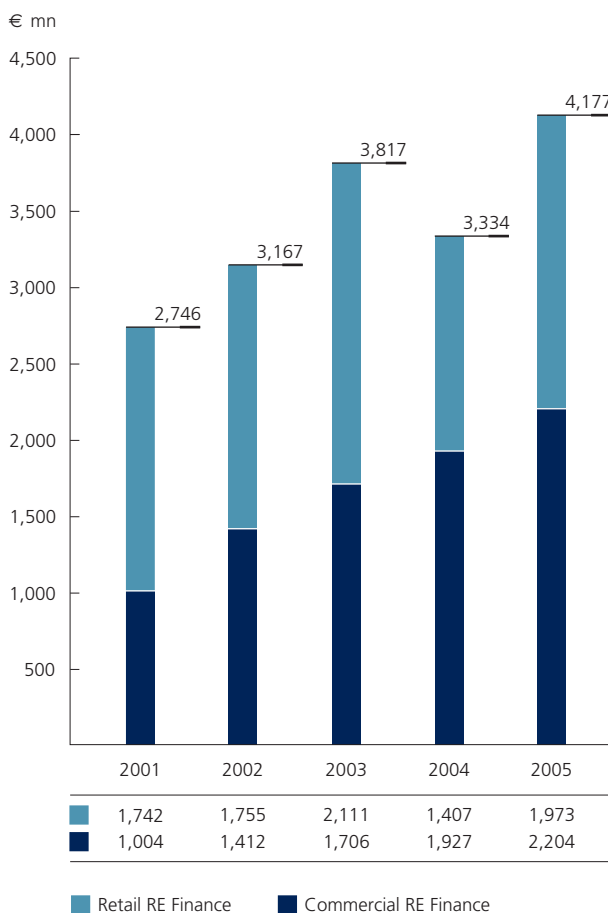
The favourable development in residential real estate financing was attributable above all to DG HYP's attractive range of products, as well as to intensified marketing efforts in conjunction with the bank's partners in the German cooperative banking sector. Our "TOP-Super 60" loan in particular, is a product designed for financings with a low loan-to-value-ratio, offering customers flexible financing options at attractive terms and maturities. This product alone accounted for 25 per cent of new business, and contributed significantly to DG HYP's positive business development.

With their extensive presence and more than 30 million customers throughout Germany, real estate loans arranged by roughly 1,300 German cooperative banks continue to form the basis of our retail distribution. We successfully supported our partner banks in their distribution and marketing activities in residential real estate financing. Specific measures in this context included strengthening the support services provided by our bank advisors, who offer for example, a specialised, individual advisory service covering DG HYP's entire product range. During the period under review, the cooperative banks – together with Bausparkasse Schwäbisch Hall – significantly increased the volume

of business intermediated to DG HYP compared with the previous year. An agreement was reached with Bausparkasse Schwäbisch Hall regarding the responsibility for retail distribution and service to partner banks within the German cooperative banking sector. As DG HYP will resume retail coverage within the sector in the future, existing agreements with Bausparkasse Schwäbisch Hall were terminated with effect from 31 March 2006.

We will continue to develop the retail business, in cooperation with the cooperative banks. The results achieved in the previous financial year show that we are well on track towards advancing this business division successfully in a difficult competitive environment.

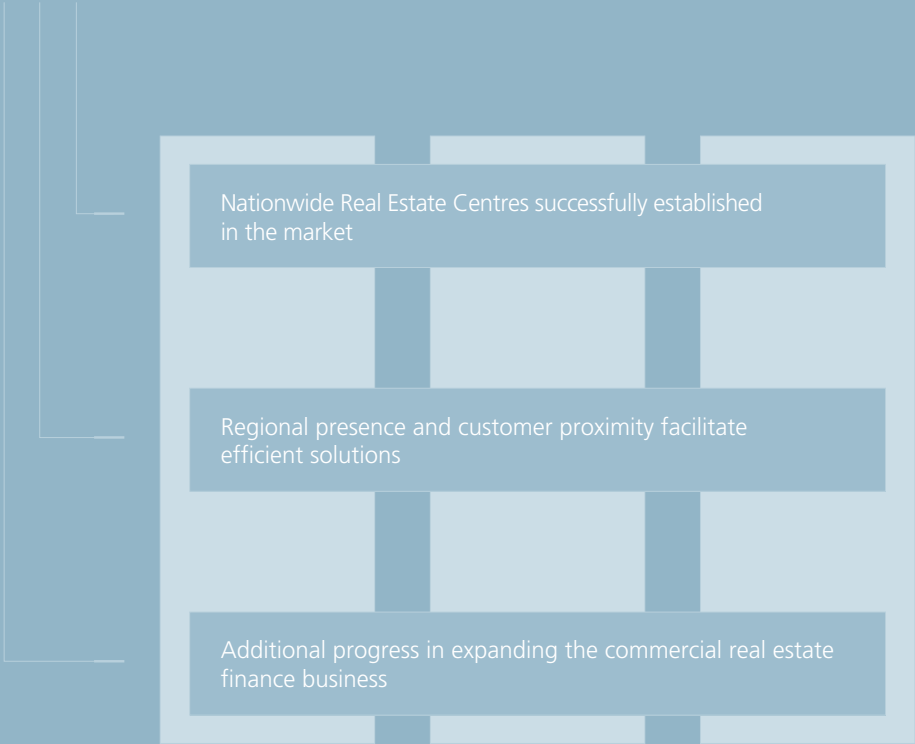
NEW PROPERTY LENDING BUSINESS (INCLUDING: LOAN EXTENSIONS)



Please note that the charts and diagrams depicted do not constitute a part of the Management Report, for the purpose of the Financial Statements.

COMMERCIAL REAL ESTATE FINANCE

CONTINUOUS GROWTH IN OUR GERMAN CORE MARKET



COMMERCIAL REAL ESTATE FINANCE

Although the environment remains difficult, there is evidence that the German market for commercial real estate is recovering slightly. Due to regional and cyclical reasons however, varying trends are emerging in the individual market segments.

Positive trend in office real estate

The turnaround in the market for office real estate that was already evident last year has picked up momentum. We welcome the fact that demand for floor space in many important services centres has risen considerably compared with the previous year, in some cases with double-digit growth rates. In conjunction with this development, positive rental price development is evident again in some prime locations, offering interesting business opportunities to investors.

Overall, there are some indications of floor space being taken up again. Nevertheless, the market still needs to absorb significant excess capacity from the boom years of 2000/2001. The strength of economic momentum in 2005 was insufficient to generate a sustained reduction of the surplus supply through increased capacity utilisation in the services sector.

Growth in retail floor space

Consumer hesitation amongst private households caused retail sales to fall further. Nevertheless, the volume of available floor space continues to expand unabated in prime locations. Demand is driven mainly by shopping centres and mega-stores, and has generated predatory competition. Roughly 840,000 m² of new retail space is currently under construction in Germany.

REAL ESTATE LENDING PORTFOLIO, BY REGION (31 DEC 2005)



However, this development only reflects the overall industry trend. Closer analysis reveals the reality of a more differentiated picture, amongst the more than 400,000 retail companies. There are considerable differences in sales performance, in terms of product range and sector, as well as differentiated development in the individual retail locations. As a rule, rents fall and vacancies rise on the back of weak demand for retail real estate in sub-prime and peripheral locations, as well as in structurally weak regions.

Logistics real estate with growth potential

High growth rates are expected in logistics real estate. The market volume for logistics systems services (contract logistics) in Germany is estimated at € 60 billion, of which approx. € 11 billion have been realised to date. Continued high demand for modern and flexible goods distribution centres, finished goods warehouses, and logistics centres, should generate annual growth of between 15 and 20 per cent in this market segment.

International growth trend

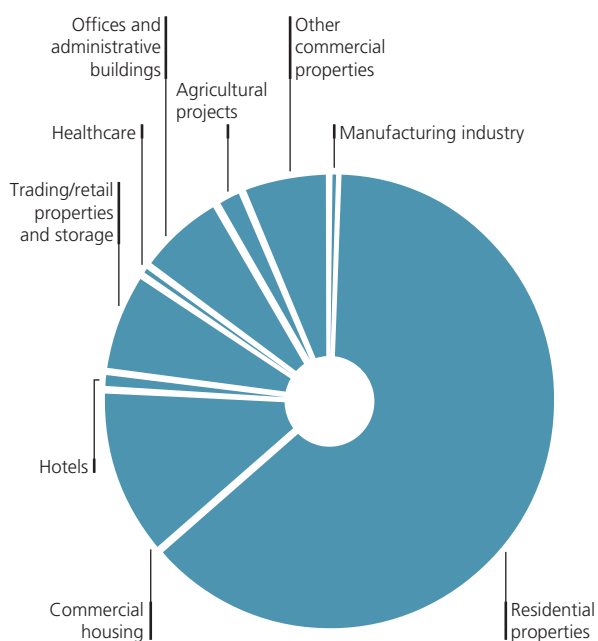
Despite the absence of any full-blown economic recovery, there are indications of a positive growth trend in rental turnover in Europe's 21 most important real estate markets, and in the economic centres of the US. The performance of the office real estate markets in metropolitan areas where we have representative offices is particularly positive. These are ranked top of the list in Europe with regard to office space turnover and rents.

Expansion continues

Following a two-year expansion and restructuring process, continuous growth has successfully secured DG HYP's position in commercial real estate finance within our German home market. One of the key success factors is our decentralised presence, with front and back office units in our Munich, Stuttgart, Frankfurt/Main, Dusseldorf, Berlin and Hamburg Real Estate Centres. We view our regional market knowledge and efficient local loan processing as important competitive strengths.

The volume of new business and loan extensions in commercial real estate finance climbed to € 2.2 billion in the 2005 financial year; this equates to a 14.4 per cent rise over the previous year (€ 1.9 billion). New business originated directly performed particularly well, posting growth of 43.7 per cent. Loan extensions, albeit down on the previous year, were in line with expectations. The significance of international business – which is still in the start-up phase – is growing: it accounted for 6.3 per cent (2004: 3.2 per cent) of originated new business.

REAL ESTATE LENDING PORTFOLIO, BY TYPE OF PROPERTY (31 DEC 2005)



	in %
Manufacturing industry	0.7
Residential properties	64.4
Commercial housing	11.1
Hotels	1.3
Trading/retail properties and storage	7.5
Healthcare	0.8
Offices and administrative buildings	6.9
Agricultural projects	2.0
Other commercial properties	5.3
TOTAL	100.00

CREDIT TREASURY

The Credit Treasury division consistently developed and refined the active management of DG HYP's loan portfolio during the 2005 financial year, transferring credit risks and loan portfolios. To manage the portfolio, the bank's risk management team constantly monitors exposure, with the objective of optimising the risk/return profile of our assets and thus achieving a more efficient use of our capital. Credit Treasury is responsible for implementing suitable portfolio transactions. We also succeeded in expanding the activities of this business division, to include a portfolio management advisory and service offering for third parties.

Dynamic development of markets for loan securitisations and portfolio transfers

The importance of transferring credit risks onto the capital market through securitisation has increased considerably in recent years. The dynamic growth of the European securitisation markets persisted throughout in 2005, where securitisations of real estate loans via RMBS and CMBS continued to account for a substantial share of the market. Besides the synthetic securitisation of credit risks, true sale securitisations and the direct purchase and sale of loan portfolios became an increasingly established market in Germany. International investors are stepping up their exposure to the non-performing loans asset class. With transaction volumes reaching around € 20 billion in Germany, this segment has reached a record high in the 2005 financial year.

Innovative portfolio transactions

DG HYP has actively exploited existing market opportunities, positioning itself successfully on the German and

international capital markets, where it has meanwhile executed securitisations with an aggregate volume of € 3.3 billion. We continued the synthetic sale of real estate credit risks in the 2005 financial year with *PROSCORE-VR 2005-1*. Given the granularity and geographical diversification of the underlying portfolio, the structure of this multi-seller CMBS is a novelty on the German securitisation market. The transaction's reference portfolio comprises 3,072 loans, totalling € 735 million, mainly for commercial real estate. Besides DG HYP, a further six cooperative banks participated as originators.

In the 2005 financial year, DG HYP also sold a retail portfolio comprising some 3,000 non-performing real estate financings, totalling € 300 million, to an international investor. This allowed us to further enhance the overall portfolio structure and free up resources, in order to optimise the management of problem loan restructuring in the retail business.

Besides structuring our own portfolio transactions, we are also increasingly acting as a service provider for third parties. In the 2005 financial year we arranged – for the first time – the sale of a DZ BANK portfolio of receivables with a total volume of around € 580 million.

DG HYP further increased investment in structured credit products during the 2005 financial year. In this area, our exposure to MBS purchases on the secondary market is mainly in the established securitisation markets of Europe and the US, where the bank pursues a selective investment strategy. In addition to investing on the capital market,

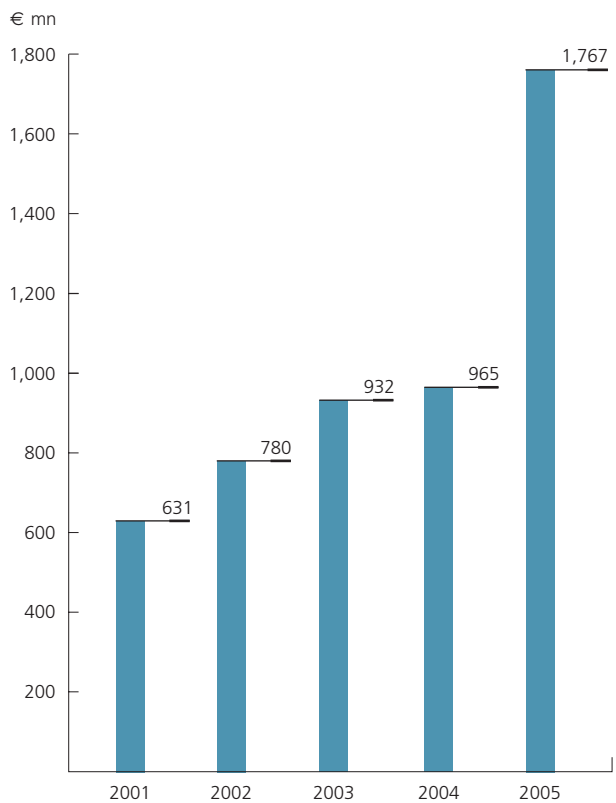
individually structured portfolio transactions within the scope of private deals are becoming increasingly important. As well as synthetic MBS investments, we also conducted small-volume portfolio purchases ('true buy') for the first time. This broadens the opportunities available to us for utilising transactions tailored to achieve targeted risk/return-oriented portfolio diversification. Overall, new portfolio investments of € 1,767 million considerably exceeded the previous year's figure of € 965 million. The volume of DG HYP's MBS portfolio was € 3.4 billion as at the balance sheet date.

Successful debut with PPP models

We completed another important step in furthering the structured finance activities of the Credit Treasury business division by entering into the financing business within the scope of public/private partnership schemes. Our market debut in the PPP business centres on the competence we have gained from structuring complex real estate financing solutions, together with our expertise and favourable market position in local authority lending.

The expansion and restructuring of an educational centre formed the basis for the success of our first PPP transaction in the 2005 financial year. We develop a strategic basis on which decisions are met and financings structured, in order to enhance the viability of local authority projects and hence support the optimisation of real estate management.

NEW PORTFOLIO INVESTMENTS



TREASURY

SUCCESSFUL BUSINESS DEVELOPMENT,
BASED ON A TRANSPARENT ISSUING STRATEGY

Strong market penetration in
originated loans to local authorities

Powerful *Pfandbrief* issuer,
with attractive Jumbo issues

Extended investor base,
both in Germany and abroad

PUBLIC-SECTOR LENDING

In the year under review, market development in local authority lending was defined mainly by continued high levels in the public sector's financing requirements. Local authorities, cities and municipalities used the attractive interest rate levels to secure favourable long-term funding, also through forward loans. At the same time, the abolition of state guarantees for the public-sector banks – as well as the withdrawal of some competitors – generated new business opportunities with regard to supply.

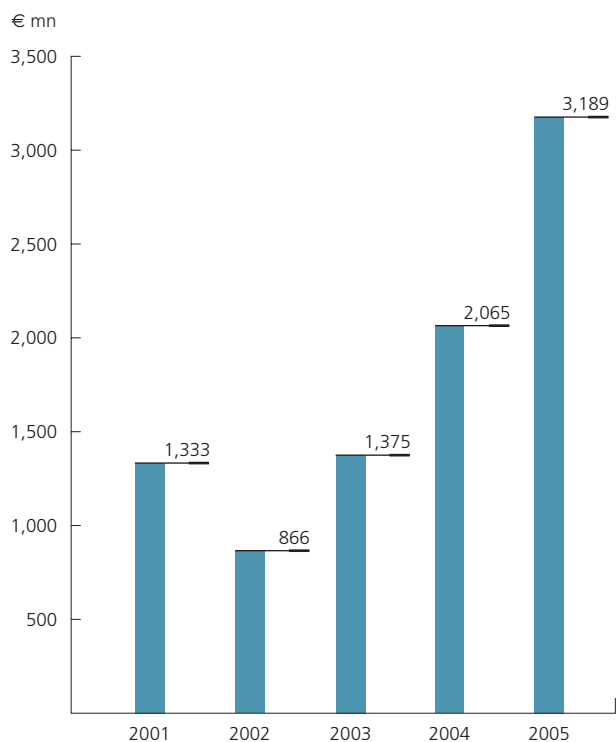
DG HYP was therefore able to significantly extend the volume of local authority lending during the 2005 financial year, with improving margins. Together with the cooperative banks, we have meanwhile established 8,100 customer relationships with local authorities and formed the basis for the provision of funding at attractive terms for a variety of regional infrastructure projects, as well as for the

current financing of local authority facilities. DG HYP has established business relationships with every third local authority in Germany, and is the leading player in the German cooperative banking sector.

The volume of new business and loan extensions for originated loans to local authorities reached € 3.2 billion, exceeding the previous year's level by 54.4 per cent.

In the 2005 financial year, DG HYP took on its books a total of € 10.2 billion in loans eligible as cover assets for public-sector covered bonds. In line with our strategy of flexibly managing the cover assets pool, we preferred to acquire fungible bonds (€ 5.2 billion). New business in promissory note loans amounted to € 1.8 billion. The volume of public-sector lending at year-end was € 41.8 billion (2004: € 39.4 billion).

ORIGINATED LOANS TO LOCAL AUTHORITIES – NEW BUSINESS AND LOAN EXTENSIONS



REFINANCING

DG HYP has maintained its strong presence on the capital markets during the course of the 2005 financial year. We also benefited this year from favourable spread developments and the positive overall performance of the *Pfandbrief* market. Given the bank's core business, its refinancing activities centre on mortgage bonds (*Hypothekendarlehen*) and public-sector covered securities (*Öffentliche Pfandbriefe*). Within this context, our objective is also to increase the share of international placements through our Debt Issuance Programme (DIP) and to meet the investors' requirements accordingly.

At € 13.2 billion, total new issuance was in line with the previous year. The largest part of this volume was in covered issues, whereby public-sector covered securities accounted for € 10.6 billion, and mortgage bonds for € 1.3 billion; € 1.3 billion was raised through uncovered refinancings, via bearer bonds and promissory notes.

Triple-A rating for DG HYP *Pfandbriefe*

With roughly € 60.4 billion in securities outstanding, DG HYP is one of Germany's regular issuers of *Pfandbriefe*. DG HYP *Pfandbriefe* are rated AAA by the rating agencies Standard & Poor's and Fitch Ratings, and thus offer institutional investors an extremely solid investment. Separate cover assets pools are managed as collateral pools for mortgage bonds and public-sector covered securities. These are exclusively backed by senior charges on real property, or by loans to public-sector entities, respectively. By computerising the active management of the *Pfandbriefe* cover assets pool, we ensure compliance with the

provisions of the German *Pfandbrief* Act as well as the requirements of the rating agencies.

Jumbo *Pfandbrief* issues

An important pillar of our refinancing strategy is the issuing of jumbo-sized *Pfandbriefe*. As previously, DG HYP successfully kick-started the market in 2005 with the first jumbo *Pfandbrief* of the year – a seven-year, € 2 billion issue.

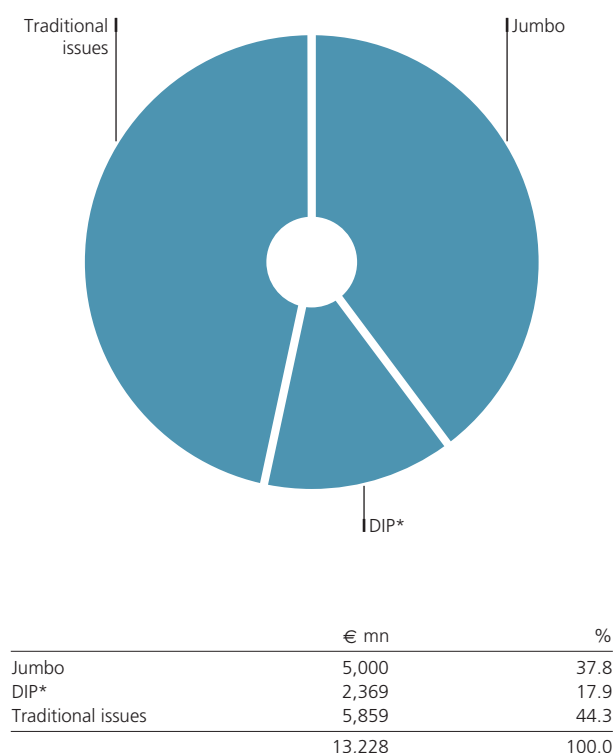
With the first dual-tranche jumbo – a parallel issue with five and ten-year maturities, total volume of € 2.5 billion – DG HYP placed an innovative product on the *Pfandbrief* market that was tailored to suit investors' requirements. The total order book amounted to just under € 3.5 billion, so that the transaction was oversubscribed by 40 per cent. To ensure a liquid secondary market, the ten-year jumbo tranche issued in June was increased by € 500 million to € 1.5 billion. The bond was well received on the market: it offered investors a yield pickup of 7.8 basis points over the 10-year reference German government bond (3.25 per cent Bund maturing 4 July 2015), and a 1.7 basis point discount to mid swaps.

Both jumbo issues were placed with a broad range of investors on the domestic and international markets, and have performed very well on the secondary market. The issues met with strong demand from international investors in particular, who absorbed over 50 per cent of the total amount placed. In this context, DG HYP benefits from its clear issuing strategy and a good relationship with

DG HYP RATINGS

	Public-sector covered securities	Mortgage bonds	Long-term debt (counterparty rating)/ outlook	Short-term debt (counterparty rating)	Subordinated debt
Standard & Poor's	AAA	AAA	A/stable	A-1	A-
Fitch Ratings	AAA	AAA	A+/stable	F1	A

REFINANCING STRUCTURE FOR 2005



* Debt Issuance Programme (DIP)

investors, which was enhanced within the scope of the various roadshows held worldwide.

The volume of outstanding DG HYP jumbo *Pfandbriefe* is currently about € 29.9 billion. A series of DG HYP jumbos is listed on the electronic trading platform EuroCreditMTS. In order to facilitate placement worldwide, we brought two global issues to the market with a total volume of € 4.75 billion.

Customised funding

In addition to standardised, large-volume *Pfandbriefe*, DG HYP also placed smaller individually-structured issues, including registered securities. Such private placements are explicitly structured to meet specific investor requirements. Given the ongoing low interest rate environment, we saw particular demand for floating rate issues (FRNs). Altogether, € 364 million was securitised via step-up bonds, single-callables and multi-callables.

Placement in the German cooperative banking sector

During the period under review, a total of € 5.8 billion was issued in bonds and promissory notes through the German cooperative banking sector, which represents an important investor and marketing base for DG HYP. This equates to a 43 per cent share of the volume of DG HYP issues placed, compared with 38 per cent the year before. DZ BANK's immense placement power within the cooperative banking sector, combined with the sector's homogeneity, contributed to this result.

Debt Issuance Programme

The standardised DIP platform is an important tool in the funding process, given the increasing internationalisation of our investor base. Issues brought to the market within the scope of this standardised programme accounted for 17.9 per cent of the refinancing volume. The DIP was adjusted in line with market requirements during the 2005 financial year, and increased from € 10 billion to € 25 billion. The issuing programme comprises covered bearer bonds in the form of public-sector covered securities and mortgage bonds, as well as uncovered bearer bonds.

Derivatives

The nominal volume of derivatives outstanding as at 31 December 2005 was € 151 billion. We use derivatives mainly to hedge jumbo *Pfandbriefe* and other issues, where in individual cases the requisite minimum issuing volume exceeds the lending volume to be refinanced. Furthermore, we use interest rate swaps to hedge interest rate risks from assets that were acquired for the cover assets pool.

KEY STRATEGIC SHAREHOLDINGS

Shareholdings that are of material importance to DG HYP's strategic position include VR WERT – Gesellschaft für Immobilienbewertungen mbH, and IMMOFORI Gesellschaft für Immobilien Forderungsinkasso mbH. We disposed of our 40 per cent stake in VR Kreditwerk AG to DZ BANK within the scope of the restructuring of shareholdings within the Group.

The key assignments of VR WERT, which was established in 1999 as a wholly-owned subsidiary of DG HYP, are to prepare and audit lending and market valuations. The services are offered throughout Germany from seven locations – Hamburg, Berlin, Cologne, Dresden, Frankfurt/Main, Stuttgart and Munich. VR WERT is supported in Germany and abroad by around 100 cooperation partners. It has successfully established itself in recent years as a specialist for real estate valuations. Favourable operating results were achieved in the 2005 financial year, with sales increasing to € 8.1 million (2004: € 7.2 million).

IMMOFORI, a wholly-owned DG HYP subsidiary, was established at the beginning of the 2005 financial year as a servicer of NPL portfolios. It secured market entry through a series of initial advisory mandates, as well as providing a servicing facility to third-party portfolios. Within its first full year of operation, IMMOFORI generated a positive operating result on sales of € 1.5 million. DG HYP has thus broadened the range of forward-looking services it offers in the active management of real estate credit portfolios.

FINANCIAL SITUATION AND RESULTS OF OPERATIONS

Financial situation

DG HYP's total assets as at the balance sheet date stood at € 79.1 billion, a 7.2 per cent increase over 31 December 2004.

At € 24.8 billion, the real estate loan portfolio was unchanged from the previous year. The MBS portfolio climbed 53.2 per cent, to € 3.4 billion. Public sector financing rose by € 2.5 billion to € 41.8 billion. With reductions of € 4.6 billion through redemption payments and disposals, together with strong new business in 2005, the portfolio of local authority loans was slightly below last year's level. At € 20.2 billion, securities held for investment were € 2.5 billion higher than at the end of 2004. The total loan portfolio increased by € 3.6 billion, to € 70 billion.

The securities portfolio used for yield and liquidity management rose by € 1.5 billion to € 6.9 billion.

The development of liabilities in the 2005 financial year was dominated by the high level of new issues in the first half of the year. The volume of securitised liabilities rose accordingly, by € 5.3 billion to € 52.8 billion.

Own funds and risk-weighted assets

DG HYP's core (Tier I) capital was strengthened considerably in the year under review, through € 30 million in allocations to the capital reserves as well as € 180 million raised in perpetual silent contributions.

Risk-weighted assets, as defined by the capital ratio according to the German Banking Act (*Grundsatz I*), amounted to € 20.8 billion as at the balance sheet date.

DEVELOPMENT OF LENDING VOLUME

€ mn	31 Dec 2005	31 Dec 2004	Change from the previous year	
			€ mn	%
Real estate lending	24,790	24,809	- 19	- 0.1
MBS	3,396	2,216	1,180	53.2
Public-sector lending (total)	41,833	39,379	2,454	6.2
– Loans to local authorities	21,616	21,643	- 27	- 0.1
– Securities	20,217	17,736	2,481	14.0
Total portfolio	70,019	66,404	3,615	5.4

RISK-WEIGHTED ASSETS, AS DEFINED BY THE CAPITAL RATIO ACCORDING TO THE GERMAN BANKING ACT (*GRUNDSATZ I*) AS AT 31 DECEMBER 2005

€ mn						
	100 %	50 %	25 %	20 %	10 %	Total
Risk weighting						
Balance sheet items	7,501	9,235	–	2,453	370	19,559
Off-balance sheet items	994	70	4	–	–	1,068
Derivatives	–	–	–	129	–	129
Total	8,495	9,305	4	2,582	370	20,756

OWN FUNDS

€ mn	31 Dec 2005	31 Dec 2004	Change from the previous year	
			€ mn	%
Issued share capital	90	90	0	0.0
Reserves	617	587	30	5.1
Silent partnership contributions	774	594	180	30.3
Special item for general banking risks	13	13	0	0.0
Items not eligible for inclusion	- 40	- 44	4	- 9.1
Core capital	1,454	1,240	214	17.3
Supplementary capital	757	745	12	1.6
Deductibles pursuant to section 10 (6) of the KWG	- 14	- 8	- 6	75.0
Liable capital	2,197	1,977	220	11.1
			in percentage points	
Equity ratio	10.6	10.1		0.5
Core capital (Tier 1) ratio	7.0	6.3		0.7

This had the effect of improving the core capital (Tier 1) ratio from 6.3 to 7.0 per cent as at 31 December 2005; the equity ratio rose from 10.1 to 10.6 per cent.

Results of Operations

Taking into consideration special effects from the previous year, DG HYP's earnings situation developed in line with expectations during 2005. Gross profit was € 289.9 million (2004: € 333.7 million, of which real estate disposals accounted for € 27.5 million).

DG HYP's net interest income in 2005 of € 325.6 million, which was down by € 7.5 million on 2004, remains burdened by the effects of maturities of existing high-margin exposures. Naturally, the positive effects of new business development will not be felt in full for some years yet. In light of our forecasts, we are confident we will succeed in increasing net interest income again in 2006.

Our cooperation with the distribution partners in the German cooperative banking sector usually results in a

OVERVIEW OF THE INCOME STATEMENT

€ mn	2005	2004	Change from the previous year	
			€ mn	%
Net interest income	325.6	333.1	- 7.5	- 2.3
Net commission result	- 58.5	- 40.0	- 18.5	- 46.3
Other operating income	22.8	40.6	- 17.8	- 43.8
Gross profit	289.9	333.7	- 43.8	- 13.1
Administrative expenses	178.1	180.0	- 1.9	- 1.1
Other operating expenses	4.5	2.6	1.9	73.1
Operating profit excluding risk provisioning	107.3	151.1	- 43.8	- 29.0
Risk provisioning/revaluation results	- 55.9	- 72.3	16.4	22.7
Operating profit	51.4	78.8	- 27.4	- 34.8
Net extraordinary income/expenses	- 1.3	- 4.4	3.1	70.5
Taxes	0.0	18.5	- 18.5	- 100.0
Partial profit transfer	39.2	38.4	0.8	2.1
Transfer to the fund for general banking risk	10.9	0.0	10.9	100.0
Profit transfer	0.0	17.5	- 17.5	- 100.0

negative net commission result. This figure rose from € –40.0 million in the previous year to € –58.5 million in 2005, and was accounted for by the positive development in retail business as well as by our strong issuing activity within the scope of refinancing and loan securitisation. We generated service income from our portfolio placement service for third parties for the first time in 2005; this area of business has further potential for growth in the future.

Other operating income in 2004 was defined above all by capital gains on the sale of the bank's office buildings in Hamburg and Berlin. The € 22.8 million figure for 2005 is accordingly lower than in 2004 (€ 40.6 million), and is in line with our expectations.

Costs development

Administrative expenses of € 178.1 million were lower than in the previous year (2004: € 180 million). While personnel expenses increased in line with our projections, consistent cost management provided for a reduction in other administrative expenditure compared to 2004; this was particularly evident in certain project and consultancy costs (including costs incurred for IT projects, Basel II, IFRS).

Risk provisioning

The balance of risk provisioning and revaluation results was a net expenditure of € –55.9 million in 2005, down from the € –72.3 million figure in 2004.

The net balance comprises the revaluation result of € 42.1 million, which includes profits on securities sales within the scope of managing our cover assets pool, and from the disposal of participations. In the process of restructuring shareholdings within the Group, we sold our 40 per cent holding in VR Kreditwerk to DZ BANK.

Loan loss provisions accounted for € 98.0 million, after € 113.0 million in 2004. This figure reflects the results of our systematic portfolio adjustments carried out in recent years, and which were completed in 2005. It also takes into consideration the partial disposal of our non-performing loan portfolio, in an amount of approx. € 300 million. All told, we are well positioned to further reduce our risk provisioning in the years ahead.

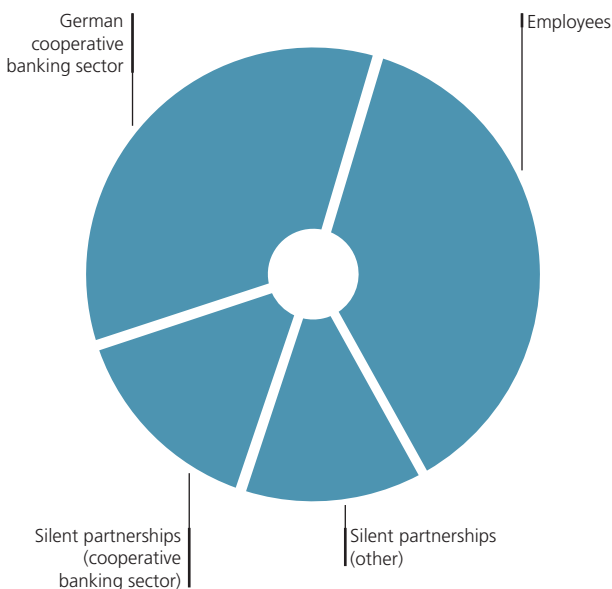
Net extraordinary income/expenses

Similar to last year, net extraordinary income/expenses includes restructuring expenses of € 1.3 million that were incurred in conjunction with staff-related measures (2004: € 4.4 million).

Net income

The operating result including risk provisioning amounted to € 51.4 million after € 78.8 million in 2004. Of this amount, € 10.9 million was transferred to the fund for general banking risks, pursuant to section 340g of the HGB, to further strengthen our regulatory Tier 1 capital. Taking the partial profit transfer to silent partnerships of € 39.2 million into consideration, the net result was breakeven. In 2004, net income of € 17.5 million was transferred to DZ BANK, under the profit transfer agreement which remains in place.

VALUE GENERATED AND BREAKDOWN OF CONTRIBUTIONS 2005



	€ mn	%
Employees	51.9	37.3
German cooperative banking sector*	48.3	34.7
Silent partnerships (cooperative banking sector)	20.7	14.8
Silent partnerships (other)	18.4	13.2
TOTAL	139.3	100.0

* Levies paid to associations plus commissions paid

RISK REPORT

Risk management – objectives and organisation

a) Objectives of risk management

DG HYP's risk management process is geared towards exploiting the business potential within the scope of the bank's capacity to carry and sustain risk, emphasising profitability. Within this context, we follow the guidelines of optimising the risk/return profile of the lending business, with respect to individual transactions as well as within the framework of active management of the entire portfolio. The individual types of risk in the lending and securities business are standardised to permit comparison, in order to provide a basis on which capital allocation throughout the entire bank is managed, with an emphasis on risk and return.

b) Responsibilities

The organisation and assignment of responsibilities for DG HYP's risk management is focused on the requirements of the bank's business model, within the framework of applicable regulatory requirements, in particular, the Minimum Requirements for the Credit Business of Credit Institutions (*Mindestanforderungen an das Kreditgeschäft – "MaK"*) and the Minimum Requirements for the Conduct of Trading Activities of Credit Institutions (*Mindestanforderungen für das Betreiben von Handelsgeschäften – "MaH"*). DG HYP has also developed and implemented risk management and risk controlling systems that take into account all market and competitive requirements. This forms the basis that ensures the proper operation and efficiency of the risk management process.

Management Board. All members of the Management Board are jointly responsible for risk management at DG HYP. The Management Board determines the risk policy with regard to defining the business and risk strategies, determining the types of business pursued, and defining the justifiable overall risk level, in line with the bank's capacity to carry and sustain risk.

Risk/Return Management Committee. The Risk/Return Management Committee is the central body for risk management across the entire bank. Besides including the members of the Management Board as committee members carrying voting rights, the heads of Finance/Controlling, Credit Treasury and Treasury as well as the heads of Credit Risk Management units are also mem-

bers of the Committee; they, however, have no voting rights. The Committee generally convenes once per week, and concerns itself in particular with the management of the risks of the entire bank as well as the allocation of capital.

Risks and Participations Committee of the Supervisory Board. This Committee comprises up to four of the bank's twenty-one Supervisory Board members. It is responsible for the decision-making regarding certain loan exposures, portfolio transactions, and participating interests which – in line with the Internal Rules of Procedure – are not within the remit of the Management Board.

Supervisory Board. The entire Supervisory Board decides on the acquisition or disposal of participating interests in the event of changes exceeding € 500,000 in the book value of such interests; on the establishment or disposal of business lines; the establishment of branches or representative offices; and the Internal Rules of Procedure for the Management Board. Furthermore, it also decides on material issues related to loans or participations that are not explicitly assigned to the Risks and Participations Committee.

c) Functions

Risk Planning. Planning, as a bank-wide exercise, comprises the planning of income and costs, as well as the risks associated with DG HYP's individual business activities. Based on the strategic business orientation as part of a 5-year plan, the bank carries out operative planning on an annual basis. Within this planning process, risk limits and earnings projections are determined in the respective business units on the basis of their capacity to carry and sustain risk.

Risk Management. The Risk Management function is split into three units, in line with the relevant front office divisions (Residential Real Estate Finance, Commercial Real Estate Finance, and Credit Treasury). Credit Risk Management is responsible for managing counterparty risk, at a portfolio level or regarding individual exposures, within the scope of the credit risk strategy as defined from time to time. This comprises both the implementation and active management of provisions within the scope of the credit risk strategy, monitoring the counterparty risk within the scope of granting and processing loans, early identification

of potential risks in the lending business and intensified handling of distressed loans, plus restructuring and recovery of lending exposures through the corresponding procedures and control systems. Credit Treasury is responsible for credit risk management on a portfolio level. The management of market and liquidity risks is the responsibility of Treasury, within the scope of asset/liability management.

Risk Controlling. Risk Controlling is responsible for current reporting and – together with the respective risk management unit – for monitoring risk on a portfolio level. This comprises quantifying the risk exposure, monitoring the quality and accuracy of data relevant to the risk exposure, monitoring the limit utilisations, and risk reporting to the Management Board. For this purpose, Risk Controlling prepares a *MaK*-compliant credit risk report on a quarterly basis, which outlines the key structural features of the lending business. A specific monitoring report for the retail business is produced on a quarterly basis, using scoring data generated from new business and behavioural scoring of the existing portfolio. An overall risk report is drafted monthly, which illustrates current credit risks as well as market risks and operational risk. Furthermore, Risk Controlling also carries out daily risk reporting on the market risks to which DG HYP is exposed, in accordance with *MaH*. Risk Controlling's main conclusions are reported regularly to the Supervisory Board.

Internal Audit. The internal audit examines whether the demands on the internal controlling systems, the risk management and controlling systems, and the necessary reporting, are adequately met.

d) Basel II

The new Basel Capital Accord (commonly referred to as "Basel II"), which will come into force as of 1 January 2007, is focused on securing the stability of the banking system and promoting banking supervision with greater qualitative focus.

The core element of Basel II is greater risk-adjusted differentiation of the regulatory capital requirements for loans, depending on the credit quality of the borrower. It is particularly relevant to DG HYP that small-sized retail loans are subject to adequate portfolio-oriented risk weighting, which is likely to provide relief regarding the extent of capital adequacy requirements pertaining to banks.

All told, the planned regulations of the Basel Committee confirm our approach to a risk/return-oriented business and portfolio management. DG HYP will implement the Foundation Internal Ratings-based Approach (FIRB) within the scope of Basel II. Developing our internal rating systems to implement the requirements of the Basel II Accord remains on schedule. In 2005, we concluded the implementation of all the internal rating and scoring processes required for adopting the FIRB.

All projects involved in preparing for the introduction of Basel II have been run in close cooperation with the corresponding requirements for the DZ BANK Group since 2003. They also correlate closely with the cross-institutional Basel II projects carried out by the Federal Association of German Credit Unions and Rural Banking Cooperatives (*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken – "BVR"*) and the Association of German Mortgage Banks (*Verband deutscher Pfandbriefbanken – "vdp"*).

Counterparty risk

Counterparty risk denotes the risk that a borrower is unable to repay a loan, either in part or not at all. It also applies to a derivative counterparty who is unable to meet his future payment obligations in part or not at all, or to a situation where the value of a participating interest is impaired. Due to the particular relevance of real estate lending as DG HYP's core business, credit risk is at the forefront of our observations. The management of credit risk is conducted largely as follows:

- rating and portfolio-oriented management of new business and loan extensions;
- credit pricing that is in line with the associated risks;
- active portfolio management (constant portfolio monitoring and management);
- active management of problem loans (early warning process, intensified handling, restructuring and settlement).

a) Lending process

The lending process for high-volume/smaller-sized retail business is based on a largely standardised application scoring system that corresponds to the requirements of *MaK* as well as to the Basel II regulations. Processing for this lending business is outsourced to VR Kreditwerk, observing the provisions of section 25a of the KWG. Depending on the relevant score, incoming loan applications up to € 300,000 are either approved automatically, approved or rejected on the basis of a separate manual review within DG HYP, or are automatically rejected. In the retail lending business, the lending decisions for loans exceeding € 300,000 are always based on a manual review, as well as on a scoring model. DG HYP carries out the entire loan processing for retail loans of between € 500,000 and € 1,000,000.

Commercial real estate finance, which also comprises loans exceeding € 1 million for properties largely used for residential purposes (per primary obligor group in accordance with section 19 (2) of the KWG), encompasses distribution and customer service in DG HYP's decentralised real estate centres. These act as 'market' units according to *MaK*, while the corresponding decentralised back-office units are part of Credit Risk Management/Commercial Real Estate Finance. Each lending decision requires a separate vote by the market unit as well as by the back-office unit. The loan application is authorised on the basis of lending volume and risk classification. The corresponding parameters are laid down in the credit and portfolio strategies.

b) Limit system

DG HYP has a limit system in place to manage and monitor counterparty and country risks. This system calculates the utilisation of external limits (country risk limits in the DZ BANK Group, and default risks in accordance with section 13 of the KWG), setting internal limits for country and default risks simultaneously and independently of one another. The respective limits must be adhered to at all times, and are also monitored online.

Limit utilisation is documented continuously on the basis of regular reports prepared by Risk Controlling. The Management Board is informed immediately of limit breaches, after which it decides on suitable measures to be taken.

Counterparty limits are determined depending on the individual default risk of the respective business partner. An indicator-based internal scoring process was developed specifically for those smaller and medium-sized banks that are often not externally rated. As of 2006, the limits will be

set for banks in accordance with the relevant 'BVR II' rating procedure, as defined by the Federal Association.

c) Credit scoring/rating

Early in 2003, DG HYP introduced a scoring system to assess and decide on new business applications in the retail lending business. Thanks to this process, decisions regarding applications can be largely automated and therefore conducted in a cost-effective manner. Furthermore, risk assessment can be differentiated in line with a consistent and active business management policy.

Loan applications are thus assessed in terms of customer, property and loan product specification, using a scorecard. A score is calculated for each loan on this basis, and can subsequently be displayed in a rating class on the BVR II master scale that was developed for the cooperative banking sector. Furthermore, an additional assessment is carried out through the Strategy Management™ business management system, according to management criteria applicable to new business (such as loan-to-value ratio, type of usage, regional aspects). This management tool is based on a strategy tree, whose parameters can be adjusted in the event of changes in market conditions or in response to knowledge gained from the continuous monitoring of new business from the scenario analyses carried out. Continuous backtesting of the implemented strategies ensures targeted management of the retail business.

Since the fourth quarter of 2005, we have been conducting a scoring-supported, continuous assessment of the retail loan portfolio on the basis of a so-called 'behavioural scoring' that can also be displayed in the rating classes of the BVR II master scale. This scoring process facilitates a regular portfolio assessment, which is updated monthly. The bank can thus identify rating migrations in the retail lending business at a much earlier stage than was previously feasible, and take them into account within the scope of new business and portfolio management as well as processing the portfolio.

In order to manage the credit risks inherent in commercial real estate finance, DG HYP calculates a differentiated credit rating for the borrower, within the scope of the credit analysis, along with a total property rating (macro/micro location and property rating) and the loan-to-value ratio for the individual exposure. The calculated data forms the basis for the lending decision and pricing. The borrower's rating, as well as the property's ability to cover interest and principal repayments, is at the forefront of DG HYP's forward-looking credit analysis.

In order to take the particular demands on DG HYP's commercial real estate lending business into account, we also developed (in cooperation with the central institutions of the German cooperative banking sector and BVR) a special Basel-II compliant rating system for specialised lending (SLRE – Specialised Lending Real Estate), which we implemented in 2005. These rating procedures apply to the following customer groups: real estate developers, residential property developers, development companies, closed-end funds, project developers and commercial real estate investors.

In 2005, we also introduced a rating procedure for local authorities that conforms to Basel II requirements. DG HYP played a major role in developing the municipal rating system, particularly within the scope of a cooperative project where *vdp* joined forces with S&P Risk Solutions. We use the BVR II rating procedures implemented in DZ BANK within the framework of a 'rating desk' solution for the rating of sovereigns, banks and key accounts.

In 2005, we acquired the MoriX™ market and property analysis rating system, for the purpose of classifying the properties serving as collateral. As of 2006, DG HYP will use the system through our VR WERT subsidiary, which will combine the MoriX™-results with additional assessments of the property to arrive at a market and property rating. A simplified process will be used for loans of less than € 300,000, where only the market assessment from MoriX™ will be taken into account.

All lending exposures, for which the borrower's financial circumstances must be disclosed in accordance with section 18 of the KWG, are reviewed annually and their rating adjusted if necessary. In addition, monitoring documents are prepared regularly for exposures exceeding € 2.5 million per primary obligor group. The monitoring comprises the rating analysis and other customer records, an assessment of the current rental situation, and the tenant rating(s). The property or other collateral is revalued if deemed necessary.

d) Management of problem loans

Credit exposures of more than € 500,000 are subject to intensified handling under certain circumstances. For this purpose, DG HYP developed an early warning system, which uses a variety of indicators to highlight the necessity for more intensive handling of the loan account. All cases of intensified handling are reported on a quarterly basis, with reports provided on all intensified handling cases with the same frequency. Within the scope of

monitoring, a checklist is maintained for each of these exposures, which provides information on the renewed review of collateral, the property and rating assessment, as well as measures that have already been initiated. At the same time, the outcome of this intensive review forms the basis for the decision on further support measures (normal or intensified handling, or restructuring).

Those problem credit exposures whose economic perspective can be assessed as positive are processed in the restructuring department, which forms part of the back-office. Submitting a concept that must comprise a differentiated analysis and assessment of the overall situation of the exposure and a cost-benefit analysis, as well as a comprehensive restructuring plan, forms the basis for a restructuring decision. Exposures are generally transferred to the Settlements department for workout in the event of the business relationship being terminated; this also applies to problem loans not exceeding € 500,000 and to problem exposures whose economic perspective can be assessed as negative.

e) Portfolio management

Besides the management of individual credit risks, active portfolio management is central to DG HYP's risk management process. This comprises both the assessment of individual exposures from a portfolio perspective and the risk/return-oriented management of the overall portfolio through securitisations, MBS purchases, and the acquisition and disposal of loan portfolios. Risk Management and Credit Treasury are responsible for portfolio management, while Credit Treasury alone is charged with implementing the approved strategy.

Risk Controlling uses a credit risk model (based on CreditRisk+™) to measure the counterparty risks on the basis of a portfolio analysis involving all asset classes. A Credit Value at Risk (CVaR), calculated with a confidence interval of 99.9 per cent and a one-year holding period, serves as the basis for limiting counterparty risk across the entire bank as well as for portfolio management in Credit Treasury. This process allows the bank (amongst other things) to calculate the risk contribution of individual exposures in terms of diversification within the overall portfolio, and the ensuing utilisation of the economic capital (RAROC management). The results of this regular analysis are continuously integrated in the credit risk strategy, and are taken into consideration as an additional parameter in the process of granting large-volume loans (upwards of € 25 million).

Special analyses can be used to actively manage portfolio structures through the purchase and sale of identified credit risks. This applies on the one hand to lending decisions for individual exposures – for example, large-volume loans in the syndicated lending business. On the other hand, we have already placed credit risks with external third parties in full, by way of synthetic securitisations.

At the same time, DG HYP invests in third-party MBS transactions. The duality of placing credit risks with third parties and investing in other portfolio structures offers better risk diversification in the overall portfolio – which we can thus manage in a targeted manner. Risk Controlling regularly prepares portfolio reports from the credit risk model for this purpose. These include (amongst other things) expected and unexpected loss data calculated for the overall portfolio, and a breakdown of the credit value at risk (CVaR) across the business divisions.

Market risks

For us, the concept of ‘market risks’ comprises the risks associated with fluctuations in market prices (market risks in the narrower sense), and liquidity risk. Market risk is the impact of interest rate fluctuations on the money and capital markets, and changes in exchange rates. Liquidity risk comprises the threat that DG HYP is unable to borrow the funds required to maintain payments, or the risk of only being able to do so at considerably less favourable terms.

a) Risks associated with market price fluctuations

DG HYP uses various hedging tools in its dynamic management of interest rate risk and currency risk for the bank as a whole. This consists mainly of macro hedge transactions employing interest-rate swaps and caps; options on interest-rate swaps (so-called swaptions) are also concluded occasionally, albeit to a limited extent. In addition, a number of large-sized transactions, such as granting promissory note loans to institutional clients, are hedged regularly through micro hedges against the particular interest rate risk. Interest-rate swaps and swaptions are also used for this purpose.

In order to quantify the bank’s market price risk, DG HYP calculates two VaR figures daily using a variance/co-variance procedure for all positions in each of the portfolios. The following parameters are used in the calculations, in accordance with section 32 of the provisions governing the use of internal models for the capital ratio according to the KWG:

- 250-day history;
- ten-day holding period and one-day holding period;
- 99 per cent confidence interval.

The forecasting quality of our internal VaR model is checked daily. We apply the assumptions in the Basel Committee publication on market risk as model parameters for this backtesting process:

- preceding 250-day period;
- one-day holding period;
- 99 per cent confidence interval.

Risk Controlling compares the projected changes in present value that are calculated according to these parameters, with the negative changes in present value that actually occur the following day. On this basis, we determine how often the actual negative changes in the present value exceeded the VaR figures in the risk model.

Risk Controlling informs the Management Board, as well as the Treasury, on the day-to-day Treasury performance and utilisation of the VaR limit. The Management Board decides on the management of the risk structure for the entire bank at the weekly meeting of the Risk/Return Management Committee.

b) Liquidity risk

The bank’s liquidity situation is determined daily, in line with the regulatory and daily business requirements. For this purpose, Risk Controlling provides Treasury with a differentiated overview on a daily basis, indicating future liquidity flows resulting from the individual positions in the portfolio. The Risk/Return Management Committee is

DG HYP VaR (10-DAY HOLDING PERIOD, 99 PER CENT CONFIDENCE INTERVAL) DEVELOPMENT IN 2005



provided with a weekly overview of the short- and long-term liquidity projection. Liquidity is managed on the basis of this overview, with the dual objectives of securing the bank's long-term liquidity and achieving compliance with the liquidity principle in accordance with section 11 of the KWG (*Grundsatz II*).

A liquidity controlling system was implemented in 2005, in line with the requirements of Basel II for measuring and reporting on liquidity risk. On the basis of the short- and long-term liquidity projection, a limit system will be implemented on a daily basis in 2006 and integrated in the risk monitoring process.

Operational risks

The Basel Committee defines operational risks as “the risk of direct or indirect losses resulting from inadequate or failed internal processes, people and systems, or from external events”. DG HYP has adopted this definition, albeit with marginal changes to detail in order to adjust it to the bank’s own special interests. According to the Basel II Consultative Document, as of 1 January 2007 banks will be subject to capital requirements for operational risks. DG HYP has implemented the standard approach for quantification of such risks since 2003.

A system for collecting and recording loss data has already been in place since 2002. Incoming loss reports are collected systematically, in a database arranged according to predefined categories: they are subsequently used as indicators for further improving the operating processes, and hence for reducing operational risks.

A self-assessment procedure has been carried out by all of DG HYP’s organisational units on a regular basis since 2004; current risks are assessed using a standardised electronic questionnaire. In addition, Risk Controlling carries out continuous plausibility and consistency checks.

In order to also be able to identify operational risks in good time, an early warning system regularly records various risk indicators (such as system failures, fraud, staff fluctuation). The agreed risk indicators and the collated reports are submitted anonymously within the scope of group-wide reporting to DZ BANK.

VR Kreditwerk is responsible for credit processing in the retail business and for the provision of IT services. The operational risks inherent to DG HYP from these activities are taken into consideration in the systems of VR Kreditwerk and of DG HYP, also taking into account experience gained in controlling outsourced activities.

The emphasis is on business continuity measures, addressing operational risks that arise from the use of the bank’s property and of the IT system. The key measures for dealing with such risks are laid down in the emergency

handbook. From an organisational perspective, DG HYP’s Risk Controlling is responsible for measuring operational risks. Risk Controlling reports regularly on operational risk issues to DG HYP’s Management Board, and on the activities for further developing the quantification approach, within the scope of the Risk/Return Management Committee meetings.

Strategic risks

Strategic risks include the threat of losses arising from management decisions regarding DG HYP's business policy. Strategic risk can also concern long-term success factors in DG HYP's environment, such as changes to the legal or social environment, changes in the market and competitive environment, and changes affecting customers or refinancing partners. We also include planning and reputation risks in this risk category.

In order to reduce planning risks, variance analyses are prepared as a basis for continuously reviewing planning data and assumptions.

Reputation risk concerns direct or indirect losses incurred by the erosion of DG HYP's reputation among shareholders, staff, customers, business partners and the general public. All measures and events that can affect the bank's reputation are identified in both Public Relations and Investor Relations, and in the market units concerned. They are evaluated in close cooperation with the Management Board, in order to mitigate their impact as early as possible.

DG HYP generally uses, amongst other things, investment calculations and projections, business plans including scenario-based simulations, cost/benefit analyses, and risk analyses as the basis for strategic decisions, in order to identify and minimise strategic risks. In addition, all decision proposals submitted that may involve or induce strategic risks include a statement by the responsible organisational unit on the risk content, which is taken into account in the resolution passed.

Given that, as a rule, strategic risks are subject to very complex and irregular factual connections, they cannot be included in an integrated system as special risks. They are therefore specially monitored by the Management Board; they are also monitored and continuously analysed by the respective individual organisational units responsible. The regular review of business unit strategies is also a core element of the continuous process of business unit planning and control.

OUR STAFF

Reorganisation of staff structure

In recent years, we have gradually adjusted the staff and qualification structure to meet the changed requirements in line with DG HYP's strategic realignment. This formed the basis for securing new business and exploring new markets in a sophisticated regulatory environment.

The 2003 and 2004 financial years saw a streamlining of the organisation, and a strategic orientation of our real estate lending activities: these significant structural changes were conducted through staff capacity reductions in some areas, and increases in others. This momentum of staff restructuring abated considerably during 2005. We further strengthened capacities, above all in credit risk management.

We cut staff numbers by using natural fluctuation where possible, and through existing collective agreements such as early and partial retirement, so that the number of employees who have entered partial retirement has increased further. As at 31 December 2005, 32 employees had entered the active phase and 29 the passive phase of partial retirement.

Personnel development – a strategic success factor

We introduced new forward-looking management tools to assist the bank's realignment process. Core elements of our human resources concept include offering parallel career paths for business experts and managers; analytical tools to assess employee potential and qualification measures; and an efficient performance assessment system.

In our personnel development strategy, we invest equally in hands-on qualification measures and in additional expertise by acquiring new specialists. During the annual target agreement and assessment discussion that man-

agers hold with each of their staff, individual requirements for development and qualifications will receive particular attention. In 2005, our qualification campaign focused in particular on the necessary training required with regard to Basel II, credit rating and on measuring real estate in accordance with IAS/IFRS. A total of 510 staff members took part in 63 internal training programmes.

Furthermore, a joint training programme with VR IMMO was implemented during the period under review, and the first measures undertaken. We also launched a sponsorship programme for trainees, targeted at young, qualified staff that have the potential and commitment necessary to take on specialist and managerial functions. The group of participants, comprising staff from Bausparkasse Schwäbisch Hall, VR Kreditwerk and DG HYP, is based on a modular concept designed by an external training team.

Education

One of the core aspects of our staff development is to ensure that we are able to attract trainees from our own ranks. In the year under review, seven job entrants qualified as bank officers, while two candidates completed their business management studies at the College of Advanced Vocational Studies. As at 31 December 2005, 23 young people were employed as vocational trainees by DG HYP.

Training at DG HYP is conducted in close cooperation with VR Kreditwerk and the German cooperative banking sector. The partner banks make a valuable contribution to promoting the expertise – and a focus on sales – of our staff, and to the success of our graduate training programme. In December 2005, DG HYP was awarded the "Excellence in Training" award from the Hamburg Chamber of Commerce, in acknowledgement of its commitment and services.

Social benefits

DG HYP specifically promotes health and safety at the workplace. Ergonomic advice from the company doctor, a mobile massage service, in-house sports groups and the commitment of work safety experts and representatives are standard. Our staff also benefit from the variable schemes for hours worked, as well as child-care support. The sick rate level has been low for many years, and at 3 per cent for the year under review, is considerably lower than the national average.

Cooperation within the framework of VR IMMO

The targeted harmonisation of our staff management within the scope of VR IMMO was one of the main duties in 2005. A consolidation of tasks, under the personnel administration system SAP/R3 HR in 2005, following extensive preparation, allowed joint payroll accounting as well as customised personnel planning and controlling processes. Further focal points of the intensified cooperation were a joint job centre and customised planning of personnel management projects.

NUMBER OF EMPLOYEES

Number of active employees

	31 Dec 2005	31 Dec 2004
Management Board	2	2
Salaried employees	545	543
Vocational trainees	23	25
Total	570	570
Weighted staff capacity	545.4	543.3

In addition, 62.6 employment relationships were inactive as at 31 December 2005 (e.g. due to part-time maternity leave; long-term sickness; or employees having entered the 'passive phase' of partial retirement).

NUMBER OF RECIPIENTS OF RETIREMENT BENEFITS

	31 Dec 2005	31 Dec 2004
Retired employees	225	214
Surviving dependants	41	43

OUTLOOK

Market environment

We expect the moderate upside trend in economic development to continue in Germany over the next two financial years. Following the declines of recent years, we believe that the domestic real estate markets have emerged from the doldrums. The trend towards a more pronounced differentiation of the real estate markets will continue. Germany remains Europe's largest real estate market and as such, offers very attractive potential for real estate finance.

The foreign real estate markets in which DG HYP has a presence, or is active within the scope of the cross-border strategy, offer very interesting market potential, above all in the UK and the US. The financial centres of these countries offer real estate investors attractive returns, and growth opportunities in the years ahead.

The domestic local authorities in Germany are faced with the immense challenge of high investment and financing requirements in the coming years. Within this context, public/private partnerships will become increasingly important. The objective is to improve public authority cost structures and to structure public-sector projects more efficiently.

Overall, we see good business opportunities in the years ahead for our activities in real estate and public-sector finance. Competition amongst the banks is expected to remain very intensive in our German home market. However, as we approach the 2007 implementation of Basel II, loan pricing will become increasingly risk-oriented.

Business Development

In view of the existing challenges and opportunities offered by the economic environment, we will focus our business divisions on attractive market segments and

products, on extending our active portfolio management and structured finance activities, and on optimising the loan processes and further strengthening credit risk management.

On this basis, we are forecasting continuous growth in new business and loan extensions in residential and commercial real estate finance in the years ahead. Given the growth perspective and positive margin development in new business in recent years, we envisage a turnaround in net interest income in the current 2006 financial year, and continuous increases in the years ahead. This also applies to gross profit.

We will also invest in expertise and personnel for the future, within the scope of the bank's strategic development framework. In doing so, we will continue to focus on administrative expenditure, which we will contain by way of strict cost management.

The completion of our portfolio adjustment in 2005, the development of our credit risk management processes, as well as active portfolio management, all pave the way for further reducing risk provisioning. With this in mind, we expect loan loss provisioning to fall further in the years ahead.

On this basis, we are also forecasting a continuous rise in DG HYP's operating income over the same timeframe.

To support the growth in the lending business, further measures were agreed with DZ BANK to ensure that the core capital (Tier I) ratio is sustained at above 7 per cent.

All told, with our strategic orientation, DG HYP is well positioned to fulfil its role as an active, creative player in a challenging and changing market environment.

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BALANCE SHEET
AS AT 31 DECEMBER 2005

ASSETS

BALANCE SHEET

	€ 000's	Note #	€ 000's	€ 000's	31 Dec 2004 € 000's
Cash funds				13,115	18,741
a) Cash on hand			1		1
b) Balances with central banks			13,114		18,740
of which: with Deutsche Bundesbank	13,114				(18,740)
Loans and advances to banks		(6)		5,811,488	5,628,414
a) Loans secured by property mortgages			236,882		224,585
b) Loans to local authorities			4,609,192		4,842,993
c) Other loans and advances			965,414		560,836
of which: Payable on demand	551,635				(384,241)
of which: Collateralised by pledged securities	–				(–)
Loans and advances to customers		(6)		41,857,146	42,006,326
a) Loans secured by property mortgages			24,553,159		24,584,706
b) Loans to local authorities			17,006,381		16,800,091
c) Other loans and advances			297,606		621,529
of which: Collateralised by pledged securities	–				(–)
Bonds and other fixed-income securities		(9)		30,499,880	25,294,445
a) Bonds and debt securities			(30,244,301)		(24,852,014)
aa) Public-sector issuers			14,726,283		12,049,422
of which: Securities eligible as collateral with Deutsche Bundesbank	12,297,922				(11,509,132)
ab) Other issuers			15,518,018		12,802,592
of which: Securities eligible as collateral with Deutsche Bundesbank	14,004,347				(9,343,915)
b) Own bonds issued			255,579		442,431
Nominal amount	253,010				(429,447)
Equities and other non-fixed income securities		(9)		16	16
Participations		(9)		2,958	2,470
of which: Interests in banks	264				(–)
Interests in financial services providers	–				(–)
Interests in affiliated companies		(9)		3,991	5,331
of which: Interests in banks	–				(–)
Interests in financial services providers	–				(–)
Trust assets		(12)		598,633	444,093
of which: Trustee loans	564,901				(410,361)
Intangible fixed assets		(13)		40,212	44,294
Tangible fixed assets		(13)		3,391	4,647
Other assets				25,034	30,821
Deferred taxes				5,925	5,925
Prepaid expenses		(15)		277,840	327,031
a) From new issues and lending			276,586		326,069
b) Other			1,254		962
Total assets				79,139,629	73,812,554

AS AT 31 DECEMBER 2005

LIABILITIES AND EQUITY

	€ 000's	Note #	€ 000's	€ 000's	31 Dec 2004 € 000's
Liabilities to banks		(16)		11,271,650	11,566,568
a) Outstanding registered mortgage bonds (<i>Hypotheken-Namenspfandbriefe</i>)			1,080,043		1,082,687
b) Outstanding registered public-sector covered bonds (<i>öffentliche Namenspfandbriefe</i>)			3,828,018		2,882,478
c) Other liabilities			6,363,589		7,601,403
of which: Payable on demand	205,333				(234,341)
Registered mortgage bonds	4				(5)
and registered public-sector covered bonds surrendered to lenders as collateral for borrowings	15,531				(26,095)
Liabilities to customers		(16)		11,869,677	11,923,985
a) Outstanding registered mortgage bonds (<i>Hypotheken-Namenspfandbriefe</i>)			3,060,433		3,487,420
b) Outstanding registered public-sector covered bonds (<i>öffentliche Namenspfandbriefe</i>)			6,009,026		5,502,382
c) Other liabilities			2,800,218		2,934,183
of which: Payable on demand	165,982				(192,953)
Registered mortgage bonds	39,369				(52,152)
and registered public-sector covered bonds surrendered to lenders as collateral for borrowings	26,031				(46,482)
Securitised liabilities		(16)		52,811,923	47,522,516
Bonds issued					
a) Mortgage bonds (<i>Hypothekenspfandbriefe</i>)			14,344,290		14,501,606
b) Public-sector covered bonds (<i>öffentliche Pfandbriefe</i>)			33,472,276		28,150,959
c) Other debt securities			4,995,357		4,869,951
Trust liabilities		(12)		598,633	444,093
of which: Trustee loans	564,901				(410,361)
Other liabilities				75,452	94,355
Deferred income		(15)		111,148	120,775
a) From new issues and lending			111,024		120,635
b) Other			124		140
Provisions				83,495	82,054
a) Provisions or pensions and similar obligations			56,746		56,478
b) Provisions for taxes			450		466
c) Other provisions			26,299		25,110
Subordinated liabilities		(17)		658,985	620,442
Profit-participation certificates		(18)		153,643	153,643
of which: Due within two years	7,925				(0)
Fund for general banking risks				24,078	13,178
Equity				1,480,945	1,270,945
a) Subscribed capital		(19)	(863,687)		(683,687)
aa) Share capital			90,000		90,000
ab) Silent partnership contributions			773,687		593,687
b) Capital reserves		(20)	524,113		494,113
c) Retained earnings		(20)	(93,145)		(93,145)
ca) Legal reserves			945		945
cb) Other retained earnings			92,200		92,200
Total equity and liabilities				79,139,629	73,812,554
Contingent liabilities		(22)			
Liabilities from guarantees and indemnity agreements				720,973	588,599
Other commitments					
Irrevocable loan commitments				987,249	739,844

PROFIT AND LOSS ACCOUNT
FOR THE PERIOD FROM 1 JANUARY TO 31 DECEMBER 2005

PROFIT AND LOSS ACCOUNT

FOR THE PERIOD FROM 1 JANUARY TO 31 DECEMBER 2005

	€ 000's	Note #	€ 000's	€ 000's	2004 € 000's
Interest income from					
a) Lending and money market transactions			2,801,661		2,910,810
b) Fixed-income securities and debt register claims			<u>1,083,799</u>		<u>896,075</u>
				3,885,460	3,806,885
Interest expense				<u>3,561,020</u>	<u>3,475,139</u>
				324,440	331,746
Current income from					
a) Participating interests			35		535
b) Interests in affiliated companies			<u>10</u>		<u>58</u>
				45	593
Income from profit-pooling, profit transfer, and partial profit transfer agreements				1,108	722
Commission income			19,491		16,926
Commission expense			<u>77,994</u>		<u>56,891</u>
Net commission result				- 58,503	- 39,965
Other operating income		(28)		22,780	40,564
General administrative expenses					
a) Personnel expenses					
aa) Wages and salaries			41,125		36,902
ab) Compulsory social security contributions and expenses for pensions and other employee benefits			<u>10,842</u>		<u>11,476</u>
			51,967		48,378
of which: Pension expenses	4,897				(5,833)
b) Other administrative expenses		(29)	<u>115,156</u>		<u>114,876</u>
				167,123	163,254
Amortisation/depreciation and write-downs of intangible and tangible fixed assets				10,976	16,721
Other operating expenses				4,548	2,583
Amortisation and write-downs of receivables and specific securities, as well as additions to loan loss provisions				92,715	113,909
Income from write-ups on participations, interests in affiliated companies, and investment securities				36,984	41,579
Expenses for losses assumed under profit-transfer and similar agreements				141	-
Profit from ordinary activities				51,351	78,772
Extraordinary income			-		-
Extraordinary expenses			<u>1,318</u>		<u>4,399</u>
Net extraordinary income/expenses		(30)		- 1,318	- 4,399
Taxes on income		(31)	-		18,212
Other taxes not disclosed under "Other operating expenses"			<u>-</u>		<u>279</u>
				-	18,491
Profits transferred under partial profit transfer agreements				39,133	38,382
Profits transferred under profit transfer agreements				-	17,500
Transfer to the fund for general banking risks				10,900	-
Net income				-	-

Notes to the Financial Statements

(1) General information

The financial statements of DG HYP for the financial year 2005 have been prepared in accordance with the provisions of the German Commercial Code (*Handelsgesetzbuch – “HGB”*), the German Public Limited Companies Act (*Aktien-gesetz – “AktG”*), and the German Pfandbrief Act (*Pfand-briefgesetz – “PfandBG”*); in conjunction with the provisions of the German Accounting Directive for Banks (*Verordnung über die Rechnungslegung der Kreditinstitute – “RechKredV”*).

A decision was taken, following conclusion of the audit of the financial statements, to change the structure of regulatory Tier 1 capital, by way of a transfer to the fund for general banking risks, pursuant to section 340g of the HGB.

Given the non-materiality of subsidiaries, in accordance with section 296 (2) of the HGB, the company has not prepared consolidated financial statements.

(2) Accounting policies

Receivables are valued at nominal value under section 340e (2) HGB. Any difference between the nominal value and the actual payment amount is shown as a deferred item. All recognisable, existing individual lending risks were covered by specific loan loss provisions. Existing risks of default in the retail lending business were covered by recognising specific provisions at a flat rate. We have formed a tax-deductible general loan loss provision to cover expected loan losses which have been incurred but not identified as such at the balance sheet date. Special risks arising from banking operations are accounted for by the fund for general banking risks (section 340g of the HGB) and general risk provisions (section 340f of the HGB).

Securities issued by public-sector entities, or by banks under public-law, acquired within the scope of the bank's public finance business, as well as Mortgage Backed Securities (MBS) held for investment, were accounted for as fixed assets. Premiums and discounts are amortised in interest income over the term of the securities. Other debt securities and other fixed-income securities are generally allocated to liquidity reserves, and valued strictly at the lower of cost or market, pursuant to section 253 (3) of the HGB.

Securities transferred under repurchase agreements are accounted for, and valued (including accrued economic benefits) in line with their original classification, simultaneously recognising a liability equivalent to the agreed repurchase amount. The difference between the repurchase amount and the amount received is reported under deferred items and amortised in interest income over the term of the transaction.

Liabilities classified as structured products (as defined in Accounting Note BFA 1.003 issued by the German Institute of Auditors – “IDW”) are accounted for as uniform liabilities as they only contain embedded interest rate derivatives. Such liabilities are grouped with corresponding hedge transactions, to form valuation units.

Fixed assets are carried at cost less regular straight-line depreciation, where applicable. Movable fixed assets are predominantly depreciated on a straight-line basis, using the maximum rates permissible under tax laws, or degressively with a subsequent transfer to straight-line depreciation. Low-value assets are written off in full during their year of purchase. Standard software is reported under intangible assets, as prescribed by the Main Committee of the German Institute of Auditors (*IDW RS HFA 11*).

Liabilities are shown on the balance sheet at the amount due for repayment. The difference between the nominal value and the initial carrying amount of liabilities is recognised under deferred items.

Contingent liabilities are covered by provisions equalling the anticipated amount of the liability. Provisions for pensions have been determined using an interest rate of 6% based on the guideline tables issued by Heubeck in 2005 using the cost (“*Teilwert*”) method in accordance with the actuarial principles.

Early repayment penalties charged for loan repayments or extensions during the fixed-interest term of a loan are fully recognised in interest income.

Premium payments for swaptions entered into as a hedge against the impact of statutory loan termination rights pursuant to section 489 of the German Civil Code (*Bürgerliches Gesetzbuch – “BGB”*) are generally amortised over the term of the transactions. As such amortisation of premium payments is not recognised for tax purposes, we report a deferred tax asset pursuant to section 274 (2) of the HGB.

Premiums paid or received for credit default swaps are amortised in commission income over the terms of the transactions.

Income from the disposal (close-out) of interest rate-based derivative financial instruments are generally recognised in interest income. Where interest rate swaps are grouped with securities, to form valuation units (asset swaps), income realised upon closing out swaps are recognised in line with the recognition of income of the underlying transaction, in the net result on financial assets, or in the net risk provisioning balance, respectively.

Goodwill capitalised upon the merger with Schleswig-Holsteinische Landschaft Hypothekbank

Aktiengesellschaft Kiel ("*SHL HYP*") is amortised over the expected useful life (15 years), pursuant to section 255 (4) sentence 3 of the HGB, and in line with applicable tax rules.

(3) Derivative financial instruments

Financial derivatives are accounted for separately in auxiliary ledgers. These instruments are generally used to hedge against the interest rate and currency risk exposure of on-balance sheet transactions. Current interest payments are amortised and recorded in net interest income.

(4) Currency translation

Assets and liabilities from foreign exchange transactions are translated in line with section 340h of the HGB and Statement BFA 3/1995 issued by the German Institute of Auditors. Book receivables, securities, liabilities and unsettled spot transactions are generally translated using the ECB reference rate prevailing on the balance sheet date. Income and expenses from currency translation are recognised in the income statement in accordance with section 340h of the HGB. Income and expenses from foreign exchange forwards which were entered into exclusively as a hedge of interest-bearing balance sheet items are recognised in interest income.

Notes to the Balance Sheet
and Profit and Loss Account

(5) Loans and advances to banks/to customers

As in the previous year, no subordinated receivables were outstanding at the balance sheet date.

(6) Lending business

Mortgage loans	Principal € mn	Carrying amount € mn
to banks	235	237
to customers	24,329	24,553
Total	24,564	24,790
Portfolio development (principal)	€ mn	€ mn
Balance at 31 Dec 2004		24,921
Additions during the financial year 2005		
Disbursements	2,300	
Transfers	32	
Other additions	–	2,332
Disposals during the financial year 2005		
Scheduled repayments	919	
Unscheduled repayments	1,678	
Transfers	92	
Other disposals	–	2,689
Balance at 31 Dec 2005		24,564
Loans to local authorities	Principal € mn	Carrying amount € mn
to banks	4,505	4,609
to customers	16,828	17,007
Total	21,333	21,616
Portfolio development (principal)	€ mn	€ mn
Balance at 31 Dec 2004		21,294
Additions during the financial year 2005		
Disbursements	4,630	
Transfers	–	
Other additions	–	4,630
Disposals during the financial year 2005		
Scheduled repayments	3,543	
Unscheduled repayments	1,048	
Transfers	–	
Other disposals	–	4,591
Balance at 31 Dec 2005		21,333

(7) Coverage

	Mortgage bonds 31 Dec 2005 € mn	Mortgage bonds 31 Dec 2004 € mn	Public-sector covered bonds 31 Dec 2005 € mn	Public-sector covered bonds 31 Dec 2004 € mn
Ordinary cover	18,862	19,054	43,832	38,275
– Mortgage loans	18,862	19,054		226 *)
– Loans to local authorities (including securities from municipal issuers)	–	–	43,832	38,049
Substitute cover	395	486	–	–
– Securities	395	486	–	–
– Derivatives	–	–	–	–
Total cover	19,257	19,540	43,832	38,275
Pfandbriefe subject to coverage requirements	18,114	18,656	42,280	35,562
Excess cover (nominal)	1,143	884	1,552	2,713
Excess cover (present value)	1,913	1,539	2,465	3,246

*) under a municipal guarantee

Given that excess cover based on present values also includes accrued interest, the figures are higher compared to excess cover based on nominal values. Present values were determined using money market and swap rates prevailing on the balance sheet date.

**(8) Disclosure pursuant to section 28 (1) nos. 1 – 3 of the German Pfandbrief Act
Outstanding Pfandbriefe and related cover assets**

	Nominal amount 31 Dec 2005 € mn	Present value 31 Dec 2005 € mn	Risk-adjusted present value 31 Dec 2005 € mn
a) Total amount of mortgage bonds			
outstanding	18,114	19,209	18,691
Cover assets pool	19,257	21,122	20,335
of which: Derivatives	–	–	–
Excess cover	1,143	1,913	1,644
Excess cover (%)	6.3	10.0	8.8

re a) Maturity structure (remaining term)	31 Dec 2005				Total € mn
	up to 1 year € mn	> 1 to 5 years € mn	> 5 to 10 years € mn	> 10 years € mn	
Mortgage bonds	2,877	10,985	4,191	61	18,114
Cover assets pool	2,875	8,421	7,134	827	19,257

b) Total amount of public-sector covered bonds	Nominal amount	Present value	Risk-adjusted present value
	31 Dec 2005 € mn	31 Dec 2005 € mn	31 Dec 2005 € mn
outstanding	42,280	44,694	42,843
Cover assets pool	43,832	47,159	45,073
<i>of which: Derivatives</i>	51	1	- 3
Excess cover	1,552	2,465	2,230
Excess cover (%)	3.7	5.5	5.2

re b) Maturity structure (remaining term)	31 Dec 2005				Total € mn
	up to 1 year € mn	> 1 to 5 years € mn	> 5 to 10 years € mn	> 10 years € mn	
Public-sector covered bonds	2,842	21,636	11,490	6,312	42,280
Cover assets pool	4,544	17,713	16,109	5,466	43,832

**Disclosure pursuant to section 28 (2) no. 1a of the German Pfandbrief Act
Breakdown of cover assets for mortgage bonds by loan amount**

	Mortgages serving as cover*
	31 Dec 2005 € mn
up to € 300,000	15,120
> € 300,000 to € 5 million	2,435
> € 5 million	1,307
Total	18,862

* excluding substitute cover

Disclosure pursuant to section 28 (2) no. 1b, c of the German *Pfandbrief* Act
Breakdown of cover assets for mortgage bonds by country where real property collateral is located,
and by type of property

Country	Commercial properties € mn	Commercial housing properties € mn	Residential properties € mn	Single-family homes € mn	Multi-family homes € mn	Office buildings € mn	Commercial buildings € mn	Industrial buildings € mn	Other commercial buildings € mn	Unfinished new buildings not yet yielding returns € mn	Total € mn
Austria	-	-	0.1	0.5	0.1	13.3	-	-	-	-	14.0
Belgium	-	-	0.1	0.3	-	-	-	-	-	-	0.4
Denmark	-	-	-	0.1	-	0.1	-	-	-	-	0.2
France	-	-	1.8	28.6	0.6	267.5	8.2	-	31.4	0.7	338.8
Germany	6.1	-	2,637.2	8,607.7	3,243.8	1,150.1	318.5	59.8	2,303.0	124.2	18,450.4
Greece	-	-	-	-	-	-	-	-	-	-	-
Luxembourg	-	-	-	-	-	20.1	-	-	-	-	20.1
Netherlands	-	-	0.0	9.9	-	17.4	-	-	6.7	-	34.0
Norway	-	-	-	0.0	-	-	-	-	-	-	0.0
Portugal	-	-	-	0.0	-	-	-	-	-	-	0.0
Sweden	-	-	-	-	-	3.4	-	-	-	-	3.4
Spain	-	-	-	-	-	-	-	-	0.4	-	0.4
United Kingdom	-	-	0.4	0.2	-	0.0	-	-	-	-	0.6
Total	6.1	-	2,639.6	8,647.3	3,244.5	1,471.9	326.7	59.8	2,341.5	124.9	18,862.3

* excluding substitute cover

Breakdown of mortgages serving as cover* by German Federal states

German Federal state	31 Dec 2005 € mn	31 Dec 2004 € mn
Baden-Württemberg	1,718	1,757
Bavaria	1,293	1,187
Berlin	994	1,031
Brandenburg	677	665
Bremen	113	123
Hamburg	497	488
Hesse	1,552	1,554
Lower Saxony	3,546	3,744
Mecklenburg-Western Pomerania	594	607
North Rhine-Westphalia	3,183	3,269
Rhineland-Palatinate	687	697
Saarland	80	78
Saxony	722	723
Saxony-Anhalt	442	449
Schleswig-Holstein	2,035	2,122
Thuringia	317	319
Germany	18,450	18,813
Outside Germany (EU countries / Other countries)	412	241
Total	18,862	19,054

* excluding substitute cover

**Disclosure pursuant to section 28 (2) no. 2 of the German Pfandbrief Act
Payments in arrears on mortgage receivables**

Aggregate payments which are at least 90 days overdue	31 Dec 2005 € mn
France	0.67
Germany	82.42
Netherlands	0.01
Total	83.10

Disclosure pursuant to section 28 (2) of the German Pfandbrief Act
Forced sales and forced administrations pending

	31 Dec 2005	
	Commercial properties Number	Commercial housing properties Number
No. 3a		
Forced sales pending	287	1,063
Forced administrations pending *)	142	568
*) of which: Included in forced sales pending	122	462
Forced sales executed	128	1,628
	Number	Number
No. 3b		
Purchases of properties to prevent losses (foreclosed assets)	1	9
of which: Still part of cover assets	–	–
	€ mn	€ mn
No. 3c		
Total arrears	33.3	69.8
of which: on interest due	3.5	13.8
	€ mn	€ mn
No. 3d		
Repayments of mortgage loans through redemption	183.2	233.2
through other forms of repayment	294.9	648.8

Disclosure pursuant to section 28 (3) no. 1 of the German *Pfandbrief Act*
Breakdown of cover assets for public-sector covered bonds by country of domicile of the borrower and, in the case of full guarantee, of the guarantor

Country	Sovereign borrowers € mn	Regional public-sector entities € mn	Local public-sector entities € mn	Other borrowers € mn	Total € mn
Austria	522	–	–	720	1,242
Belgium	340	15	–	74	429
Canada	–	318	–	–	318
Cyprus	7	–	–	–	7
Czech Republic	50	–	–	–	50
Finland	157	–	–	–	157
France	200	225	–	241	666
Germany *	699	9,734	11,698	12,230	34,361
Greece	824	–	–	–	824
Hungary	82	–	–	–	82
Iceland	24	–	–	–	24
Ireland	100	–	–	–	100
Italy	988	434	25	57	1,504
Latvia	25	–	–	–	25
Lithuania	–	23	–	–	23
Luxembourg	–	–	–	200	200
Netherlands	150	–	8	–	158
Norway	–	–	–	20	20
Poland	83	–	–	–	83
Portugal	650	–	–	–	650
Slovakia	35	–	–	–	35
Slovenia	5	–	–	–	5
Spain	303	2,223	21	142	2,689
Switzerland	–	64	–	–	64
USA	–	90	26	–	116
Total	5,244	13,126	11,778	13,684	43,832

* including derivatives (€ 51 mn)

Disclosure pursuant to section 28 (3) no. 2 of the German *Pfandbrief* Act
Aggregate payments in arrears by at least 90 days
on cover assets for public-sector covered bonds

	31 Dec 2005 Nominal cover amount € mn
Germany	
Sovereign states	–
Regional public-sector entities	–
Local public-sector entities	–
Other	104
Total	104

(9) Negotiable securities

Balance sheet item	Listed		Unlisted		Amount of negotiable securities not valued at the lower of cost or market	
	31 Dec 2005 € 000's	31 Dec 2004 € 000's	31 Dec 2005 € 000's	31 Dec 2004 € 000's	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Bonds and other fixed-income securities	27,864,744	23,685,583	2,635,136	1,608,862	1,951,852	1,261,811
Equities and other non-fixed income securities	16	16	–	–	–	–
Participations	–	–	2,150	1,887	–	–
Interests in affiliated companies	–	–	–	1,504	–	–

(10) Open-market transactions

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Open-market transactions entered into with Deutsche Bundesbank	3,766,926	3,455,389

(11) Securities repurchase agreements

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Carrying amount of securities pledged under repo agreements	–	1,307,420
Repurchase amount	–	1,309,132

(12) Trust business

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Assets held in trust comprise:		
– Loans and advances to banks	–	–
– Loans and advances to customers	564,901	410,361
– Participations	33,732	33,732
	598,633	444,093
Trust liabilities are carried vis-à-vis:		
– Banks	564,901	410,361
– Customers	33,732	33,732
	598,633	444,093

(13) Breakdown of, and statement of changes in fixed assets

	Purchase or production cost				Depreciation and amortisation			Carrying amounts		
	1 Jan 2005	Additions	Transfers	Disposals	Financial year	Transfers	Disposals	Total	31 Dec 2005	1 Jan 2005
	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's	€ 000's
I. Intangible assets	82,481	4,570	–	78	8,652	–	78	46,761	40,212	44,294
II. Tangible fixed-assets										
1. Land and buildings	51	–	–	–	–	–	–	51	–	–
2. Office furniture and equipment ¹⁾	44,397	1,093	–	1,204	2,324	–	1,179	40,895	3,391	4,647
	44,448	1,093	–	1,204	2,324	–	1,179	40,946	3,391	4,647
					Net change					
III. Financial assets										
1. Participations	3,484				– 526				2,958	2,470
2. Interests in affiliated companies	6,823				– 2,832				3,991	5,331
3. Equities and other non-fixed income securities	16				–				16	16
4. Investment securities ²⁾	17,561,985				3,257,403				20,819,388	17,939,629

¹⁾ Fully used for the bank's own operations.

²⁾ Given the temporary impairment of securities usually held to maturity, a € 12.776 million write-down to the fair value of € 20,806.612 million was not recognised, in line with section 253 (2) of the HGB.

(14) List of investments pursuant to sections 285 no. 11 and 340a of the HGB

Minimum stake of 20 % Name/registered office	Equity interest %	Equity capital € 000's	Results € 000's
Landschaftliche Grundstücksgesellschaft mbH, Kiel	100.0	800	– 141 *)
VR WERT Gesellschaft für Immobilienbewertungen mbH, Hamburg	100.0	100	947 *)
IMMOFORI Gesellschaft für Immobilien Forderungsinkasso mbH, Hamburg	100.0	475	115 *)
MAROLA Grundstücksgesellschaft mbH & Co. KG, Grünwald	100.0	3	– 1
MALEA Grundstücksgesellschaft mbH & Co. KG, Schwabhausen	100.0	10	8
TXS Financial Products GmbH, Ellerau	26.0	43	– 282
Bauland Schleswig-Holstein eG, Bad Bramstedt	25.0	2,114	142

*) Profit and loss transfer agreement with DG HYP

During the financial year 2005, DG HYP sold its 40% holding in VR Kreditwerk AG to DZ BANK, and reduced its holding in Barthels Hof GmbH & Co. KG to a stake of 6%.

(15) Prepaid expenses and deferred income

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Assets		
Sub-item a) From new issues and lending comprises		
– Difference between the nominal amount and the higher disbursement amount of receivables	34,100	54,150
– Difference between the nominal amount and the lower issuing amount of liabilities	196,735	225,533
Liabilities and equity		
Sub-item a) From new issues and lending comprises		
– Difference between the nominal amount and the lower disbursement amount of receivables	55,969	62,090

**(16) Breakdown of, and statement of changes
in debt securities and borrowed funds**

	Principal € mn	Carrying amount € mn
Registered mortgage bonds		
to banks	1,049	1,080
to customers	2,981	3,060
Mortgage bonds	14,045	14,344
	18,075	18,484
Registered public-sector covered bonds		
to banks	3,748	3,828
to customers	5,866	6,009
Public-sector covered bonds	32,644	33,472
	42,258	43,309
Other debt securities	4,924	4,995
Borrowed funds		
from banks	1,503	1,529
from customers	2,556	2,636
	4,059	4,165
Total	69,316	70,953

Development (principal)

	31 Dec 2004 € mn	Additions € mn	Disposals € mn	31 Dec 2005 € mn
Mortgage bonds and registered mortgage bonds	18,630	1,310	1,865	18,075
Public-sector covered bonds and registered public-sector covered bonds	35,575	10,577	3,894	42,258
Other debt securities	4,788	1,319	1,183	4,924
Borrowed funds	4,263	60	264	4,059
Total	63,256	13,266	7,206	69,316

(17) Subordinated liabilities

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Subordinated		
other debt securities	188,121	188,121
borrowed funds	470,864	432,321
Expenses incurred	34,996	37,120

The terms of subordinated liabilities comply with the provisions of section 10 (5a) of the German Banking Act (*Kreditwesengesetz* – "KWG"), and do not provide for any early repayment obligations. There are no provisions or plans for a conversion of such funds to capital, or into another form of debt.

No individual subordinated liability amounts to 10% or more of the aggregate amount of subordinated liabilities. Subordinated liabilities carry an average interest of 5.4%, and have original maturities of between 5 and 23 years.

(18) Profit-participation certificates

Issuer	Year of issue	Amount € mn	Coupon %	Repayment*
DG HYP	1993	51.1	7.25	1 Jun 2009
DG HYP	1993	51.1	7.00	1 Jun 2014
DG HYP	1994	25.5	6.50	1 Jun 2008
DG HYP	1999	1.5	6.20	1 Jun 2007
DG HYP	1999	5.1	6.79	1 Jun 2011
DG HYP	1999	2.6	6.63	1 Jun 2009
SHL HYP/DG HYP	1996	2.6	7.20	28 Jun 2007
SHL HYP/DG HYP	1996	2.0	7.24	28 Jun 2007
SHL HYP/DG HYP	1996	1.8	7.24	28 Jun 2007
SHL HYP/DG HYP	1997	2.6	6.90	28 Jun 2008
SHL HYP/DG HYP	1997	2.6	6.95	15 Jun 2008
SHL HYP/DG HYP	1997	5.1	6.95	15 Jun 2008
		153.6		

* The term of profit-participation certificates ends on 31 December of the preceding year.

Profit-participation certificates qualify as liable capital pursuant to section 10 (5) of the KWG. The holders of profit-participation certificates receive an annual distribution in the amount of the respective coupon, which takes precedence over the profit entitlements of shareholders.

(19) Subscribed capital

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Share capital	90,000	90,000
Silent partnership contributions	773,687	593,687
Total	863,687	683,687

The issued share capital amounts to € 90,000,000 and is divided into 3,500,000 notional no-par value shares ("unit shares"). VR-Immobilien AG, Frankfurt/Main ("VR IMMO") holds 3,321,500 shares (94.9%), of which 1,131,320 shares are held in trust by other entities. The remaining 178,500 shares (5.1%) are held by DZ BANK Deutsche Zentral-Genossenschaftsbank AG, Frankfurt/Main.

To further strengthen its equity capital, the bank raised € 180 million in perpetual silent partnership contributions during the financial year under review. The remaining silent partnership contributions amounting to € 593.7 million have been made available in tranches maturing at the end of the financial years 2007 through 2009. All silent contributions complied with the provisions of section 10 (4) of the KWG at the reporting date; they are based on partial profit transfer agreements pursuant to section 292 (1) no. 2 of the AktG.

(20) Breakdown of, and statement of changes in reserves

	31 Dec 2004 € 000's	Additions € 000's	Disposals € 000's	31 Dec 2005 € 000's
Capital reserve	494,113	30,000	–	524,113
Retained earnings	(93,145)			(93,145)
– Legal reserves	945	–	–	945
– Other retained earnings	92,200	–	–	92,200
Total	587,258	30,000	–	617,258

The contribution to the capital reserve was shared between VR IMMO (94.9%) and DZ BANK (5.1%), in line with their respective shareholding.

(21) Revaluation reserves

No revaluation reserves pursuant to section 10 (2b) sentence 1 no. 6 of the KWG were included in liable capital.

(22) Contingent liabilities

This item includes predominantly € 651 million in loan guarantees extended to DZ BANK AG as cover for new commercial real estate finance exposures extended by DZ BANK and guaranteed by DG HYP.

(23) Relationships with affiliated enterprises and subsidiaries**Affiliated enterprises**

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Loans and advances to		
– banks	603,349	481,952
– customers	53,490	24,852
Bonds and other fixed-income securities	–	–
Liabilities to		
– banks	3,989,360	3,934,983
– customers	1,046,840	1,086,661
Securitised liabilities	8,666,818	5,842,102
Subordinated liabilities	–	–

Subsidiaries

There were no loans and advances, or liabilities, to subsidiaries at the reporting date.

(24) Breakdown of maturities for receivables and liabilities

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Assets		
Loans and advances to banks		
Remaining term – payable on demand	551,635	384,241
– up to three months	741,378	381,556
– between three months and one year	241,524	117,357
– between one year and five years	3,343,985	3,785,396
– more than five years	932,966	959,864
	5,811,488	5,628,414
Loans and advances to customers		
Remaining term – up to three months	1,422,016	1,633,018
– between three months and one year	2,010,232	2,054,423
– between one year and five years	8,288,162	8,362,158
– more than five years	30,136,736	29,956,727
	41,857,146	42,006,326
Bonds and other fixed-income securities maturing in the following year	1,636,253	1,097,901
Liabilities and equity		
Liabilities to banks		
Remaining term – payable on demand	205,333	534,341
– up to three months	4,840,938	5,619,642
– between three months and one year	396,579	524,544
– between one year and five years	1,588,193	1,704,595
– more than five years	4,240,607	3,183,446
	11,271,650	11,566,568
Liabilities to customers (excluding savings deposits)		
Remaining term – payable on demand	165,982	192,953
– up to three months	536,776	488,527
– between three months and one year	593,366	927,197
– between one year and five years	3,132,656	3,524,509
– more than five years	7,440,897	6,790,799
	11,869,677	11,923,985
Certificated liabilities maturing in the following year	7,601,891	6,303,137

(25) Assets and liabilities in foreign currencies

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Assets include foreign-currency receivables in the total amount of	2,325,994	424,335
Liabilities and equity include foreign-currency liabilities in the total amount of	2,361,542	441,251

(26) Outstanding forward transactions

The following types of forward transactions based on foreign currencies, interest rates or other underlying instruments were outstanding as at the balance sheet date:

€ mn	Nominal amounts by residual term			Total	Fair value 2005 positive negative (counterparty risk)	
	≤ 1 year	> 1–5 yrs.	> 5 yrs.			
Interest rate instruments						
OTC products						
Interest rate swaps	41,921	58,149	45,911	145,981	2,329	4,003
including: Forward swaps	400	35	448	883	9	27
including: With embedded caps/floors	–	226	121	347	17	8
including: With embedded puts/calls	–	15	346	361	–	–
Interest rate options	2,839	1,480	22	4,341	170	6
including: Swaptions bought	1,065	1,480	12	2,557	170	–
including: Swaptions sold	1,774	–	10	1,784	–	6
Exchange-traded products	–	–	–	–	–	–
Currency-related instruments						
Cross-currency swaps	112	41	747	900	9	109
Foreign exchange forwards	–	–	–	–	–	–
Foreign exchange swaps	–	–	–	–	–	–
Credit derivatives						
Credit default swaps	–	–	2,683	2,683	–	–
including: Protection seller	–	–	235	235	–	–
including: Protection buyer	–	–	2,448	2,448	–	2
Credit Linked Notes	–	–	49	49	49	–
including: Protection seller	–	–	49	49	49	–
including: Protection buyer	–	–	–	–	–	–
Forward transactions exposed to other price risks	–	–	–	–	–	–
Total	44,872	59,670	49,412	153,954	2,557	4,120

The transactions identified above are used to manage interest rate, currency and counterparty risk exposure. Counterparties are OECD banks and central governments. Interest rate swaps are valued using present values, determined by discounting cash flows using market interest rates in line with the credit risk and maturities concerned, as indicated by the yield curve prevailing on the balance sheet date.

Options are valued using option pricing models. These are applied on the basis of generally recognised assumptions regarding valuation parameters, in particular the value and volatility of the underlying instrument, the agreed exercise price (interest rate), the remaining lifetime of the contract, as well as the risk-free interest rate for that lifetime.

Credit derivatives are valued on an individual basis, predominantly on the basis of the default probability of the reference obligations concerned.

Market values are determined without consideration of netting agreements. No add-ons or credit quality weightings – as defined pursuant to the capital ratio according to the German Banking Act (*Grundsatz I*) – are taken into account. Negative market values of derivatives are offset by positive market values of the related hedged balance sheet items.

The aggregate carrying amount of interest rate options, which is reported under other assets, is € 13.4 million.

(27) Other financial obligations as defined in section 285 no. 3 of the HGB

Real estate leasing contracts entered into within the scope of sale-and-lease-back transactions involve leasing obligations in an aggregate amount of € 165.1 million until 2019.

(28) Other operating income

This item includes € 5.6 million in rental income, and a market entry premium of € 10.0 million received in connection with the spin-off of retail distribution activities.

(29) Administrative expenses

€ 562,000 in audit fees for the financial statements was charged by the external auditors pursuant to section 319 (1) sentences 1 and 2 of the HGB, and recognised in expenses during the year under review. Expenses for other audit activities carried out by the external auditors amounted to € 103,000.

(30) Net extraordinary income/expenses

Net extraordinary income/expenses contains restructuring expenses of € 1.3 million that were incurred in conjunction with staff-related measures.

(31) Taxes on income

Due to the preferential tax treatment of the disposal of the bank's holding in VR Kreditwerk AG, and also due to other tax-exempt income, no taxes on income were payable in the financial year 2005.

(32) Cash flow statement

€ mn		2005	2004
1.	Net income for the period (including income/loss portion attributable to minority shareholders) excluding extraordinary items and taxes	51	78
	Non-cash items comprised in net income for the period, and reconciliation to cash flow from operating activities		
2.	+/- Depreciation, write-downs and additions on receivables, tangible fixed assets and financial assets	104	139
3.	+/- Increase/decrease in provisions	1	- 1
4.	+/- Other non-cash expenses/income	1	2
5.	-/+ Profits/losses from the disposal of tangible fixed assets and financial assets	- 37	- 69
6.	-/+ Other adjustments (net balance)	- 325	- 333
7.	= Subtotal	- 205	- 184
	Cash changes in assets and liabilities from operating activities		
8.	Loans and advances		
8a.	+/- - to banks	- 202	2,097
8b.	+/- - to customers	39	- 627
9.	+/- Securities (excluding financial assets)	- 2,321	- 2,381
10.	+/- Other assets from operating activities	- 100	13
11.	Liabilities		
11a.	+/- - to banks	- 297	663
11b.	+/- - to customers	- 41	1,073
12.	+/- Securitised liabilities	5,236	2,932
13.	+/- Other liabilities from operating activities	87	- 77
14.	+ Interest and dividends received	3,890	3,832
15.	- Interest paid	- 3,522	- 3,430
16.	+ Extraordinary cash receipts	-	-
17.	- Extraordinary cash payments	- 1	- 4
18.	+/- Income tax payments	-	- 8
19.	= Cash flow from operating activities	2,563	3,899
20.	Receipts from the disposal of		
20a.	+ - financial assets	66	93
20b.	+ - tangible fixed assets	-	98
21.	Payments for investments in		
21a.	- - financial assets	- 2,881	- 4,096
21b.	- - tangible fixed assets	- 1	- 3
22.	+ Cash receipts from the disposal of consolidated companies and other business units	-	-
23.	- Cash payments for the acquisition of consolidated companies and other business units	-	-
24.	+/- Changes in cash funds due to other investing activities (net balance)	- 4	- 8
25.	= Cash flow from investing activities	- 2,820	- 3,916
26.	+ Cash receipts from issue of capital	30	48
27.	Cash payments to owners and minority shareholders		
27a.	- - Dividends paid	-	- 18
27b.	- - Other distributions/cash payments	- 39	- 38
28.	+/- Changes in cash funds due to other capital movements (net balance)	260	32
29.	= Cash flow from financing activities	251	24
30.	Cash funds at the beginning of the period	19	12
31.	+/- Cash flow from operating activities	2,563	3,899
32.	+/- Cash flow from investing activities	- 2,820	- 3,916
33.	+/- Cash flow from financing activities	251	24
34.	+/- Effect on cash funds of exchange rate movements, changing in reporting entity structure and revaluation	-	-
35.	= Cash funds at the end of the period	13	19

(33) Executive bodies of DG HYP**Supervisory Board**

Dr. Alexander Erdland Bank director – Chairman – (Chairman from 8 March 2005; until 14 February 2006)	Maik Brammer Bank employee (from 8 March 2005)	Jens Meyer Bank employee (from 8 March 2005)
Dr. Ulrich Brixner Bank director – Chairman – (until 8 March 2005)	Hans-Jürgen Buhlert Bank employee	Thomas Müller Bank director
Wolfgang Kirsch Bank director – Deputy Chairman – (Deputy Chairman from 8 March 2005)	Carl-Christian Ehlers Bank director	Manfred Nüssel President of the German Raiffeisen Federation
Dr. Christopher Pleister President of the Federal Association of German Credit Unions and Rural Banking Cooperatives (BVR) – Deputy Chairman – (until 8 March 2005)	Maren Ehlers Bank employee (until 8 March 2005)	Erich Schaller Bank director
Dagmar Mines Bank employee – Deputy Chairman – (from 8 March 2005)	Norbert Flaig Bank director (from 8 March 2005)	Herbert Schindler Director Badischer Genossenschaftsverband e. V. (Association of Cooperative Banks in Baden) (from 8 March 2005)
Peter Bade Bank director (from 8 March 2005)	Heinz Gommans Bank director	Martin Schmitt Bank director (from 1 January 2006)
Rainer Bauer Bank director (until 8 March 2005)	Ralph Gruber Bank employee (from 8 March 2005)	Martina Sternberg Bank employee (until 8 March 2005)
Friedhelm Bellmann Employee (until 8 March 2005)	Holger Hinz Bank employee (until 8 March 2005)	Diedrich Taaken Bank director
	Jürgen Jacoby Bank director (until 8 March 2005)	Dietrich Voigtländer Bank director (from 8 March 2005)
	Klaus Kohlmorgen Employee	Heino Westermann Bank director (ret'd.) (until 8 March 2005)
	Dietmar Küsters Bank director	Winfried Willer Employee (Deputy Chairman until 8 March 2005)
	Hans-Theo Macke Bank director (from 8 March 2005; until 31 December 2005)	
Management Board	Dr. Wolf Schumacher Chairman (until 8 March 2005)	Harald Pohl (until 14 November 2005)
Hans-Theo Macke Chairman (from 1 January 2006)	Friedrich Piaskowski	Christian Sewing (from 1 March 2005)

(34) Remuneration of the executive bodies

	2005 € 000's	2004 € 000's
Supervisory Board	292	296
Management Board	1,675	1,273
Former members of the Management Board or their surviving dependants	1,601	1,662
Provisions for pensions and pension commitments for former members of the Members of the Management Board or their surviving dependants	16,008	11,010

(35) Loans to members of executive bodies

	31 Dec 2005 € 000's	31 Dec 2004 € 000's
Supervisory Board	1,378	857
Management Board	1,253	614

(36) Offices held by members of the Management Board or members of staff in supervisory bodies of large limited companies

As at 31 December 2005, members of the Management Board held the following offices in supervisory bodies of large limited companies:

Friedrich Piaskowski

VR Kreditwerk Hamburg–Schwäbisch Hall AG, Hamburg/Schwäbisch Hall:
member of the Supervisory Board

(37) Average number of employees

	2005			2004		
	Male	Female	Total	Male	Female	Total
Total number of employees	343	239	582	340	241	581
of which: Full-time employees	341	207	548	336	212	548
Part-time employees *)	2	32	34	4	29	33
Vocational trainees (not included in total)	13	9	22	10	11	21

*) Weighted in line with the hours worked.

(38) Information about the parent company pursuant to section 285 no. 14 of the HGB

DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt/Main, prepares consolidated financial statements which incorporate the financial statements of DG HYP. The consolidated financial statements of DZ BANK are deposited with the Commercial Register at the Frankfurt/Main District Court (*Amtsgericht Frankfurt am Main*), and published in the German Federal Gazette.

Hamburg – Berlin, 23 February 2006

Deutsche Genossenschafts-Hypothekenbank Aktiengesellschaft

Macke

Piaskowski

Sewing

The following is an English translation of the Audit Opinion, which has been prepared on the basis of the German language version of the Financial Statements and the Management Report. The translations of the Financial Statements, the Management Report, and the Audit Opinion are provided for convenience; the respective German versions shall be exclusively valid for all purposes.

AUDIT OPINION

We have audited the annual financial statements – comprising the balance sheet, the income statement and the notes to the annual financial statements – together with the bookkeeping system, and the management report of the Deutsche Genossenschafts-Hypothekenbank Aktiengesellschaft, Hamburg – Berlin, for the business year from January 1st to December 31st, 2005. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § [Article] 317 HGB [“Handelsgesetzbuch”: German Commercial Code] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). 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 reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company 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 Company's position and suitably presents the opportunities and risks of future development.

Hamburg, February 14th / February 24th, 2006

Ernst & Young AG
Wirtschaftsprüfungsgesellschaft

Müller-Tronnier
Wirtschaftsprüfer
[German Public Auditor]

Bühning
Wirtschaftsprüfer
[German Public Auditor]

REPORT OF THE SUPERVISORY BOARD

The Supervisory Board has obtained detailed information on all material issues regarding business policy and the company's business development, in the course of five meetings held during the year under review as well as on the basis of regular oral and written reports submitted by the Management Board. The Supervisory Board thus satisfied itself with regard to the orderly management of the company's business. The Supervisory Board (or one of the Committees formed from among its members) dealt with all individual transactions submitted under legal or statutory provisions.

DG HYP's financial statements as at 31 December 2005, together with the Management Report, have been examined and certified without qualification by Ernst & Young AG Wirtschaftsprüfungsgesellschaft, the company's external auditors. The external auditors took part in the Supervisory Board meeting that dealt with the financial statements, in accordance with section 171 (1) sentence 2 of the German Public Limited Companies Act, reporting on material results of their audit and answering questions from members of the Supervisory Board.

The Supervisory Board duly noted and approved the results of the audit. Having completed the examination, no objections were raised by the Supervisory Board concerning the financial statements or the annual report (including the Management Report).

The Supervisory Board approves the financial statements, which are thus confirmed.

Mr. Harald Pohl retired from the Management Board with effect from 14 November 2005.

At the same time, the Supervisory Board would like to welcome Mr. Hans-Theo Macke, who was appointed as member chairman of the Management Board of DG HYP with effect from 1 January 2006. We wish him every success.

Hamburg – Berlin, March 2006

**Deutsche Genossenschafts-Hypothekenbank
Aktiengesellschaft**

The Supervisory Board

Kirsch	Mines
Deputy Chairman	Deputy Chairman

CORPORATE BODIES AND COMMITTEES; EXECUTIVES

Supervisory Board

Wolfgang Kirsch

Deputy Chairman of the Board of Managing Directors,
DZ BANK AG Deutsche Zentral-Genossenschaftsbank,
Frankfurt/Main,
Chairman

Dr. Christopher Pleister

President of the Federal Association of German Credit Unions and Rural Banking Cooperatives (BVR),
Berlin,
Deputy Chairman

Dagmar Mines

Deutsche Genossenschafts-Hypothekenbank AG,
Hamburg,
Deputy Chairman

Peter Bade

Member of the Management Board,
Volksbank Lüneburger Heide eG,
Soltau

Maik Brammer

Deutsche Genossenschafts-Hypothekenbank AG,
Hamburg

Hans-Jürgen Buhlert

Deutsche Genossenschafts-Hypothekenbank AG,
Hamburg

Carl-Christian Ehlers

Chairman of the Management Board,
Kieler Volksbank eG,
Kiel

Ralph Gruber

Deutsche Genossenschafts-Hypothekenbank AG,
Hamburg

Rainer Kattinger

Chairman of the Management Board,
Stuttgarter Volksbank AG,
Stuttgart

Klaus Kohlmorgen

VR Kreditwerk
Hamburg–Schwäbisch Hall AG,
Hamburg

Dietmar Küsters

Chairman of the Management Board,
Volksbank Straubing eG,
Straubing

Dr. Matthias Metz

Chairman of the Management Board,
Bausparkasse Schwäbisch Hall AG,
Schwäbisch Hall

Jens Meyer

Deutsche Genossenschafts-Hypothekenbank AG,
Hamburg

Thomas Müller

Member of the Management Board,
Dresdner Volksbank
Raiffeisenbank eG,
Dresden

Manfred Nüssel

President of the German
Raiffeisen Federation,
Berlin

Erich Schaller

Chairman of the Management Board,
Raiffeisenbank Hof eG,
Hof

Herbert Schindler

Director,
Badischer Genossenschaftsverband e.V.
(Association of
Cooperative Banks in Baden),
Karlsruhe

Martin Schmitt

Chairman of the Management Board,
Kasseler Bank eG Volksbank
Raiffeisenbank,
Kassel

Diedrich Taaken

Chairman of the Management Board,
Volksbank Esens eG,
Esens

Dietrich Voigtländer

Member of the Management Board,
DZ BANK AG Deutsche
Zentral-Genossenschaftsbank,
Frankfurt am Main

Winfried Willer

VR Kreditwerk
Hamburg–Schwäbisch Hall AG,
Hamburg

Stand: 1 April 2006

Management Board, Department Heads

Management Board

and distribution of responsibilities

Hans-Theo Macke

Chairman

- Sales Cooperative Sector
- Corporate Communications and Strategy
- Human Resources
- Internal Audit
- Management Board Office/Legal
- Organisation/Information Technology

Friedrich Piaskowski

- Commercial Real Estate Finance
- Treasury
- Credit Treasury

Christian Sewing

- Credit Risk Management
- Finance/Controlling
- Treasury Settlements
- Administration

Department Heads

Markus Bolder

Credit Treasury

Dirk Brandes

Commercial Real Estate Finance

Detlef Gäbler

Credit Risk Management
Retail

Sven Henkel

Organisation/Information
Technology

Joachim Heuck

Human Resources

Stefan Lachnit

Sales Cooperative Sector

Dr. Thomas Müller

Finance/Controlling

Hartmut Rahner

Treasury

Silke Riel-Wittekind

Management Board Office/Legal

Siegfried Schneider

Treasury Settlements

Frank Stöfer

Credit Risk Management
Credit Treasury

Dr. Olaf Streuer

Corporate Communications
and Strategy

Dr. Klaus Vajc

Credit Risk Management
Commercial

Peter Vögelein

Interne Revision

Stand: 1 April 2006

Trustees, Advisory Council

Trustees

Dr. Michael Labe

Judge at the Hamburg
Higher Regional Court
(*Hanseatisches Oberlandesgericht
Hamburg*),
Hamburg

Hans-Georg Herrmann

Deputy Trustee
Member of the Management Board
(rtd.) of the State Central Bank for
the Free Hanseatic City of Hamburg,
Mecklenburg-West Pomerania
and Schleswig-Holstein
(Main Office of
Deutsche Bundesbank),
Hamburg

Dr. Peter Lassen

Deputy Trustee
Presiding Judge at the Hamburg
Higher Regional Court
(*Hanseatisches Oberlandesgericht
Hamburg*),
Hamburg

Advisory Council

Karsten Kahlcke

Chairman of the Management Board,
Raiffeisenbank im Kreis Plön eG,
Lütjenburg,
Chairman

Dr. Dr. Claus Becker

Chairman of the Management Board,
Volksbank Darmstadt eG,
Darmstadt,
Deputy Chairman

Dr. Franz G. Leitner

Chairman of the Management Board,
Volksbank Freiburg eG,
Freiburg,
Deputy Chairman

Meinolf Bäcker

Member of the Management Board,
Volksbank Arnsberg-Sundern eG,
Arnsberg

Herbert Bauer

Senior General Manager,
Bank 1 Saar eG,
Saarbrücken

Peter Bersch

Chairman of the Management Board,
Volksbank Bitburg eG,
Bitburg

Fritz Bokelmann

Chairman of the Management Board,
Volksbank eG,
Osterholz-Scharmbeck

Enno Emmerinck

Member of the Management Board,
Volksbank Hamburg Ost-West eG,
Hamburg

Dr. Rolf Flechsig

Member of the Management Board,
Berliner Volksbank eG,
Berlin

Alfred Foistner

Chairman of the Management Board,
Raiffeisenbank Oberschleißheim eG,
Oberschleißheim

Manfred Geyer

Chairman of the Management Board,
RaiffeisenVolksbank eG
Gewerbebank,
Ansbach

Konrad Irtel

Chairman of the Management Board,
Raiffeisenbank Rosenheim eG,
Rosenheim

Ulrich Jakobi

Chairman of the Management Board,
Volksbank Wetzlar-Weilburg eG,
Wetzlar

Willy Köhler

Chairman of the Management Board,
Volksbank Rhein-Neckar eG,
Mannheim

Friedrich Lehmann

Chairman of the Management Board,
Raiffeisenbank Ehingen eG,
Ehingen

Rudolf Müller

Chairman of the Management Board,
Volksbank Bonn Rhein-Sieg eG,
Bonn

Egon Niebuhr

Member of the Management Board,
VR Bank Pinneberg eG,
Pinneberg

Stand: 1 April 2006

Advisory Council

Wilhelm Rippen

Member of the Management Board,
Raiffeisenbank Wesermarsch-Süd eG,
Brake

Tilman Römpp

Member of the Management Board,
Volksbank Bautzen eG,
Bautzen

Alfred Salz

Member of the Management Board,
Volksbank Rhein-Wupper eG,
Leverkusen

Rainer Schaidnager

Member of the Management Board,
Raiffeisenbank Kempten eG,
Kempten

Christian Scheinert

Member of the Management Board,
Volksbank eG,
Elmshorn

Klaus Sievers

Chairman of the Management Board,
VR Bank eG,
Niebüll

Elmar Stender

Chairman of the Management Board,
Volksbank Marl-Recklinghausen eG,
Marl

Günther Wainowski

Member of the Management Board,
Vereinigte Volksbank AG
Böblingen/Sindelfingen –
Schönbuch – Calw/Weil der Stadt,
Sindelfingen

Rolf Witezek

Member of the Management Board,
Volksbank Gießen eG,
Gießen

Stand: 1 April 2006

DG HYP OFFICES

Deutsche Genossenschafts-Hypothekenbank AG

20095 Hamburg

Rosenstrasse 2
PO Box 10 14 46
20009 Hamburg
Phone +49 40 33 34-0
Fax +49 40 33 34-11 11

10117 Berlin

Pariser Platz 3
PO Box 08 01 62
10001 Berlin
Phone +49 30 3 19 93-51 01
Fax +49 30 3 19 93-50 60

Real Estate Centres for commercial investors

DG HYP

Berlin Real Estate Centre

Dirk Brandes
Pariser Platz 3
10117 Berlin
Phone +49 30 3 19 93-51 01
Fax +49 30 3 19 93-50 60

DG HYP

Dusseldorf Real Estate Centre

Hans-Josef Holtgreffe
Ludwig-Erhard-Allee 9
40227 Dusseldorf
Phone +49 211 22 04 99-10
Fax +49 211 22 04 99-40

DG HYP

Frankfurt Real Estate Centre

Rudolf Beresko
Friedrich-Ebert-Anlage 2-14 (City-Haus)
60325 Frankfurt/Main
Phone +49 69 75 06 76-21
Fax +49 69 75 06 76-99

DG HYP

Hamburg Real Estate Centre

Hans Henrik Dige
Rosenstrasse 2
20095 Hamburg
Phone +49 40 33 34-37 78
Fax +49 40 33 34-11 02

DG HYP

Munich Real Estate Centre

Wolfgang Berchtold
Türkenstrasse 16
80333 Munich
Phone +49 89 51 26 76-10
Fax +49 89 51 26 76-30

DG HYP

Stuttgart Real Estate Centre

Harald Alber
Heilbronner Strasse 41
70191 Stuttgart
Phone +49 711 12 09 38-0
Fax +49 711 12 09 38-30

Representative Offices

DG HYP

London Representative Office

Kevin O'Connell
10 Aldersgate Street
London EC1A 4HJ
United Kingdom
Phone +44 20 777 676-12
Fax +44 20 777 676-19

DG HYP

New York Representative Office

Jean Barden
375 Park Avenue, Suite 2603
New York NY 10152
USA
Phone +1 203 918 13 26
Fax +1 203 461 83 19

Stand: 1 April 2006