Prepared for tomorrow

ANNUAL REPORT 2019

Aareal

YOUR COMPETITIVE ADVANTAGE.

Key Indicators

	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Results		
Operating profit (€ mn)	248	316
Consolidated net income (€ mn)	163	226
Consolidated net income allocated to ordinary shareholders (€ mn)[1]	145	208
Cost/income Ratio (%)[2]	41.0	40.4
Dividende per share (€)[3]	2.00	2.10
Earnings per ordinary share (€)[1]	2.42	3.48
RoE before taxes (%)[1]	8.7	11.6
RoE after taxes (%)[1]	5.7	8.3

	31 Dec 2019	31 Dec 2018
Statement of financial position		
Property finance (€ mn)[4]	25,882	26,395
Equity (€ mn)	2,861	2,928
Total assets (€ mn)	41,137	42,687
Regulatory indicators[5]		
Risk-weighted assets (€ mn)	11,195	13,039
Common Equity Tier 1 ratio (CET1 ratio) (%)	19.6	17.2
Tier 1 ratio (T1 ratio) (%)	22.3	19.5
Total capital ratio (TC ratio) (%)	29.9	26.2
Common Equity Tier 1 ratio (CET1 ratio) (%) – Basel IV (estimate)[6]	13.5	13.2
Employees	2,788	2,748

	31 Dec 2019	31 Dec 2018
Moody's		
Issuer rating	A3	A3
Senior Preferred[7]	A3	A3
Senior Non Preferred[8]	Baa1	Baa1
Bank deposit rating	A3	A3
Mortgage Pfandbrief Rating	Aaa	Aaa
Fitch Ratings[9]		
Issuer default rating	A-	A-
Senior Preferred	A	A
Senior Non Preferred	A-	A-
Deposit ratings	A	A
Outlook	negative	stable
Sustainability ratings[10]		
MSCI	AA	AA
ISS-ESG	prime (C+)	prime (C)
CDP	Awareness Level C	Management Level B-

1) The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.
2) Structured Property Financing segment only
3) 2019: Proposal to be submitted to the Annual General Meeting
4) Excluding € 0.4 billion in private client business (31 December 2018: € 0.6 billion) and € 0.4 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2018: € 0.5 billion)
5) When calculating own funds, annual profits were taken into account, based on the Management Board's proposal for appropriation of profits for the 2019 financial year, and incorporating the pro-rata accrual of net interest payable on the AT1 bond. The appropriation of profits is subject to approval by the Annual General Meeting. The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning the NPL inventory as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account for determining regulatory indicators.
6) Underlying estimate, given a 72.5 % output floor based on the final Basel Committee framework dated 7 December 2017. The calculation of the material impact upon Aareal Bank is subject to the outstanding EU implementation as well as the implementation of additional regulatory requirements (CRR II, EBA requirements etc.).
7) Moody's terminology: "Senior Unsecured"; the rating for the Debt Issuance Programme was discontinued in February 2020
8) Moody's terminology: "Junior Senior Unsecured"; the rating for the Debt Issuance Programme was discontinued in February 2020
9) The ratings reported as at 31 December 2018 were published on 21 January 2019. The ratings reported as at 31 December 2019 were published on 10 January 2020. On 4 March 2020, Fitch Rating announced its intention to review the rating of banks, including that of Aareal Bank. This review is related to the introduction of revised bank rating criteria by Fitch Ratings (published on 28 February 2020).
10) Please refer to our website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/) for more details.

This report contains rounded numbers, which may result in slight differences when aggregating figures and calculating percentages.

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Prepared for tomorrow

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Transparency

Our online Annual Report:
ar.aareal-bank.com/2019

STRATEGY

On the right track for success

Aareal Bank Group determined strategic thrusts for the period following its successful "Aareal 2020" programme at the beginning of 2020 – just before the massive economic distortions caused by the coronavirus pandemic set in. Under the guiding principle ”Aareal Next Level“, the Group aims to realise its full operating potential in the years to come. Whilst our general strategic orientation remains in place, we will develop the individual business activities in a targeted manner, in order to sharpen their own independent profiles, thus creating value for all stakeholders in an increasingly challenging environment.

For many years, Aareal Bank Group has been a success story in the German banking sector. During this story's current chapter, we have consistently – and very successfully – implemented the ”Aareal 2020” programme for the future, launched in 2016.

In the Structured Property Financing segment, this has enabled us to materially increase our flexibility regarding regions, asset classes, structures, and exit channels, whilst driving the expansion of our business along the value creation chain, for example, with our investment in Mount Street.

Our Consulting/Services segment on the other hand, has been clearly geared towards growth – both regarding the Bank and especially our subsidiary Aareon, whose international business we have significantly strengthened within the scope of ”Aareal 2020” – also by way of acquisitions. Furthermore, we have laid the foundation for Aareon to increasingly position itself as a digital solutions provider.

We have pursued numerous new initiatives in the start-up sector and increased our power to innovate in both Group segments, clearly enhancing the efficiency of structures and processes – and we have also invested heavily in our IT. For example, Aareal Bank was the first institution in Germany to fully migrate its core system to S/4 HANA – a milestone on our path towards a highly efficient organisation.

In the course of its final year, the ”Aareal 2020” programme's results are gratifying. Our Bank has reinvented itself: in terms of content, organisation, and culture. Today, Aareal Bank Group performs better, is more robust, more efficient, more innovative and more agile than ever. This is something we can build upon when entering the next phase of our development.

Read an interview with Hermann J. Merkens:
ar.aareal-bank.com/2019/merkens-en

The next development level – Aareal Next Level

The challenges we – and the rest of the financial sector – are confronted with in these times of regulatory pressure, digitalisation and persistently low interest rates, are huge. To be prepared, we initiated a Group-wide strategic review process in 2018, the results of which are now available: under the guiding principle ”Aareal Next Level”, we will lift Aareal Bank Group onto the next development level over the medium term – and thus not only allow its business potential to take effect, but also to exploit new strategic options.

Our principal objective is to achieve an evolutionary development based on what we have already achieved; we see no need to fundamentally change our strategy in the near future, and the strategic beliefs which have guided us during the implementation of ”Aareal 2020” remain viable.

However, starting points for further sharpening our strategic profile present themselves. Under the motto ”Activate!” the main objective in our Structured Property Financing segment, the Group’s backbone, is to safeguard the success achieved in the past years and our best-in-class position – even in an adverse environment: by systematically making use of the flexibility we have gained, a further expansion along the value creation chain, and improved efficiency.

ANextLevel

Activate. Elevate. Accelerate.

ACTIVATE!	Structured Property Financing

- Focus on a broader range of lending, structuring and exit opportunities –flexibly ”playing” the matrix (countries, asset classes, structures)
- Expanding opportunities in servicing and digitalisation
- Protect the Group's backbone – securing the ”best-in-class” position

ELEVATE!	Housing sector and related industries

- Broaden the product portfolio by leveraging our deep understanding of client processes and infrastructure
- ... by further expanding the range of products, focusing on commission income
- Exploit opportunities for developing business models in cooperation with clients and other market participants

ACCELERATE!	Aareon

- Implement the published organic growth strategy, designed to double EBITDA over the medium term
- ... especially through organic growth of our of digital solutions product portfolio
- Additional acceleration through further M&A activities – if and when opportunities arise

In the Consulting/Services segment, we aim to reduce the overlaps and cross-dependencies between the Bank and Aareon, whilst strengthening the independence of the individual brands and business models – securing existing synergies at the same time. In specific terms, this means that Aareal Bank, as a leading provider of payment transaction services for the German housing industry, will reposition itself under the motto "Elevate!": in addition to the focus on deposit-taking, the Bank will evolve to become a provider of further innovative products and services, including an expansion into new related markets requiring specific payment transactions know-how.

Aareon, in turn, as an integral part of our refined Group strategy, is to significantly increase its growth rate ("Accelerate!"), developing a strong value perspective as a separately positioned software company independent of the parent. To this end, Aareon will consistently implement the programme it presented in 2019, which is expected to double earnings in the medium term, primarily through the further expansion of its digital business. Targeted M&A activities are expected to generate additional growth.

In line with the strategic orientation of sharpening the independent profiles of the individual business activities, segment reporting will also be adjusted, starting with the report for the first quarter of 2020, to comprise three segments (instead of two previously): Structured Property Financing, the Bank's business with the housing sector and related industries, and Aareon. The strategic cornerstones defined with "Aareal Next Level" will gradually be backed by further measures and initiatives to be taken across the Group in the months ahead. Assuming a more positive environment, the initiatives undertaken in the context of "Aareal Next Level" will permit to achieve return on equity before taxes of around 12 % over the medium term.

12 %

return on equity before taxes – can be achieved through "Aareal Next Level" over the medium term, assuming a more positive environment.

Strategic guidelines established for the future

We have established the strategic guidelines and made our ambitions clear. Now we must further specify "Aareal Next Level" and drive Aareal Bank Group's evolutionary development – with courage and fervour.

We are aware of two facts: firstly, lasting success can only be achieved if we generate success for our clients. Secondly, in these volatile times we must be ready to adjust time and again, and to walk entirely new paths if so required.

If we manage to realise the existing potential step by step in the years to come, following the guiding principle of "Aareal Next Level", then we will continue Aareal Bank Group's success story over the medium- to long-term – and thus beyond our 100th anniversary in 2023.

Overview of Aareal Bank Group

Aareal Bank Group is a leading international provider of smart financing, software products, digital solutions and payment transaction applications in the property sector and related industries. Aareal Bank AG, whose shares are included in Deutsche Börse's MDAX index, is the Group's parent entity and headquartered in Wiesbaden.

We strive to offer our clients pioneering solutions which help them explore competitive advantages and enable long-term business success. We have bundled our portfolio of services into two business segments.

In the Structured Property Financing segment, we support our clients in making large-volume commercial property investments. The investment properties mostly comprise office buildings, hotels, shopping centres, logistics and residential property, as well as student apartments. Our clients include institutional investors, private equity firms, family offices, financial institutions, private individuals, listed property companies, pension funds, and investors with a focus on a particular sector.

In the Consulting/Services business segment we advise and support companies from the housing, property and energy industries, helping them to create optimised and efficient business processes and payment systems. Our subsidiary Aareon also supports them in developing their company-specific digital ecosystems – to connect them with their stakeholders and closely related sectors.

DIGITAL ROADMAP

Innovations shape our future

Digitalisation has already sustainably changed our world – and will continue to do so, which is why Aareal Bank Group developed a comprehensive digital roadmap a few years ago. The aim is to further expand our pioneering role in the provision of innovative digital solutions to our clients.

However, digital solutions and digitalised processes alone are not enough to make cooperation more efficient and productive, and to develop new business models; major changes can only take place if working conditions are adjusted and if the culture of cooperation within an enterprise changes.

This is a claim which Aareal Bank Group will incorporate more strongly in its entrepreneurial actions: we can only effectively react to a working environment becoming increasingly complex and faster if we can count on cross-functional networks and multi-disciplinary teams. Appropriate working conditions, structures and processes are to be established at Aareal Bank Group; at the same time, training programmes are being launched and a cultural transformation process has been initiated to firmly establish this approach with executives and employees.

Aareal Bank Group's start-up programme plays a significant role: "First of all, our start-up programme is obviously a great tool to better recognise and understand the drivers behind the digital development and market trends," says Henning Zander, Head of Aareal Bank Group's start-up programme. "That, however, also applies to pioneering forms of collaboration. We are currently putting a lot of thought into how we can further develop the models which we are already using within the Company – making them even more effective. Discussions and exchanges of information with young, innovative and unconventional companies are a great help."

Aareal Bank Group's start-up programme aims at cooperations, participation in accelerator programmes, strategic investments, and the development of own start-ups. For example, in 2019 Aareal Bank acquired a stake in PropTech1 Ventures, a venture capital fund specialising in European PropTech start-ups. "This fund investment gives us access to between ten and fifteen tech-savvy property sector companies, whose development and working patterns we can now closely follow," Zander confirms. "This not only increases our innovative strength, but also benefits the further development of our collaboration models."

More details online:
aareal-bank.com/en/start-up

The four dimensions of digitalisation

Innovation is not an end in itself for us, but rather part of a comprehensive, strictly client-oriented strategy. Our digital roadmap has four strategic directions – and the start-up programme is a key component.

Aareal Bank Group

Optimise organisational performance

- Expansion of digital client communication
- Expansion of digital client service and maintenance
- Optimise database systems
- Enhance flexibility of sales organisation

Develop new financing and payment solutions

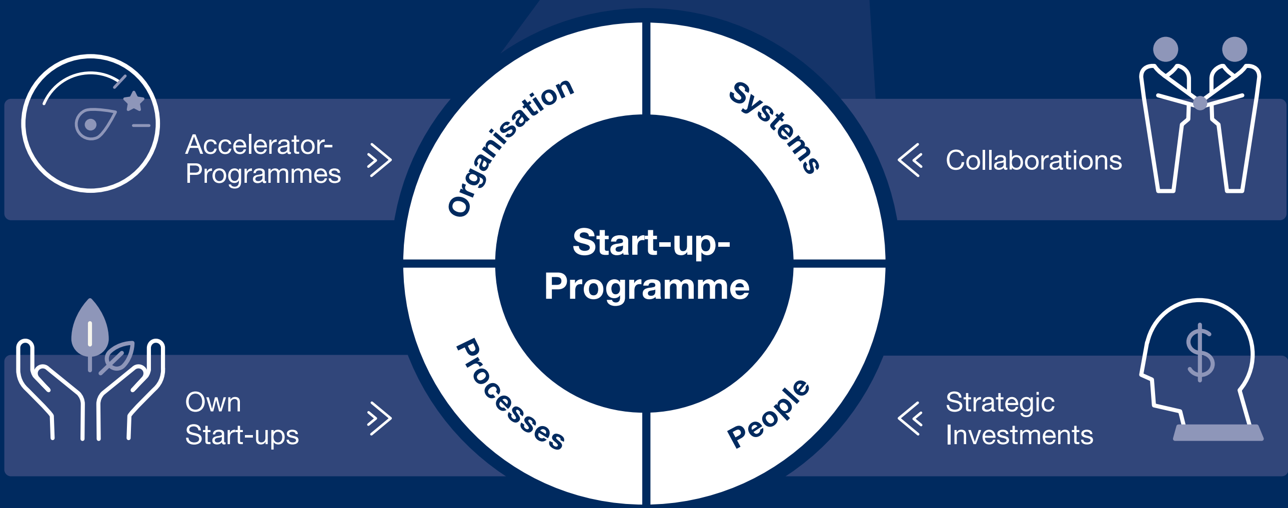
- Continuous expansion/development
- Launch a variety of apps, such as Aareal Sign
- Payments and data processing solutions

Continue developing the existing product portfolio

- Further development of the ERP portfolio
- Transfer successful local solutions into other markets
- Further development of the BK 01 product family

Develop new digital solutions

- CRM, BRM and SRM solutions
- Implement the platform strategy
- Start-up cooperations and partnering



RESPONSIBILITY

Sustainable company management

Financial institutions play a particularly important role when it comes to implementing sustainable development, since every product and every service to be developed and created must be financed as well. Therefore, we are convinced that the financial industry plays an essential role for functioning and future-proof economies.

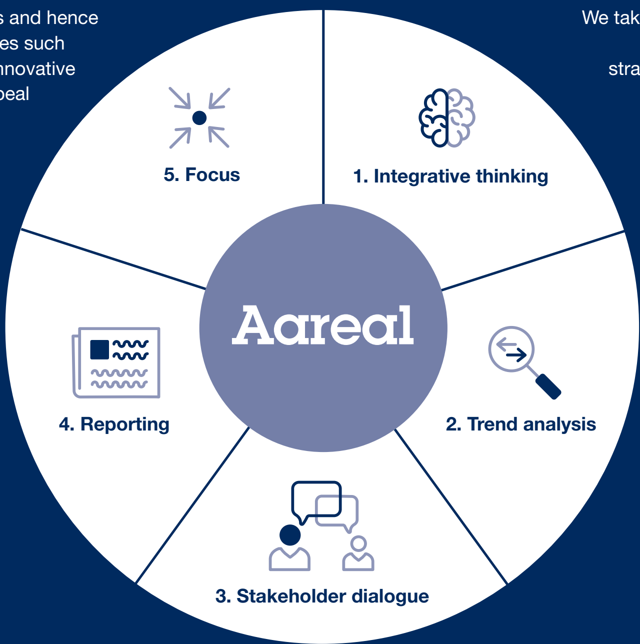
Aareal Bank Group's stands for sustainable business practices, reliability and predictability. We pay close attention to social and ecological aspects when making business decisions, and we wish to contribute to sustainable development – to generate sustainable value for all our stakeholders. Thus, our integrated corporate strategy has a long-term, sustainable focus.

Our principles of corporate responsibility are summarised in our sustainability mission statement and define the aim of our sustainability management:

Our sustainability mission statement

We set priorities, implement decisions and hence reinforce corporate sustainability values such as strict client orientation, reliability, innovative ability, corporate integrity and our appeal as an employer.

We take an integrated approach and broaden the areas of activity identified in our strategic programme to include social and ecological issues.

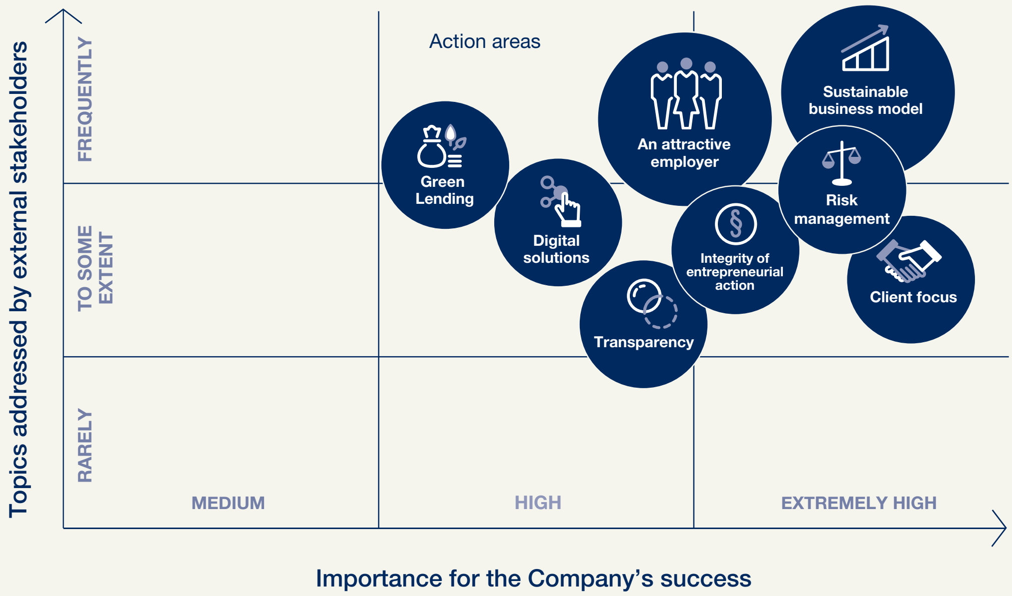


We make sure that business decisions take account of ecological, social and governance factors, and communicate our progress and the challenges we face transparently and credibly.

We analyse trends holistically, evaluate the resulting opportunities and risks, and align our forward-looking sustainability programme with this.

We focus on all relevant stakeholder groups, seek to engage in active dialogue with them in a variety of ways and show how we make use of the insights we have gained.

Our materiality matrix



Our business activities have manifold impact on sustainability aspects. To determine, cluster, and prioritise our action areas, we regularly hold structured talks with our stakeholders on the one hand, and with representatives from our various divisions on the other, subsequently deriving our materiality matrix from the results of these discussions.

Discussions with our stakeholders show that the topic of sustainability within the realms of economy and society is becoming significantly and increasingly relevant. More and more stakeholders are joining the conversation, dealing with the question of how we – as a provider of financing solutions and services – contribute to sustainable development.

The main focus lies on our portfolio of services: which sustainable effects does our lending business have? How do our consultancy and digitalisation solutions impact social challenges? Meanwhile, other topics, such as operational resource efficiency or sustainable procurement, are increasingly taken for granted.

In line with these results, we further refined our materiality analysis in the 2019 financial year. Material for the Company's success are a future-proof business model, risk management, a consistent client focus, our corporate integrity, and our appeal as an employer. The sustainable effects of our business areas ("green lending" and "digital solutions") and the topic of "transparency" are especially important.

Our sustainability management is allocated to Investor Relations – with a direct reporting line from the Group Sustainability Officer to the CEO. This way, we emphasise the strategic importance of sustainability for our corporate philosophy, steer practical implementation at the highest level, and make sure that relevant ESG information is integrated into communication with our stakeholders

More details online:
aareal-bank.com/en/responsibility

STRUCTURED PROPERTY FINANCING

Smart solutions for property investors

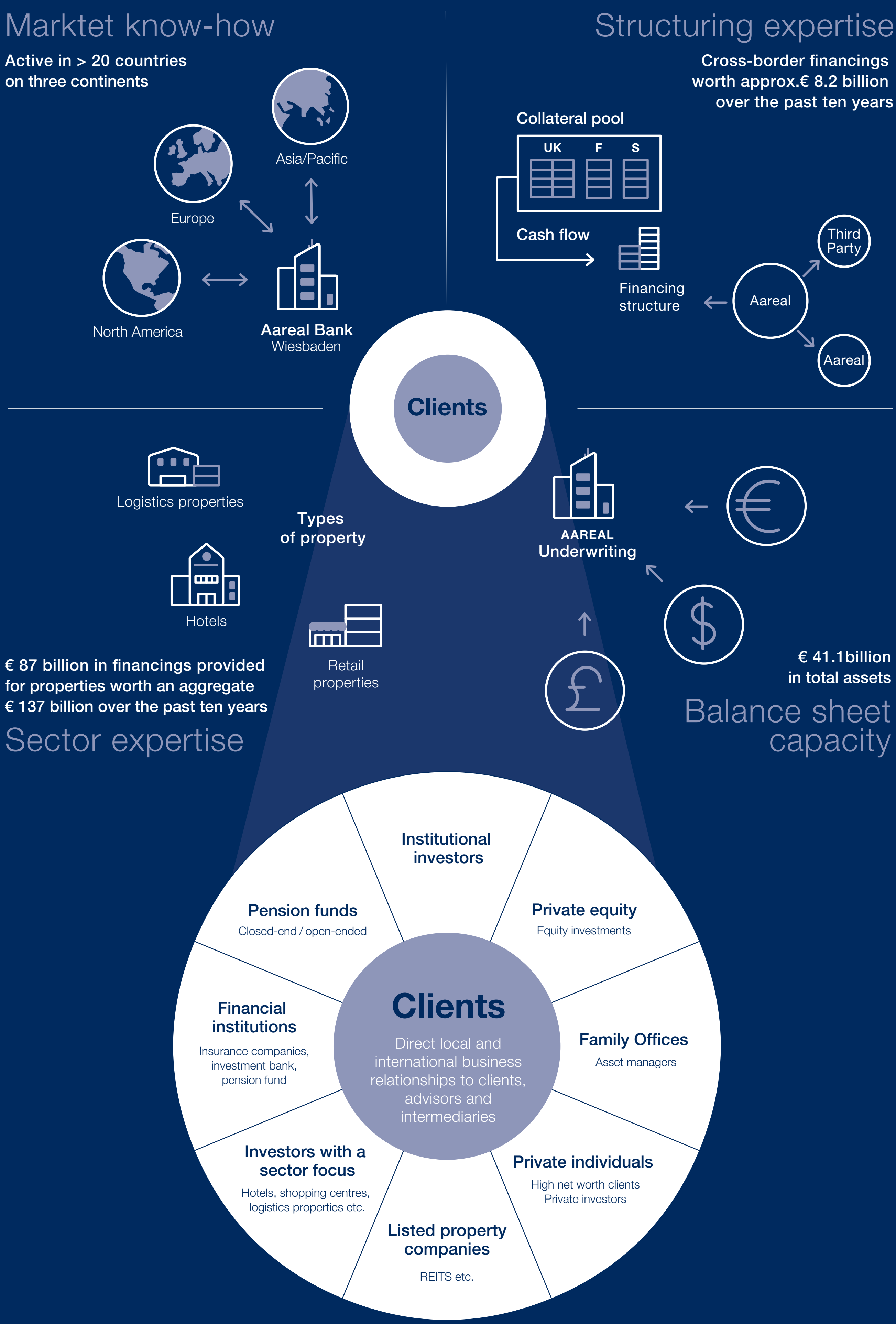
The Structured Property Financing segment encompasses all of Aareal Bank Group's property financing and funding activities. Here we support our clients in making large-volume commercial property investments. These clients include, in particular, institutional investors, private equity firms, family offices, financial institutions, private individuals, listed property companies, pension investors, and investors with a focus on a particular sector.

Our focus lies on the financing of office buildings, hotels, shopping centres, logistics and residential properties, as well as student apartments. In most cases, these are existing properties – in Europe, North America and Asia/Pacific.

Clients appreciate our in-depth local market expertise and our sector-specific know-how, which we are continuously expanding via locally-based experts together with our own dedicated teams for logistics, shopping centres, and hotel properties. With our high-level syndication expertise, our cross-border experience, and established network of international partners we can offer our clients maximum flexibility when realising their projects. In addition, we are a strong partner for our clients thanks to our balance sheet capacity, our digitalisation expertise, and – last but not least – our reliability.

€ 26.7 billion

Lending volume commercial property financing


Marktet know-how
Active in > 20 countries on three continents
Asia/Pacific
Europe
North America
Aareal Bank
Wiesbaden
Structuring expertise
Cross-border financings worth approx.€ 8.2 billion over the past ten years
Collateral pool
UK
F
S
Cash flow
Financing structure
Third Party
Aareal
Aareal
Clients
Logistics properties
Types of property
Hotels
Retail properties
€ 87 billion in financings provided for properties worth an aggregate € 137 billion over the past ten years
Sector expertise
AAREAL
Underwriting
€ 41.1billion in total assets
Balance sheet capacity
Institutional investors
Pension funds
Closed-end / open-ended
Private equity
Equity investments
Financial institutions
Insurance companies, investment bank, pension fund
Clients
Direct local and international business relationships to clients, advisors and intermediaries
Family Offices
Asset managers
Investors with a sector focus
Hotels, shopping centres, logistics properties etc.
Private individuals
High net worth clients
Private investors
Listed property companies
REITS etc.

Exceptional international financing projects

Aareal Bank Group offers property financing solutions for national and international clients on three continents – in Europe, North America, and Asia/Pacific. Our strength is the combination of local market expertise and specific sector know-how.

USD 167,765,000

For the senior financing of the
Class A office tower
1 Columbia Place
in San Diego, California, USA

Agent and Lead Lender

EUR 300,000,000

For the financing of
Project Ruby
A cross-border portfolio of 19 prime logistics properties in France, Germany, Italy and the United Kingdom

Arranger and Lender

HEITMAN
A REAL ESTATE INVESTMENT MANAGEMENT FIRM

GSA
SPACE TO GROW

AUD 57,000,000

For the refinancing of
Infinity Place Student Housing
in Melbourne, Australia

Arranger (Aareal Bank Asia Limited)
Lender (Aareal Bank)

Student housing – properties for the education and urbanisation megatrends

Apartments with a consistent focus on student demands are increasingly popping up in cities around the world. Aareal Bank is already a sought-after financing partner on this young market.

For more details on the dynamics of the student housing market, please refer to our online Annual Report under: ar.aareal-bank.com/2019/studenthousing-en

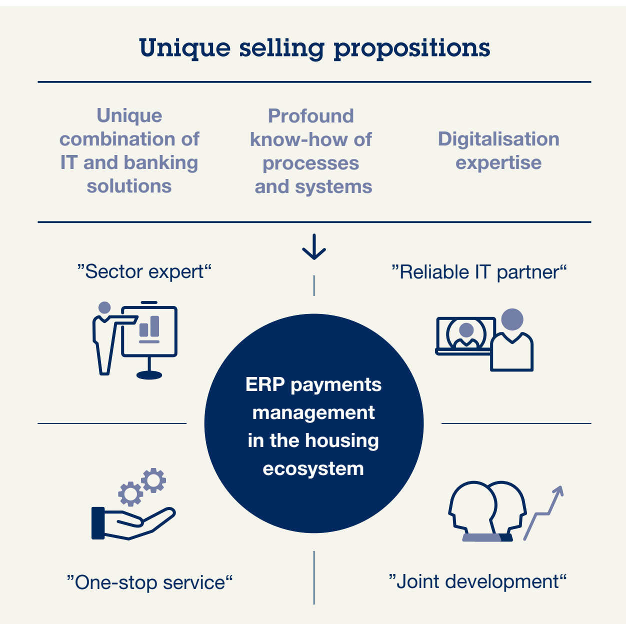
You can find details of more financing projects online:
aareal-bank.com/en/deals

CONSULTING/SERVICES

Intelligent ideas for interconnected processes

In the Consulting/Services segment, as a digitalisation partner we offer comprehensive consultancy and product solutions to companies from the housing and property industries. We strive to contribute to the highest possible efficiency of their business processes, to the optimisation of their customer services, and to the development of new business models. An important part of our services is connecting the housing and property industry with closely related sectors, especially the energy industry.

On the one hand, banking products and service offerings in the Consulting/Services segment relate to banking services associated with account management, with a focus on payment transactions. These services are provided by Aareal Bank AG – for many years a market leader for integrated payment transaction and booking systems for the institutional housing industry in Germany. Thus, the Bank also offers comprehensive solutions for cross-sector mass payments between the housing and energy industries.



The other arm of products and services in the Consulting/Services segment is offered by our subsidiary Aareon AG and relates to consulting, software, and services for digital property management. Aareon is a leading European consultancy and IT systems house for the property industry and its partners in the digital age. ERP systems are at the core of the digital ecosystem Aareon Smart World; they can be interconnected with numerous digital solutions. This integration simplifies processes, makes them more transparent and more convenient, enabling relevant stakeholders, such as property companies, business partners, and tenants/owners, to be connected with each other. Integrating buildings and building technology is also possible. Aareon's digital solutions include CRM solutions for customer relationship management with tenants/owners, portals for tradesmen or document management systems.

Our unique combination of IT and banking solutions allows us to offer all services from a single source; we are industry experts and a reliable IT partner at the same time. Clients appreciate our deep-rooted knowledge of processes and systems and our broad range of services – especially when it comes to the joint development of customised solutions.

€ 10.7 billion

Deposits (2019 average)

Aareon Group

Consultancy and IT systems house
for the European property industry

No. 1 provider of
ERP systems and digital solutions
for the institutional housing industry
in Europe

€ 252 mn
in sales revenues (2019)

Residential units managed by clients:
>10 mn

Aareal Bank

Housing industry division

Banking services
for the German housing and energy industries

No. 1 provider of
integrated payments and accounting systems
for the German housing industry

€ 10.7 bn
in deposits (2019 avg.)

>145
million entries per year

CONSULTING/SERVICES: AAREON

Partners of digital transformation

The property industry's digital transformation is continuously advancing, with the aim of establishing not only more efficient and more convenient processes for property companies via digitalisation, but also to achieve digital networking with relevant stakeholders and buildings/building technology. This opens up additional potential for new business models – for example, around housing services in cooperation with further business partners.

Aareon, the leading consultancy and IT systems house for the European property industry, is the digital transformation partner, offering ground-breaking and secure consultancy, software, and service solutions. The company pursues an international growth strategy and is present at 37 locations in Europe, 14 of which are in Germany. With our international research & development, including cross-border know-how transfer, clients benefit from the entire Group's expertise. Aareon employees' knowledge combines property industry expertise and comprehensive IT skills.

The integrated ERP systems and digital solutions Aareon provides make up the digital ecosystem Aareon Smart World, the core of which consists of country-specific enterprise resource planning (ERP) systems. These ERP systems can be connected to Aareon's other digital solutions, including software solutions and services in the areas of CRM, intelligent metering, document management, apartment handovers, or payment services.

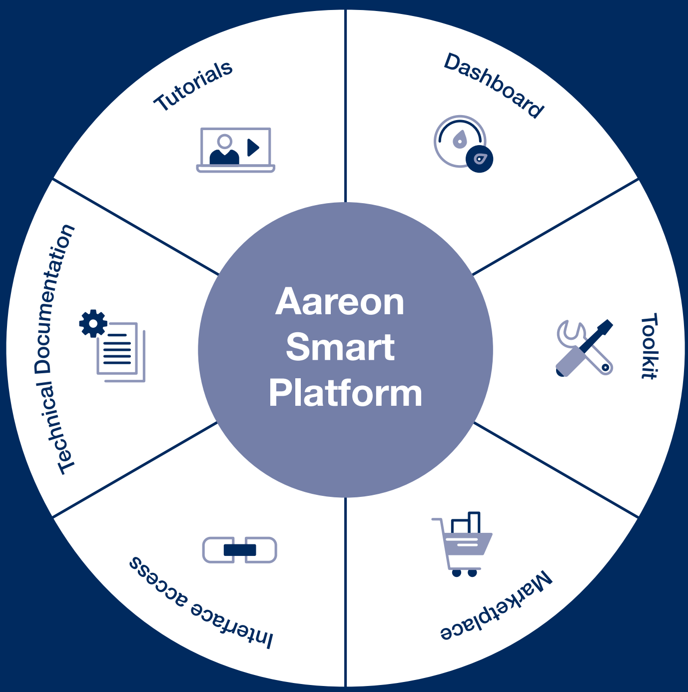
Aareon Smart World

- Digitalisation opens up completely new ways of interaction, thus exploring new value creation potential for the property industry.
- Lower costs, easier-to-use dialogue between tenants/owners and employees, additional services, and the opportunity to build innovative, profitable business models.
- Smooth, seamless interaction of IT-supported processes facilitates the optimised collaboration of landlords/administrators, tenants/owners and service partners – fostering good relationships.
- Opportunity to outsource corporate IT environments, which are subject to growing requirements in terms of complexity and security – to a highly professional IT centre.

Get to know Aareon Smart World!
youtu.be/89lNCdQ73yk

Aareon Smart Platform

A secure platform where clients, partners and start-ups can connect, conceive and design digital solutions for the Aareon Smart World.



- Enhanced control
- Faster delivery
- More agility
- Better overview
- Individualised solutions

Aareon expanded its digital ecosystem for clients and partners when it launched the Aareon Smart Platform in 2019. Clients can develop IT solutions for housing and property management on this development platform, subsequently transferring them into Aareon Smart World; and partners can integrate their digital solutions into Aareon Smart World via the Aareon Smart Platform.

>10 million

(residential) units
managed by clients

TRENDING TOPICS

Thinking ahead – designing tomorrow together

Aareal Bank Group is already making the property industry of tomorrow tangible – today. From many perspectives. Whether we are talking about platform solutions for payment transactions, the future of student housing, or the way we cooperate: we are actively taking part in shaping our future, the future of our sector, and that of our clients. Experience which trends are especially important for us and what trends await us in future. Find out our trending topics in our online annual report.

Managing the diversity of payment options – the future of payments in the housing industry

Seamless payments are on the rise, revolutionising payment behaviour around the world. For the European housing industry, this is a business opportunity and a process threat at the same time. One solution: Platform solutions.

ar.aareal-bank.com/2019/payments

Digital transformation in the housing industry

To be successful in today's digital age, targeted collaboration across company boundaries is crucial. Digital ecosystems play an important role, and offer space for product innovations.

ar.aareal-bank.com/2019/platforms

Success factor "smart collaboration"

New ways of collaborating can truly enrich companies, although they only become really effective when employees develop the mindset to go along with it – and if companies let them do so.

ar.aareal-bank.com/2019/collaboration

Student housing – properties for the education and urbanisation megatrends

Apartments with a consistent focus on student demands are increasingly popping up in cities around the world. Aareal Bank is already a sought-after financing partner on this young market.

ar.aareal-bank.com/2019/studenthousing-en

Sustainable economic activity: transparency is key

Measuring, weighing, counting – sustainability effects are being increasingly quantified. With data being the foundation upon which the cornerstones of a sound, responsible, and reliable approach to business are built, the use of such data is indispensable to enable such quantification.

ar.aareal-bank.com/2019/sustainability

Logistics transformation: urban, green, digital

The logistics industry is more dynamic than almost any other. This also impacts the requirements of the properties used in this sector – and their type of financing.

ar.aareal-bank.com/2019/logistics

Energy service providers 4.0: from energy suppliers to all-inclusive service providers

Utilities are under great pressure: not only to provide more energy, but also to develop new solutions and create better customer experiences. To achieve this, they need strong partners.

ar.aareal-bank.com/2019/energy

For details on our trending topics, please refer to our online annual report:
ar.aareal-bank.com/2019/trends-en

ESSAY

Innovation responsibility

Everybody is talking about innovation – but what do they actually mean? And who is responsible for it?

To uncover the facts on the ground, it is best to start with a survey. So let's take to the street, the community, the office, be amongst people. And ask, "What do you really think about innovation?"

What? It is a stupid question because no one is about to say "nothing". You can get pretty smart answers to silly questions; you just have to dig a bit deeper. "Who is responsible for innovation at your organisation?" There are three possible answers: Don't know. Management. The innovation department. They could, they should, they have to do something.

The possible answers demonstrate that we are in dire need of real innovation. It is a question of culture. The transformation from an industrial to an information society has come a long way. A growing proportion of routine activities has become automated. Things that people used to do are now being done by networks, computers and information systems. It has the advantage of ridding us of annoying and monotonous work. The "disadvantage" is that we then have to show our true colours. Because what is left over requires us to apply ourselves. It is original, distinct work, personal judgement, personal commitment. The great Hannah Arendt defined this this kind of work as the highest level of human labour; she called it exercising judgement. As part of this process, the people who used to take orders and instructions become personally responsible. To solve concrete problems. To consider things. To decide. To be willing to improve something. All of this together leads to innovation.

This is good news. Because it makes the phrase "people are front and centre" a reality. A human being – that is a person, that is one's inner self, what one is good at and what makes one different in this complex world. The organisation of the knowledge economy can handle this sort of difference. It organises the exercise of judgement. It facilitates the innovative potential of its employees.

That is a massive leap. It transforms a duty that was once reserved to a narrow echelon of managers into a key qualification for every skilled worker. As such, everyone who is intellec-

"You can get pretty smart answers to silly questions; you just have to dig a bit deeper."

Wolf Lotter,
Business journalist and book author

tually invested and not merely playing along becomes responsible for innovation. And those intellectually invested are also those who take over responsibility, for innovation and for change.

A knowledge organisation is made up of independent people who, as Peter Drucker once put it, "carry their capital between their ears". And management? It comprises facilitators who create the best framework for these independent thinkers to operate in.

But isn't that all too naive, idealistic, utopian?

Is it not the case that many people have no desire to think for themselves, shift responsibility and innovation work to their superiors or to specialist departments and would prefer to wait and be told what needs to be done? And given the lack of qualified employees, can one demand that much independence? Do-it-yourself clearly means more work; having someone (in a metaphorical sense) "pick you up" is easier.

One could look at it that way. And reality certainly makes that arguable. But is that really how people are? Let us ask a couple of questions. Maybe some people have bad experiences with independent thinking. Maybe they have learned that one gets further with adaptability and passivity than with one's own thoughts and opinions?

The fact that so many people today are asking about the meaning and purpose of their work is a reassuring sign that change cannot be stopped. Value-based thinking shows us the way forward here. Many people are longing for more latitude and more opportunities to get stuck in – old and young alike, by the way.

Independence leads to personal responsibility. It is the most important resource for change. It is the very thing that makes us capable of innovation, and thus responsible for something better.

To our Shareholders

Prepared for tomorrow

from left:

Thomas Ortmanns
Member of the Management Board

Dagmar Knopek
Member of the Management Board

Marc Hess
Member of the Management Board

Hermann J. Merkens
Chairman of the Management Board

Christiane Kunisch-Wolff
Member of the Management Board

Christof Winkelmann
Member of the Management Board

Letter from the Management Board

Dear shareholders,
business associates and staff members,

The 2019 financial year was another challenging year – not only for the banking sector as a whole, but also for Aareal Bank. The past year was once again marked by persistently low interest rates alongside considerable political and economic uncertainty. As in previous years, we focused on implementing new regulatory requirements, and prepared early for further foreseeable regulatory changes. Thus, Aareal Bank has confronted these challenges and can look back at another successful financial year in which we not only generated good results, but also set the strategic course for the future.

The financial indicators clearly confirm: commercially, the 2019 financial year was yet another in an impressively long series of successful years for our enterprise. We achieved all our targets in the past financial year, whilst further improving the foundations for a continuation of our positive performance over the past years. Therefore, we are proud of what the entire Aareal Bank Group team achieved and managed in the financial year under review.

Aareal Bank Group's operating profit of € 248 million in 2019 was down only slightly on the adjusted figure for the previous year (€ 261 million), in spite of integration costs incurred for Düsseldorfer Hypothekenbank (DHB), in what continued to be a very challenging market and competitive environment (including the positive non-recurring effect of € 55 million from the acquisition of DHB, the previous year's figure was € 316 million). Operating profit was thus within the projected target range, despite expenses of approximately € 50 million being incurred for the accelerated reduction of risk exposures. The other operating indicators were also in line with the forecasts: net interest income, which was stable despite the persistently low level of interest rates, remained within the projected range. This was also the case for loss allowance – higher than in the previous year as a result of accelerated de-risking in the second half of 2019 – as well as for the further marked improvement in net commission income and moderately higher administrative expenses.

Aareal Bank not only developed its operating business further in line with projections during the past year. It also continued to target an improved starting position for the years ahead. As such, we delivered accelerated de-risking – announced at mid-year 2019 – i.e. the accelerated reduction of risk exposures on the credit side and in the securities portfolios, at reasonable expense. Our risk exposure to Italy was thus reduced by one-third, and total NPL volume was even down by around 40 per cent from its mid-year high. Moreover, the de-risking exercise had a positive impact on our capitalisation, as well as improving average loan-to-value ratios in our credit portfolio. We have thus significantly strengthened the structure of the assets side of our balance sheet. Considering all these positive effects, the accelerated de-risking carried out so far has – in our opinion – been a major success.

Aareal Bank countered the decline in the portfolio related to de-risking through continued dynamic new business origination, totalling € 7.7 billion for the year as a whole. Hence, the portfolio volume of € 26.7 billion as at year-end remained within the target corridor of € 26 billion to € 28 billion. We surpassed our margin target, which underlines our ability to allocate new business flexibly to attractive markets, whilst adhering to unchanged high quality standards at the same time.

We also recorded a successful year outside the banking business, with our software subsidiary Aareon remaining on a growth trajectory during the year under review: for 2019, Aareon once again reported a marked increase in sales revenue compared to the previous year, exceeding the € 250 million threshold for the first time. Sales revenues from digital products continued their especially dynamic development, soaring by 20 per cent. Despite announced growth investments at Aareon having been launched in the second half of the year, the subsidiary's earnings contribution also continued to rise.

With solid business in the Structured Property Financing segment and dynamic growth at Aareon, Aareal Bank Group's fundamental operating business trends are still intact, giving us a good starting position to master the challenges lying ahead, and adding to the crucial strategic decisions taken in the past months for the period following the end of the current "Aareal 2020" programme for the future. In the years ahead, the Group will develop the individual business activities in a targeted manner under the motto of "Aareal Next Level" – with an unchanged general strategic orientation – and strengthen their independent profiles, aiming to accelerate the Group's overall growth whilst creating value for the shareholders and other stakeholders in a market, competitive and regulatory environment holding ever-growing challenges.

Whilst the emphasis in property financing is on securing the market position in an adverse environment, the Group is targeting the development of new potential in both the Bank's business with the housing sector and related industries, and at Aareon. Aareon, in particular, is expected to significantly increase its growth momentum, developing a strong independent value proposition as a software company with a standalone market position. For this purpose, Aareon will consistently implement its growth programme, presented in 2019, which is designed to double results over the medium term – predominantly through an expansion of digital businesses. Targeted M&A activities are expected to generate additional growth.

To strengthen the independent profiles of the individual business activities and to enhance external perception of their respective economic success, we will change our segment reporting as of the first quarter of 2020, shifting to three instead of the present two segments: Structured Property Financing, banking business with the housing sector and related industries, and Aareon.

The new segment reporting will externally reflect our refined strategy, with which we will raise our Company to a new development level over the medium term. Within the Bank, numerous Group-wide measures and initiatives will be carried out in the next months – all of which are based on "Aareal Next Level". Assuming a more positive environment compared to the current situation, the measures and initiatives undertaken will permit return on equity before taxes of around 12 per cent over the medium term.

Aareal Bank Group believes the market and competitive environment will remain challenging in the current year. It also expects ongoing political and economic uncertainty. No relief is to be expected either from regulatory pressures or from the low interest rate environment. On the whole we expect operating profit in 2020 to be in line with the previous year's level, along with stable consolidated net income. From today's perspective, we should even be able to achieve the latter when economically viable opportunities arise for a continued selective, accelerated de-risking.

As a result of the spread of the coronavirus and the efforts to combat it, considerable volatility and serious implications can currently be observed on the capital markets, but also in the overall economic environment. At present, it is impossible to assess if and to what extent these may influence the business and earnings development, hence they are not included in our forecasts.

Despite all of this, we are confident that we will once again manage to successfully steer your Company through a challenging environment in 2020 and beyond, consistently creating value for all stakeholders based on a solid operating business and a convincing strategy.

We thank you for the trust you have placed in the path we have pursued to date. The Management Board of Aareal Bank Group, its executives and staff, will devote all their energy to uphold this trust. I hope you will stay with us in the future too!

Yours sincerely,

Hermann J. Merkens
Chairman of the Management Board

The Aareal Bank Share

Investor Relations activities

As a listed public limited company included in the MDAX® index, Aareal Bank is subject to numerous disclosure obligations. Aareal Bank sees these as an opportunity to enter into open and constructive dialogue with analysts, investors and clients, as well as with the media.

This dialogue, greatly valued by Aareal Bank, is pursued diligently and intensively, regardless of the economic environment, and is considered a prerequisite for the long-term success as a publicly listed company. Only when company developments are discussed in a timely, open and transparent manner can market participants evaluate potential opportunities and risks that may result from market developments as well as from regulatory changes, and discuss them with Aareal Bank.

To this end, two conferences are held, among other things, in Frankfurt each year for analysts and the media, at which the Management Board presents the results of the financial year under review in great detail, and also provides a strategic outlook for the future, comprising the current financial year as well as the medium-term horizon. Aareal Bank also uses the quarterly publications conference calls as an opportunity to inform analysts, investors and the media about current Group developments.

In the course of the financial year under review, the Investor Relations team took part in eight international capital markets conferences and conducted 21 roadshows in Europe and North America and maintained market communication at a high level overall in 2019, too. The fact that the members of the Management Board also attend conferences and roadshows on a regular basis, and are available for personal discussions, is highly appreciated by investors.

In order to ensure access to timely, open and transparent information of relevance to the capital markets, Aareal Bank provides shareholders and analysts with detailed information on Aareal Bank Group and its two segments Structured Property Financing and Consulting/Services on its website at www.aareal-bank.com. Furthermore, published ad-hoc disclosures and press releases, financial reports, as well as current Investor Relations presentations, are available for download from our Investor Relations portal. The financial calendar offers an overview of the most important dates in the company calendar.

In the 2020 financial year, we will maintain our proactive communication with capital markets in order to further strengthen shareholders' confidence in the sustainable success of Aareal Bank Group's business model.

Key data and indicators of the Aareal Bank share

	2019	2018
Share price (€)[1]		
Year-end price	30.250	26.990
High	31.200	42.800
Low	22.710	26.010
Book value per ordinary share (€)	42.77	43.88
Dividends per ordinary share (€)[3]	2.00	2.10
Earnings per ordinary share (€)	2.42	3.48
Price/earnings ratio[2]	12.50	7.76
Dividend yield (%)[2]	6.61	7.80
Market capitalisation (€ mn)[2]	1,811	1,616

ISIN	DE 000 540 811 6
German Securities ID (WKN)	540 811
Mnemonic	
Deutsche Börse	ARL
Bloomberg (Xetra)	ARL GY
Reuters (Xetra)	ARL.DE
Issued share capital (number of bearer unit shares)	59,857,221

[1] XETRA® closing prices; [2] Based on XETRA® year-end closing prices;
[3] 2019: Proposal to be submitted to the Annual General Meeting

Shareholder structure

since 3 February 2015

Analysts' opinion

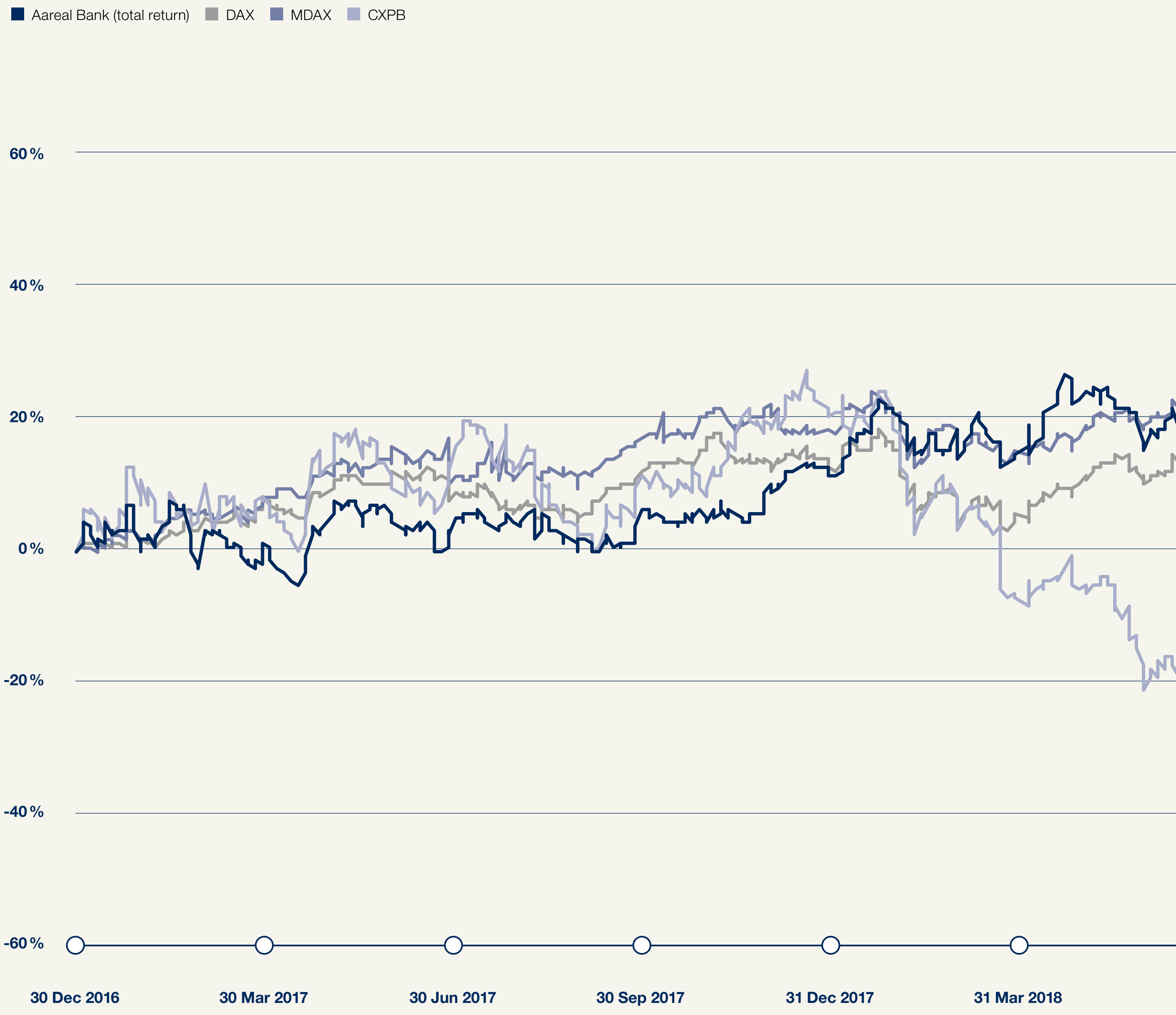
Of the 15 brokerages and analyst firms that regularly covered Aareal Bank at the start of the financial year, one firm has discontinued its coverage, whilst another firm has resumed its coverage of Aareal Bank in the course of the year. Thus, at the end of 2019 the number of brokerages and analyst firms publishing independent studies and comments about developments at Aareal Bank Group remained at 15.

Having finished the 2018 financial year on a positive note, Aareal Bank also needed to meet expectations by market participants and analysts in 2019. Aareal Bank fulfilled these high expectations – currently four "buy" and nine "neutral" recommendations, compared to two "sell" recommendations.

We regularly update and publish the analysts' recommendations on our website www.aareal-bank.com on the Investor Relations page.

Relative performance of the Aareal Bank share price

2017-2019



1 **28 February 2019**
Following a strong performance in the 2018 financial year, Aareal Bank Group expects a stable consolidated operating profit for 2019

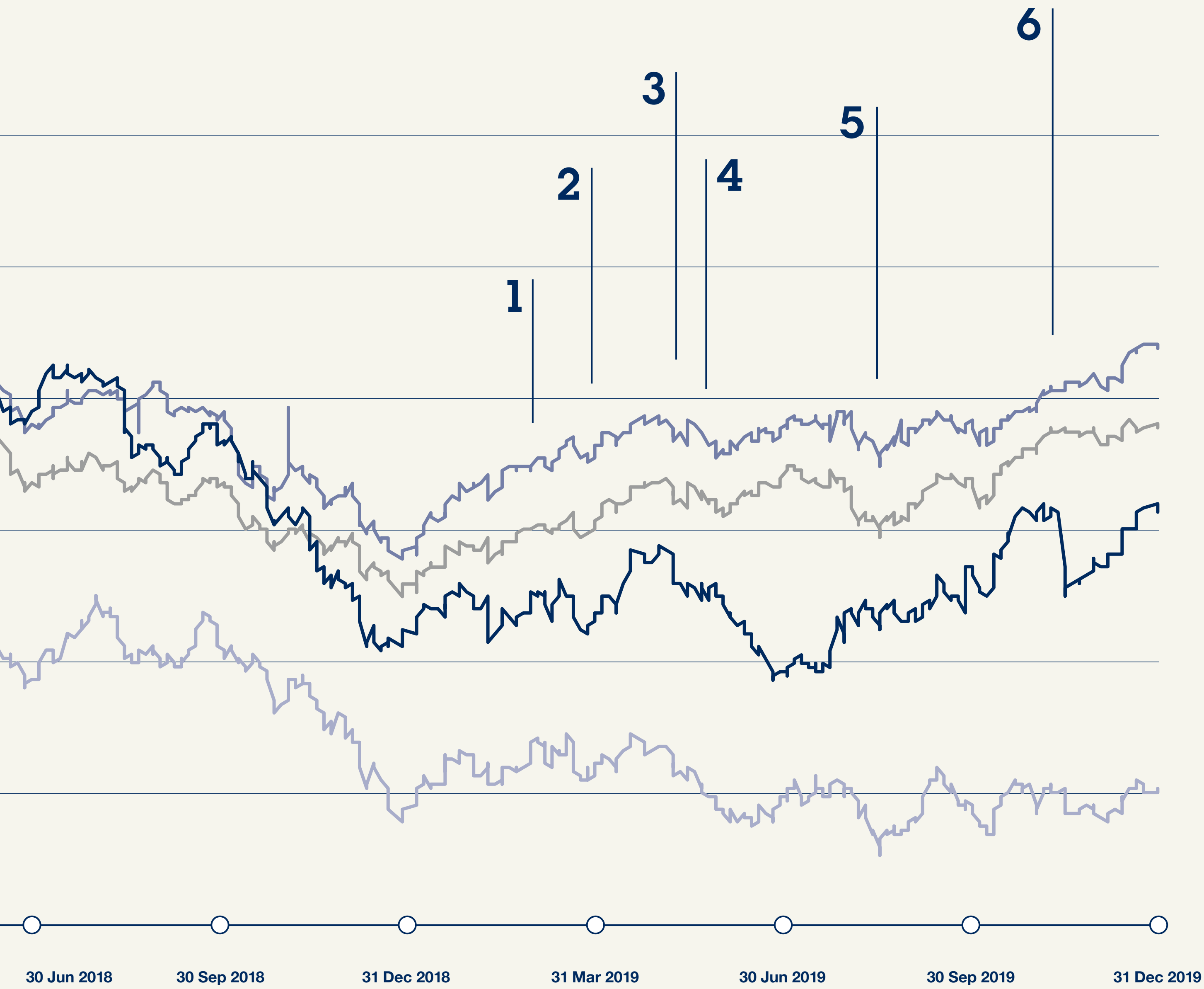
2 **28 March 2019**
Aareal Bank Group publishes its Annual Report 2018

3 **9 May 2019**
Aareal Bank Group remains on track in 2019

4 **22 May 2019**
Annual General Meeting of Aareal Bank AG resolves to pay a dividend of € 2.10 per share for the 2018 financial year

5 **13 August 2019**
Aareal Bank Group remains on track in the second quarter: net interest income remains stable while net commission income increased significantly thanks to Aareon's performance

6 **12 November 2019**
Aareal Bank Group posts a solid result for the third quarter



Aareal Bank Group is a leading provider of smart financing, software products and digital solutions for the property sector and related industries. It is active in more than 20 countries across three continents – in Europe, North America and Asia/Pacific.

Group Management Report

Group Management Report

Aareal Bank Group is an international property specialist. It is active in more than 20 countries across three continents – in Europe, North America, and in the Asia/Pacific region.

Fundamental Information about the Group

Business model

Aareal Bank AG, headquartered in Wiesbaden, Germany, is the parent company of the Group. Its shares are admitted to trading on the regulated market (geregelter Markt) of the Frankfurt Stock Exchange, and are included in the mid-cap MDAX® index.

The strategic business segments of Aareal Bank Group are commercial property financing and services, software products and digital solutions for the property sector and related industries.

Structured Property Financing

In the Structured Property Financing segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and the Asia/Pacific region. Aareal Bank finances commercial property investments, especially for office buildings, hotels, retail, logistics and residential properties, with a focus on existing buildings. By combining local market expertise with sector-specific know-how from the Group's head office, Aareal Bank can offer financing concepts that meet the special requirements of its national and international clients, as well as concluding structured portfolio and cross-border financings.

Aareal Bank manages its sales activities in the individual regions worldwide via a network of sales centres (hubs). In addition to the locally-based experts, the distribution centres for sector specialists covering hotels, retail and logistics properties, as well as those catering to the specific needs of investment fund clients, are located in Wiesbaden. There are two regional hubs in Europe: one hub combines sales activities for the euro zone, with a focus on the Benelux countries, France, Germany, Italy and Spain. An additional hub focuses on sales activities outside the euro zone, with a focus on the UK and Central and Eastern Europe. Distribution in Northern Europe is managed from the head office in Wiesbaden. As before, the hubs have a network – comprising branches in London, Paris, Rome, Stockholm and Warsaw – at their disposal. Furthermore, the Dublin branch holds securities. Representative offices are located in Istanbul, Madrid, and Moscow.

Aareal Bank Group's activities on the North American market are carried out through the subsidiary Aareal Capital Corporation, operating from New York City. The Singapore subsidiary Aareal Bank Asia Limited conducts the sales activities in the Asia/Pacific region.

Funding

Aareal Bank is an active issuer of Pfandbriefe, which account for a major share of its long-term funding. Moody's Aaa rating of the Pfandbriefe confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank uses a wide range of other refinancing tools, including senior preferred and senior non-preferred bonds, as well as other promissory notes and bonds. Depending on market conditions, the Bank places large-sized public issues or private placements. In the Consulting/Services segment the Bank also generates deposits from the housing industry, which represent a strategically important additional source of funding. Furthermore, it has recourse to institutional money market investor deposits.

Consulting/Services

In the Consulting/Services segment, Aareal Bank Group offers its clients from the housing sector and related industries – such as the energy sector – a combination of specialised banking services, software products and digital solutions. With its subsidiary Aareon, Aareal Bank has its own internal consultancy and IT systems house for the property sector in Europe.

Present at 37 locations in Austria, Germany, Finland, France, the Netherlands, Norway, Sweden, and the UK, Aareon offers its customers consulting, software and services to optimise IT-supported business processes in the digital age, generating a stable and long-term business volume based on the experience gained in the past years with the enterprise resource planning (ERP) systems it offers. In addition, Aareon develops a portfolio of digital solutions with its international research and development teams and in cooperation with PropTech enterprises, offering these solutions internationally. "Aareon Smart World", the digital ecosystem, connects these solutions, networking property companies with customers, staff and business partners, as well as connecting technical devices in apartments and buildings. Aareon benefits from a cross-border transfer of know-how, leveraging the respective country-specific focal areas of digitalisation to expand its range of products and services. Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud.

In its Housing Industry division, Aareal Bank offers its customers products and solutions for optimising digital payments, electronic banking and cash management processes. It markets its BK 01 software as a procedure in the German housing property industry for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. In addition to the German property industry, the German energy sector forms a second major client group of the Bank's Housing Industry division for the services mentioned above. This enables the offer of further products, facilitating the cross-sector cooperation of client groups and realising synergies via end-to-end digital processes. In conjunction with payment transactions processed via Aareal Bank's systems, deposits are generated that contribute significantly to Aareal Bank Group's refinancing base.

Within the Consulting/Services segment, Aareon and the Bank's Housing Industry division work closely together. The majority of clients in the Bank's Housing Industry division are also clients of Aareon.

Management system

Aareal Bank Group is managed using key financial performance indicators, taking the Group's risk-bearing capacity into account. Management takes place primarily at Group level, and is additionally differentiated by business segment. Group management is based on medium-term Group planning, prepared annually, which is geared towards the Group's long-term business strategy. An extensive (management) reporting system regularly provides the information required for management and monitoring purposes.

The following indicators implemented within the scope of business and return management are Aareal Bank Group's key financial indicators. They were revised at the turn of the year within the scope of the strategic development "Aareal Next Level":

- **Group/consolidated**
  - Net interest income (in accordance with IFRSs)
  - Net commission income (in accordance with IFRSs)
  - Loss allowance (in accordance with IFRSs)
  - Administrative expenses (in accordance with IFRSs)
  - Operating profit (in accordance with IFRSs)
  - Return on equity (RoE; before taxes)[1)]

[1)] RoE before taxes = $\dfrac{\text{Operating profit ./. consolidated net income attributable to non-controlling interests ./. AT1 coupon}}{\text{Average equity (IFRS) excluding non-controlling interests, other reserves, AT1 bond, and dividends}}$

- Consolidated net income allocated to ordinary shareholders of Aareal Bank[1) as of 1 January 2020
- Earnings per ordinary share (EpS)[2)
- Common Equity Tier 1 ratio (CET1 ratio) – Basel IV (estimated) –
- Liquidity Coverage Ratio (LCR) until 31 December 2019

- **Structured Property Financing segment**
  - New business[3)
  - Credit portfolio of Aareal Bank Group

- **Consulting/Services segment until 31 December 2019**
  - Aareon's contribution to consolidated operating profit (in accordance with IFRSs)

- **Aareal Bank's Housing Industry division segment as of 1 January 2020**
  - Average deposit volume from the housing industry
  - Net commission income (in accordance with IFRSs)

- **Aareon segment as of 1 January 2020**
  - Sales revenue (in accordance with IFRSs)
  - Adjusted EBITDA[4)

The Group's existing risk management system is used to manage and monitor the various risk exposures of Aareal Bank Group entities, in a centralised manner. All management-relevant information is systematically collected and analysed, to develop suitable strategies for risk management and monitoring. We also employ forecasting models for balance sheet structure, liquidity and portfolio development for strategic business and revenue planning. In addition to business-related management tools, we also use various other instruments to optimise our organisation and workflows. These include comprehensive cost management, centralised management of project activities and Human Resources controlling, for example.

Structured Property Financing also deploys supplementary management tools and indicators. The property financing portfolio is actively managed throughout Aareal Bank Group, with the aim of optimising its risk diversification and profitability. To develop risk- and return-oriented strategies for our portfolio, we evaluate market and business data, using this as a basis to simulate potential lending strategies, and to identify a target portfolio, which is part of Group planning. This helps us to identify – and to respond to – market changes at an early stage. Active portfolio management makes it possible for us to optimally allocate equity to the most attractive products and regions from a risk/return perspective, within the scope of our strategy. By taking into consideration maximum allocations to individual countries, products and property types in the portfolio, we ensure a high level of diversification and avoid risk concentrations.

In the Consulting/Services segment, or in the Bank's new Housing Industry division and Aareon segments, respectively, managing the Group entities allocated to the segment is oriented upon specific indicators depending on the respective company's core business. In addition, we use specific management indicators typical for advisory and other services in the IT business. Deposits generated from the housing industry business and net commission income will become key financial indicators, and Aareon's contribution to consolidated operating profit will be replaced by adjusted EBITDA, a standard target figure commonly applied to software companies, supplemented by sales revenue.

[1) The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis

[2) Earnings per share = $\frac{\text{Operating profit ./. income taxes ./. consolidated net income attributable to non-controlling interests ./. AT1 coupon (net)}}{\text{Number of ordinary shares}}$

[3) New business = newly-originated loans plus renewals

[4) "Earnings before interest, taxes, depreciation and amortisation" Excluding strategic investments and non-recurring effects

Report on the Economic Position

Macro-economic environment

The year 2019 was defined by many uncertainties and changes on both an economic and geopolitical front. Besides the economic slowdown compared with previous years, especially in the industrial sector, there were also significant developments in the interest rate environment and in central bank policy. Conflicts or political uncertainties in several regions of the world at the same time impacted directly or indirectly on the environment. The protectionist measures in several countries were recognised as one of the key drivers of the uncertainty.

Economy

The economy slowed down in the euro zone, and real gross domestic product grew by 1.2 %; the growth was thus lower year-on-year (2018: 1.9 %). This was especially attributable to a weak industrial sector, which impacted Germany and Italy in particular.

The UK's economy grew by 1.4 % (2018: 1.3 %). Exports were up 3.7 % year-on-year, mainly due to the inventory build-up of many companies as a result of the EU exit. The latter was a burdening factor overall that affected most economic players. The UK officially left the European Union on 31 January 2020 after the EU Withdrawal Agreement Bill was passed on 20 December 2019. As of 1 February, a transitional period is in place until year-end 2020, during which the UK remains a part of the EU single market. To avoid a hard Brexit, it is imperative that a trading agreement is concluded by 31 December 2020, which does not contribute to moderate the uncertainty reigning since 2019.

In the US, real economic growth cooled off to 2.3 % (2018: 2.9 %), especially due to fewer investments. This level can be described as moderate for the US. Consumers continued to benefit from the good employment situation, which supported consumption. At 1.6 %, growth in Canada was lower than in the previous year (2.0 %). Lower export growth and less investments were the main reasons for this development.

As expected, economic growth in the Asia/Pacific region was lower than in the previous year. This was particularly evident in China, which recorded growth of 6.1 % per annum compared with 6.7 % p. a. in 2018. The decline was attributable to the trade conflict with the US as well as to the slowdown in credit growth. Growth in economic output amounted to 1.8 % in Australia and was thus down on the previous year (2.7 %), with lower consumer spending in the second half of the year a contributory factor.

Annual rate of change in real gross domestic product

%	2019[1]	2018[2]
Europe		
Euro zone	1.2	1.9
Austria	1.5	2.3
Belgium	1.4	1.5
Finland	1.5	1.7
France	1.3	1.7
Germany	0.6	1.5
Italy	0.2	0.7
Netherlands	1.7	2.5
Spain	2.0	2.4
Other European countries		
Poland	4.2	5.1
Russia	1.3	2.3
Sweden	1.2	2.3
Switzerland	0.8	2.8
United Kingdom	1.4	1.3
North America		
Canada	1.6	2.0
USA	2.3	2.9
Asia/Pacific		
Australia	1.8	2.7
China	6.1	6.7

[1] Preliminary figures; [2] Adjusted to final results

The labour markets were positive in almost all regions in 2019. The unemployment rate in the euro zone fell by a total of 0.6 percentage points to 7.6 %. Higher declines were recorded in Spain and Italy in particular. The unemployment rate in the US declined to 3.7 % and to 5.2 % in Australia. In contrast, the unemployment rate in the UK rose by 0.7 percentage points to 3.2 %.

Inflationary pressure eased in the currency areas that are relevant for Aareal Bank Group, especially due the economic slowdown. Inflation fell by 0.6 percentage points both in the euro zone and the US to 1.2 % and 1.8 %, respectively. It fell by as much as 0.7 percentage points in the UK to 1.8 %.

Financial and capital markets, monetary policy and inflation

The year 2019 on the capital markets was defined by falling long-term and short-term interest rates in nearly all currency areas. While a basic expectation for rate increases still prevailed last year, this changed following the adjustments made by key central banks to their monetary policy. The markets were open without limitation for new issues and refinancing, which was reflected in yields close to 0 % and a 3.4 % increase in gross sales of Mortgage Pfandbriefe in Germany up to the end of October.

During the year, the European Central Bank (ECB) announced the introduction of new long-term refinancing transactions (TLTRO) and its intention to leave the key interest rates at their current level until mid-2020 at least. However, it lowered the interest rate for the deposit facility by 10 basis points to -0.50 %, additionally scaling the deposit rates depending on the deposit volume. It also relaunched an asset purchase programme of € 20 billion per month since November. Having raised its main refinancing rate (fed funds) in December 2018, the US Federal Reserve (Fed) turned its policy around and lowered it three times during 2019, by 25 basis points on each occasion. It also emphasised the return to an expansionary monetary policy when it started buying US$ 60 billion of treasury bills per month. The Bank of England made no changes to interest rates in light of the unclear situation surrounding Brexit. The Swedish Riksbank left its main interest rate unchanged in 2019 but decided in December to raise it by 0.25 percentage points to 0.0 % from 8 January 2020.

The euro's performance vis-a-vis the currencies that are relevant for Aareal Bank was varied during the year. There was no uniform trend in the euro/US dollar exchange trade either. The US dollar had made gains up to October, only to lose these again over the remainder of the year. Nonetheless, its value at year-end was above that of the end of the previous year. Although the pound sterling at year-end was higher against the euro than at the start of the year, it shed around 9 % in value between May and August as a result of the uncertainties surrounding the UK's withdrawal from the EU before climbing again in the last quarter of the year. The Swiss franc and the Canadian dollar both made gains over the euro, while the Swedish krona and the Australian dollar weakened.

Short-term interest rates[1)] fell in most of the relevant currency areas. Measured in euros, they fell in the single-basis point range, thus reinforcing the negative interest rate environment. Measured in US dollar, they fell by around 90 basis points, by 40 basis points in Canadian dollar and by as much as approximately 120 basis points in Australian dollar. The pound sterling also declined, by 12 basis points in this case. Short-term interest rates denominated in Swedish krona bucked the trend to increase by around 20 basis points and were therefore above the zero per cent line, having fallen below it at the start of the year.

A continuous downward trend, whose magnitude was almost identical in all relevant currency areas, established itself for long-term interest rates[2)] in the course of the year.

Yields on ten-year government bonds fell during 2019 in the countries that are relevant to

[1)] Calculated on the basis of 3-month Euribor or the corresponding LIBOR or other comparable rates for other currencies
[2)] Calculated on the basis of swaps in the respective currencies

Aareal Bank, falling below the zero per cent mark for Germany. However, the spreads of Italian and Spanish government bonds relative to long-term German issues tightened due to the more pronounced decline in yields in Italy and Spain.

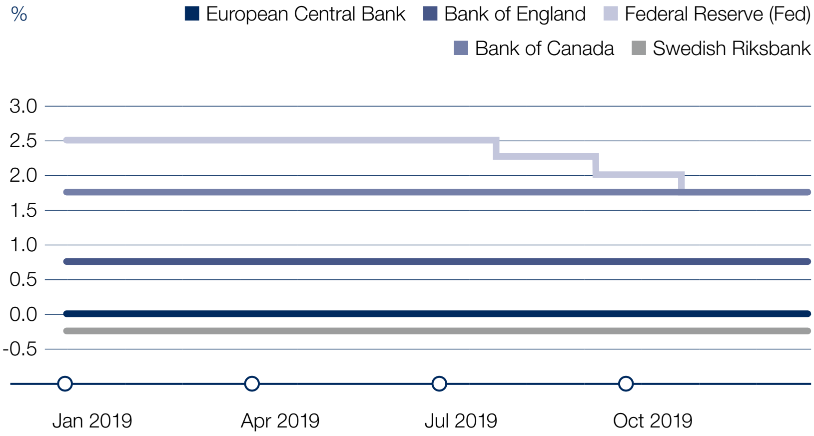
Notwithstanding political uncertainties, the primary market in the euro zone's covered bond segment was very strong in 2019 and defined by falling yields. Covered bonds totalling € 135 billion were issued last year, the highest volume since 2015, with German issuers accounting for the highest share of € 26.5 billion or 40 placements.

As in previous years, the ECB had stepped up its role as a buyer again since the end of year within the framework of its purchase programme, in response to the weak macro-economic developments in 2019.

Many investors hoped in vain again for a rise in interest rates in 2019. The ECB's expansionary monetary policy led to a significant decline in yields during the year.

The German Pfandbrief, which is considered formative for the European covered bond market, celebrated its 250th birthday in 2019.

Key rate developments in 2019[1)]



1) The chart shows the upper level of the corridor for Fed Funds.

Regulatory environment

The environment in which banks are operating continues to be defined by highly dynamic regulatory requirements, as well as by changes in banking supervision. This includes, in particular, the implementation of the final draft of the Basel III framework into EU law (known as "Basel IV"), which was endorsed by the Basel Committee's Group of Governors and Heads of Supervision (GHOS). Furthermore, the EU Commission's revision of supervisory regimes (CRR II, CRD V, BRRD II and SRMR) at EU level as well as the EBA documents (Guidelines on PD and LGD estimation, treatment of defaulted exposures, and determination of downturn LGD), will all bring about further regulatory changes. The provision put forward by the ECB, EBA and the EU Commission on the treatment of non-performing loans must also be taken into account. Moreover, both national and European regulators are imposing various new requirements – including in connection with IT/information security risks, or regarding the prevention of money laundering, tax evasion and terrorist financing. Furthermore, politics and the banking supervision deem it necessary to establish sustainability more strongly with society, and as a regulatory requirement within the economy. As such, the EU's Technical expert group on sustainable finance published the "Technical report on the EU taxonomy", and BaFin issued its "Guidance Notice on Dealing with Sustainability Risks" at the end of 2019.

The ECB's Supervisory Review and Evaluation Process (SREP) ensures a common approach on the supervisory review of banks, within the framework of Pillar 2. The SREP is built around a business model analysis, an assessment of governance, as well as of the capital and liquidity risks. The results of the individual areas are aggregated in a score value, from which the ECB derives supervisory measures on holding additional capital and/or additional liquidity buffers.

Following an amendment to the German Regulation Determining Critical Infrastructure (Verordnung zur Bestimmung Kritischer Infrastrukturen – "BSI-KritisV") in 2017, Aareal Bank AG is now additionally subject to reporting requirements vis-à-vis the German Federal IT Security Authority (BSI). The BSI required that areas and systems classified as "critical infrastructure" had to be certified by mid-2019.

Sector-specific and business developments

Structured Property Financing segment

Transaction activity worldwide in commercial property was lower than in the previous year. However, differences were observed depending on the property type. While transaction volumes in retail property declined by around 30 %, they increased for the other relevant property types by between 4 % and 10 %. Reticence among investors in retail property was evident in light of the upheavals, through online trading among other things.

Office properties benefited from the long economic cycle and the positive sentiment that continues to prevail in the service sector. In most markets, yields[1] remained on a very low level in 2019 – in part significantly below 4 %. They eased in Europe by around 25 basis points on average during the course of the year, while remaining stable in the US. They also remained stable in China and Australia. A low single-percentage increase on average was observed in rents offered in Europe, the US and Australia. They remained stable on the other hand in China.

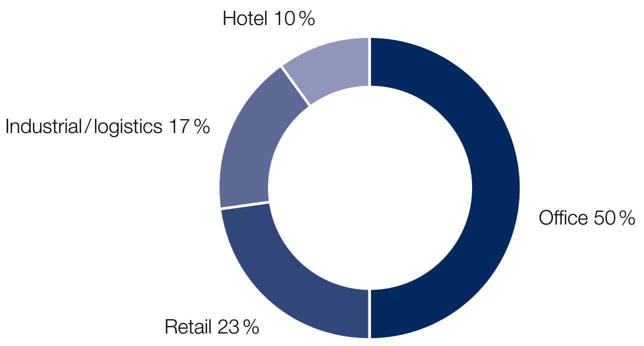
In contrast, yields on retail property rose by a few basis points on average in Europe in 2019, while remaining stable in the Asia/Pacific region and the US. Low single-percentage declines in rents on average were observed in Europe. Rents remained stable in the Asia/Pacific region and in the US.

Yields on European logistics properties decreased by an average of 25 basis points, whilst rents offered in Europe fell by an average of 1.7 % (2018: 2.5 %).

The willingness among market participants to provide finance varied during the year. In the Bank Lending Survey for the third quarter, the ECB reported on falling lending standards in Europe and lower margins due to heightened competition between the banks. However, this applied to all areas of the economy. The margin and competitive situation can also be applied to commercial property markets, as Aareal Bank observed pressure on margins in many European markets during the course of the year. In the UK, however, the willingness to provide financing for commercial property purchases fell. Lending in the US was up 13 % year-on-year in 2019, with the volume of CMBS issued particularly increasing in November, albeit less than in the previous year from a full-year perspective. All in all, it can be said that competition remains intense, which is supported by the pressure on margins in numerous European markets. Margins remained under pressure in North America too, but remained higher than in the euro zone.

In a highly competitive environment defined by uncertainties, Aareal Bank Group generated new business volume totalling € 7.7 billion (2018: € 9.5 billion) in the year under review, this was in line with our planning.

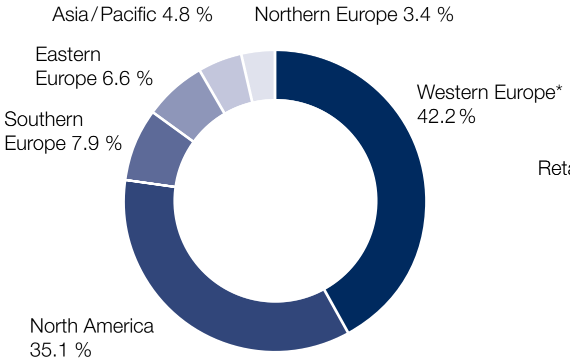
Share of transaction volume observed worldwide in 2019
%

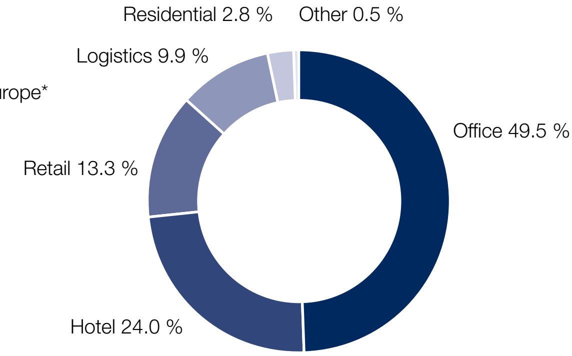


[1] Falling yields are usually associated with rising property market values, all other things remaining equal.

New business[1] 2019

by region | by type of property (%)





* Including Germany

[1] New business, excluding private client business and local authority lending business of former WestImmo

The share of newly-originated loans relative to new business was 80.1 % (2018: 75.8 %) or € 6.2 billion (2018: € 7.2 billion). Renewals amounted to € 1.5 billion (2018: € 2.3 billion). At 60.1 % (2018: 58.8 %), Europe accounted for the largest share of Aareal Bank Group's new business, followed by North America with 35.1 % (2018: 38.6 %) and the Asia/Pacific region with 4.8 % (2018: 2.6 %). The higher share of financings in the Asia/pacific region is due entirely to newly-originated loans.

With a share of 49.5 % (2018: 26.7 %), office property accounted for the largest share in new business in terms of property type, followed by hotel property, with 24.0 % (2018: 35.3 %), ahead of retail property with 13.3 % (2018: 23.3 %) and logistics property with 9.9 % (2018: 7.8 %). The share of residential property was 2.8 % (2018: 5.5 %), while other property and financings accounted for 0.5 % (2018: 1.4 %).

Europe

Transaction volumes generated in Europe in 2019 were roughly 10 % lower than in the previous year which was attributable in particular to lower transaction activities in retail and logistics properties, and to a decline of around 30 % in the UK, which is one of the largest European markets. In the UK, the exit from the EU was one of the reasons for the subdued market; however, investor reticence for retail properties also negatively impacted transaction volumes. The volumes transacted in office and hotel property on the other hand was higher year-on-year. In Europe, cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

Rental growth in the market for office property in Europe was positive on average in 2019. This trend has persisted since early 2013. At the same time, yields fell by an average of 25 basis points (2018: -8 basis points).

The situation with retail property painted a different picture. Shopping centre rents, in particular, fell by 1.8 % (2018: +2.2 %) across the whole of Europe. The weighted yield rose by 26 basis points (2018: +3 basis points).

Logistics properties remained attractive for investors in 2019. Whilst rents dropped by 1.7 % year-on-year (2018: +2.5 %), this did not affect Aareal Bank's key markets. An average decline of 25 basis points (2018: -23 basis points) in weighted investment yields attested overall continued investor demand.

Hotel properties showed largely positive trends in Europe in 2019, thanks to the sustained economic boom, with occupancy rates rising by 0.4 % year-on-year. A 1.8 % increase in the average room rate led to a 2.2 % growth in average revenue per available room, which was down on the previous year (2018: 5.2 %). The increase in the number of rooms available was reflected here. The particularly positive performance in London should be highlighted. Despite uncertainties surrounding Brexit, the increase in average revenue per available room was twice that of the European average.

The Bank originated new business of € 4.6 billion (2018: € 5.6 billion) in Europe during the year under review. As in previous years, Western Europe again accounted for the largest share of € 3.2 billion (2018: € 3.5 billion) with the strongest countries being France and Germany. Southern Europe followed with € 0.6 billion (2018: € 1.2 billion), Eastern Europe with € 0.5 billion (2018: € 0.3 billion) and Northern Europe with € 0.3 billion (2018: € 0.6 billion).

North America

The volume of transferred commercial property in the US in 2019 was roughly unchanged from the previous year's figure. Office property values were stable, while fewer retail and hotel properties – as measured by volume – were transferred than in the previous year. Transaction volumes in hotel properties in Canada were roughly 18 % lower than in the previous year. Institutional and private investors were on the buy side for the most part, while cross-border investors and REIT structures tended to be sellers.

In the market for office property, rents offered in the US rose overall by just over 2 %. The growth in rents in the metropolitan areas on the west coast tended higher than those on the east coast. On the other hand, yields hardly changed compared with the end of the previous year.

Rent offered for retail property in the US increased by 1.0 %, although there were regional differences here in the amount as well as in the course of growth. Some locations such as Boston or Chicago featured falling quoted rents. The yields did not change compared with the end of the previous year.

On the hotel markets in the US, growth in average revenue per available room stagnated in the year under review, with average room rates going up by 1.0 % and occupancy rates remaining at the previous year's level. Seeing as revenue per available room is at its highest since 2007, the discussed development is still positive. Average revenue per available hotel room was stable in Canada. Lower occupancy rates were offset by a higher average room rate.

Aareal Bank originated new business of € 2.7 billion in North America during the year under review (2018: € 3.7 billion). This business was concluded in the US and Canada.

Asia/Pacific region

The volume of transferred commercial property in the Asia/Pacific region in 2019 was approx. 10 % below the previous year's figure. The level in Australia, on the other hand, remained the same year-on-year. Cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors tended to be sellers.

The situation on the market for office property was mixed in the Asia/Pacific region. While rents in Australia increased significantly by just over 5 %, they fell in China by an average of 3.5 %.

Developments on the market for retail property in the Asia/Pacific region were comparable. Rents and yields were largely stable.

Hotel property in the Asia/Pacific region experienced a 3.2 % decline overall in revenue per available room, which was due to falling occupancy rates and lower average room rates. Regionally, the decline is attributable in particular to negative developments in Northeast Asia.

The Bank originated new business of € 0.4 billion in the Asia/Pacific region during the year under review (2018: € 0.2 billion), including financing of student housing complexes in Australia.

Integration of former Düsseldorfer Hypothekenbank AG

As planned, Aareal Bank Group concluded the integration of former Düsseldorfer Hypothekenbank AG (Düsselhyp) during the first half of 2019, with the split-off of former Düsselhyp's banking operations.

Consulting/Services segment

Bank division Housing Industry

Business development in the German housing industry proved solid in 2019 as well. Rental income has increased overall as in the previous year. Together with the long-term financing structures and very low interest rates, they secure a solid foundation and facilitate entrepreneurial investments. Nationwide, rents were around 2.7 % higher year-on-year (compared with an increase of 2.9 % in 2018).

However, market development varied from region to region. While rents rose by 0.8 % on average in rural areas in the third quarter of 2019, average rents in the municipal districts fell by 0.3 %. They also stagnated in the most popular cities ("Schwarmstädte"), while continuing to rise in the surrounding areas; this suggests that tenants are migrating out of metropolitan areas.

There is still a housing shortage. At 257,000, the number of construction permits for apartments in 2019 is down by nearly 2 % on the previous year's figure. A lack of available and affordable building land and of employees in the responsible licensing authorities is making it difficult to improve the situation; low capacity at the construction firms and high construction costs are holding back major investments. The federal government's coalition agreement estimated the average demand for new apartments at 375,000 per annum (from 2017 to 2021); this continues to be clearly missed.

The vacancy ratio based on the housing stock managed by GdW enterprises varies: at 1.4 %, the ratio in the former West German Federal states is unchanged from the previous year and should rise to 8.5 % (2018: 8.3 %) in the former East German states.

The Housing Industry division further strengthened its market position in the 2019 financial year, bringing in more business partners from the institutional housing and commercial property industries – managing more than 235,000 residential units between them – for the payments and deposit-taking businesses. Moreover, it intensified existing business relationships. We also continuously succeeded to position ourselves as a partner in the energy and waste disposal industry, particularly within the scope of digitalisation, especially through interface products (such as BK 01 eConnect and BK 01 immoconnect) facilitating cross-sector collaboration amongst our client groups. Examples include accounting documentation and invoicing of energy supplies.

With plusForta AG, Aareal Bank has acquired one of the leading German providers of tenant deposit guarantees in 2019. The additional tenant deposit alternative will be gradually integrated in our technical systems and expands the range of property industry services in the area of deposit guarantees. The purchase of software from Deutsche Kautionspartner for managing rent deposits held with other banks will complete the range in addition to Aareal Bank's account maintenance service.

In addition, the Housing Industry division has analysed the development of alternative online payment systems very intensively and is integrating corresponding procedures into existing programmes and processes. The corresponding Aareal Exchange & Payment Platform product is currently in a pilot phase and is expected to be placed on the market in 2020.

At present, more than 3,500 business partners throughout Germany are using our process-optimising products and banking services. The high volume of deposits, averaging € 10.7 billion (2018: € 10.4 billion) in the year under review, is in line with the strategic orientation. The share of rent deposits and reserves in accordance with the

German Residential Property Act was increased once again. Deposits averaged € 10.9 billion in the fourth quarter of 2019 (Q4 2018: € 10.4 billion) which we see as a sign of the trust our clients put in us.

Aareon

Aareon is a consultancy and IT systems house for the property industry and its partners in Europe. It pursues a profitable growth strategy, and continued to grow in 2019. Key factors to its success are client orientation, the growth in digital solutions, further strengthening of the ERP systems and exploration of new relevant markets and related sectors associated with the property industry. In the course of Aareon's forward-looking orientation and further intensification of research and development, a strategic investment programme focusing on digital solutions was launched specifically for this purpose. The process of internal optimisation to enhance the organisational performance and profitability also continued, and the operative organisational structure with three cross-border divisions – sales, operating (including ERP and outsourcing) and digital business – was organised to enhance proximity to the market and clients.

Aareon's contribution to earnings in the 2019 financial year was € 37 million (2018: € 36 million), including strategic investments of € 3 million, thus corresponding to its earnings forecast. This was essentially due to recurring revenues and the consulting business in all product segments, as well as to the significant revenue growth of digital solutions which are reported under commission income.

Numerous additional clients, including key accounts, were acquired for the Wodis Sigma ERP solution in the DACH region (Germany, Austria and Switzerland). Among these new customers, there are still many previous GES clients, most of whom have opted in favour of one of the Wodis Sigma modern ERP systems or for SAP® solutions and Blue Eagle, or their systems were already migrated. As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. Aareon continued to implement a large number of migration projects. The total number of Wodis Sigma customers has therefore increased to around 1,050 as at year-end. The business volumes conducted with Wodis Sigma as well as with SAP® solutions and Blue Eagle increased year-on-year. The increased business volume and regular price adjustments led to higher revenues from maintenance and SaaS contracts. Consulting revenue increased as well. Additional commercial property clients were acquired for the RELion ERP solution, resulting in higher licence and consulting revenue. The mse subsidiaries were renamed as Aareon RELion in November. The positive trend in the outsourcing business continued unabated. BauSecura's insurance business has been running slightly above the previous year's level.

The marketing process for the Aareon Occupant Change Management solution continued to run on the utilities market.

In the Netherlands, several key accounts opted for long-term contracts with the Tobias ERP solution – some products were rolled out with key accounts, too. No losses of major clients were reported. The market launch of the new Tobias 365 ERP product generation started in the second quarter on the basis of Microsoft® Dynamics® 365. The distribution of the Dutch REMS ERP solution for the commercial property business was in line with the previous year. In France, several new clients were acquired in the course of the ELAN Law, which was passed in October 2018. Several new clients were acquired in the UK, including one important key account. ERP demand also concentrated on individual software adjustments and additional modules. Aareon Sverige was able to win key tenders with the Incit Xpand ERP solution, for example with several Swedish local authorities. The key tender with the housing company OBOS, managing around 220,000 units, was won in Norway. Following the successes on the Finnish market, Aareon Sverige founded the subsidiary Aareon Finland OY at the start of the year.

Digitalisation is becoming increasingly important for the property industry. With its Aareon Smart World digital ecosystem, Aareon offers integrated solutions for automating the business processes and networking business partners and market participants. The digital transformation process for customers is therefore focused on creating added value. Aareon continues to steadily expand this offer, and benefits from the transfer of international know-how in research and development, as well as from the exchange with the proptech and start-up scene. In the Netherlands, Aareon Nederland acquired a minority stake in the Dutch PropTech OSRE B.V. ORSE designed a digital solutions platform that makes property sales and rental transactions more efficient. The first investment of subsidiary AV Management GmbH, which operates under the Ampolon Ventures brand, was ophigo which was presented at the MIPIM in Cannes and Expo Real in Munich. ophigo offers a digital platform for finding office space.

In November, Aareon signed the contract to acquire CalCon with effect from 1 January 2020. This acquisition supports Aareon's international growth strategy. The epiqr product for structural condition assessment and the new CalCon AIBATROS product generation will complement Aareon Smart World's product range.

The business volume generated with digital solutions has continued to grow strongly, by approximately 20 % year-on-year, with a growing number of clients enhancing their ERP systems with the addition of integrated digital solutions, thus developing their own digital ecosystem. The Aareon Smart Platform was introduced in Germany, France and the Netherlands, with five customers in France already opting for this offer. The Aareon Smart Platform is an open platform that allows clients and partners to develop own solutions and integrate them securely into Aareon Smart World.

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit in the 2019 financial year amounted to € 248 million (2018: € 316 million), thus corresponding to our earnings forecast. The comparative figure for the previous year benefited from a material non-recurring income of € 55 million negative goodwill from the initial consolidation of former Düsseldorfer Hypothekenbank AG (Düsselhyp), whilst the corresponding costs for the integration in the year under review amounted to € 11 million.

Net interest income amounted to € 533 million (2018: € 535 million) and was thus stable, as planned.

The loss allowance of € 90 million (2018: € 72 million) corresponded with the forecast that was increased in the third quarter (previously: € 50 million to € 80 million expected) to take account of the higher burden from accelerated de-risking.

Net commission income of € 229 million developed positively as planned, in particular due to the higher contribution from Aareon (2018: € 215 million).

The net derecognition gain amounted to € 64 million (2018: € 24 million), exceeding our forecast increased in the third quarter (previously: € 20 million to € 40 million expected) mainly as a result of structural adjustments to our securities portfolio after acquiring former Düsselhyp.

The net loss from financial instruments (fvpl) and on hedge accounting totalled € -3 million (2018: € -4 million).

Administrative expenses increased as expected, to € 488 million (2018: € 462 million), in particular due to running costs, integration expenses incurred in conjunction with the integration of former Düsselhyp, and Aareon's business expansion.

All in all, consolidated operating profit for the 2019 financial year totalled € 248 million, after € 316 million in 2018. Taking into consideration tax expenses of € 85 million and non-controlling interest income of € 2 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 161 million (2018: € 224 million).

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Consolidated net income of Aareal Bank Group

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Net interest income	533	535
Loss allowance	90	72
Net commission income	229	215
Net derecognition gain or loss	64	24
Net gain or loss from financial instruments (fvpl)	1	-2
Net gain or loss from hedge accounting	-4	-2
Net gain or loss from investments accounted for using the equity method	1	0
Administrative expenses	488	462
Net other operating income/expenses	2	25
Negative goodwill from acquisitions	–	55
Operating profit	**248**	**316**
Income taxes	85	90
Consolidated net income	**163**	**226**
Consolidated net income attributable to non-controlling interests	2	2
Consolidated net income attributable to shareholders of Aareal Bank AG	161	224

Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 145 million (2018: € 208 million). Earnings per ordinary share amounted to € 2.42 (2018: € 3.48) and return on equity (RoE) before taxes stood at 8.7 % (2018: 11.6 %). Thus, both indicators were in line with our forecast.

Structured Property Financing segment

Operating profit in the Structured Property Financing segment amounted to € 276 million (2018: € 338 million). The comparative figure for the previous year benefited from a material non-recurring income of € 55 million negative goodwill from the initial consolidation of former Düsselhyp, whilst the corresponding costs for the integration in the year under review amounted to € 11 million.

Net interest income amounted to € 549 million (2018: € 547 million) and was thus stable, as expected.

The loss allowance of € 90 million (2018: € 73 million) corresponded with the forecast that was increased in the third quarter (previously: € 50 million to € 80 million expected) to take account of the higher burden from accelerated de-risking.

The net derecognition gain amounted to € 64 million (2018: € 24 million), exceeding our forecast increased in the third quarter (previously: € 20 million to € 40 million expected) mainly as a result of structural adjustments to our securities portfolio after acquiring former Düsselhyp.

The net loss from financial instruments (fvpl) and on hedge accounting totalled € -3 million (2018: €- 4 million).

Administrative expenses increased as expected, to € 254 million (2018: € 241 million), in particular due to running costs and integration expenses incurred in conjunction with the integration of former Düsselhyp.

Overall, operating profit for the Structured Property Financing segment was € 276 million (2018: € 338 million). Taking income tax expenses of € 95 million into consideration (2018:

€ 99 million), the segment result was € 181 million (2018: € 239 million).

Consulting/Services segment

Net interest income of € -16 million in the Consulting/Services segment (2018: € -12 million) continued to be burdened by the negative margin from the deposit-taking business due to the persistently low level of interest rates.

Net commission income of € 227 million developed positively as planned, in particular due to higher contribution from Aareon (2018: € 212 million).

Administrative expenses increased, as expected, to € 242 million (2018: € 227 million), due to Aareon's business expansion and strategic investments.

Structured Property Financing segment result

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Net interest income	549	547
Loss allowance	90	73
Net commission income	10	9
Net derecognition gain or loss	64	24
Net gain or loss from financial instruments (fvpl)	1	-2
Net gain or loss from hedge accounting	-4	-2
Net gain or loss from investments accounted for using the equity method	1	0
Administrative expenses	254	241
Net other operating income/expenses	-1	21
Negative goodwill from acquisitions	–	55
Operating profit	**276**	**338**
Income taxes	95	99
Segment result	**181**	**239**

Consulting/Services segment result

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Net interest income[1)]	-16	-12
Loss allowance	0	-1
Net commission income[1)]	227	212
Net gain or loss from financial instruments (fvpl)	0	0
Net gain or loss from investments accounted for using the equity method	0	–
Administrative expenses	242	227
Net other operating income/expenses	3	4
Operating profit	**-28**	**-22**
Income taxes	-10	-9
Segment result	**-18**	**-13**

[1)] As of this reporting year, interest on deposits from the housing industry is shown under the net interest income of the Consulting/Services segment (previously included in net commission income). The previous year's figures were adjusted accordingly.

Overall, segment operating profit for 2019 was € -28 million (2018: € -22 million). Aareon's contribution was € 37 million (2018: € 36 million).

Taking income taxes into consideration, the segment result amounted to € -18 million (2018: € -13 million).

Financial position

Consolidated total assets as at 31 December 2019 amounted to € 41.1 billion, after € 42.7 billion as at 31 December 2018. The previous year's figure was impacted by the initial consolidation of former Düsselhyp at year-end 2018. This temporary increase was compensated mainly by the structural adjustment to the securities portfolio in the year under review.

Cash reserve and money market receivables

The cash reserve and money market receivables position contains excess liquidity invested at short maturities. As at 31 December 2019, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

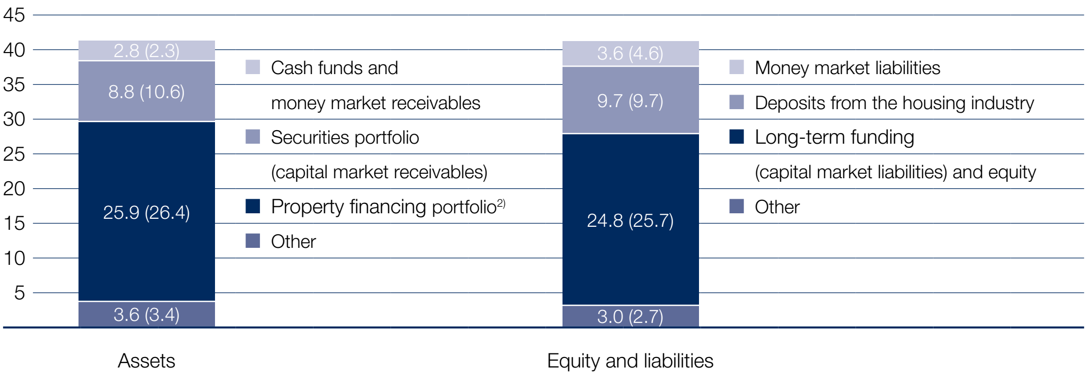
Property financing portfolio

The volume of Aareal Bank Group's property financing portfolio[1] stood at € 25.9 billion as at 31 December 2019, down by around two percentage points from the year-end level 2018 (€ 26.4 billion); this was due – in part – to accelerated de-risking. Including former WestImmo's private client and local authority lending businesses it was within our forecast.

Portfolio allocation by region and continent changed only selectively compared with the end of the previous year. Whilst the portfolio share of exposures in Western Europe rose by around 2.7 percentage points and in North America by around 2.1 percentage points, it was down by around 2.8 percentage points for Southern Europe due to accelerated de-risking in Italy, and fell by around 1.6 percentage points in Eastern Europe. It remained relatively stable for all other regions. Accelerated de-risking also led to a corresponding lower LTV in Southern Europe.

Statement of financial position – structure as at 31 December 2019 (31 December 2018)

€ bn

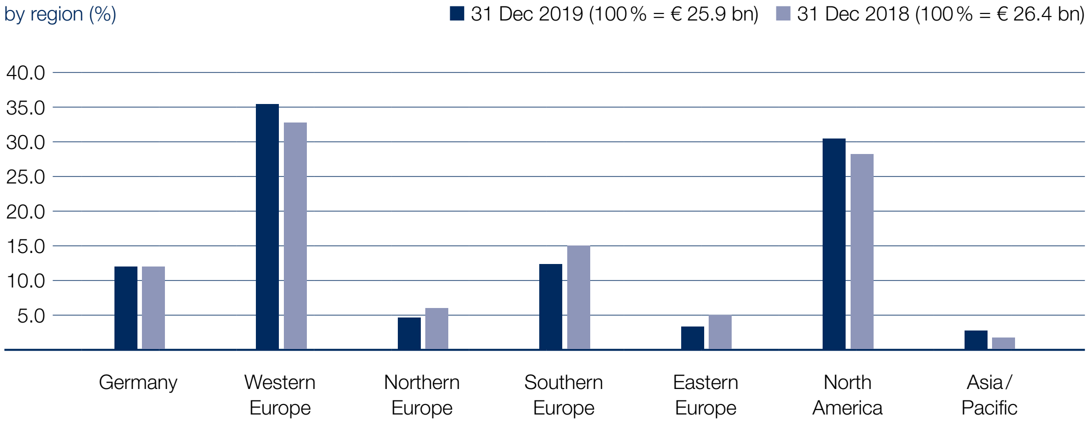


[1] Excluding former WestImmo's private client business and local authority lending business

[2] Excluding € 0.4 billion in private client business (31 December 2018: € 0.6 billion) and € 0.4 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2018: € 0.5 billion), and excluding loss allowance

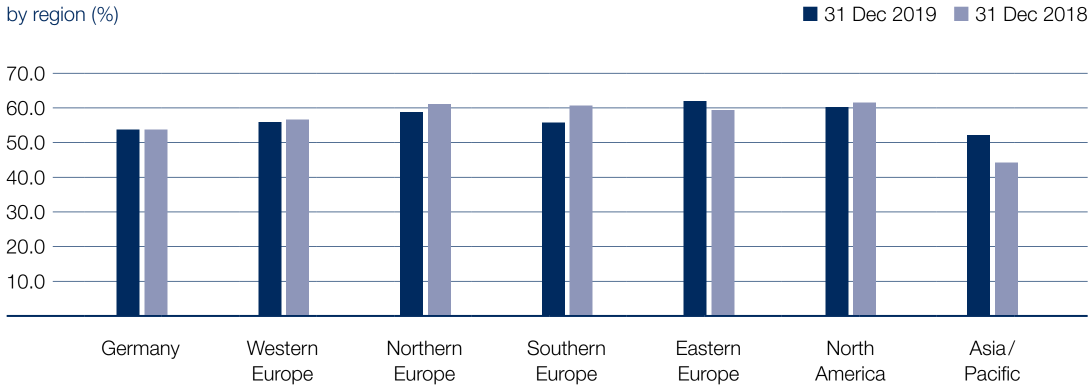
Property financing volume[1)] (amounts drawn)

by region (%)



Average LTV of property financing[1)]

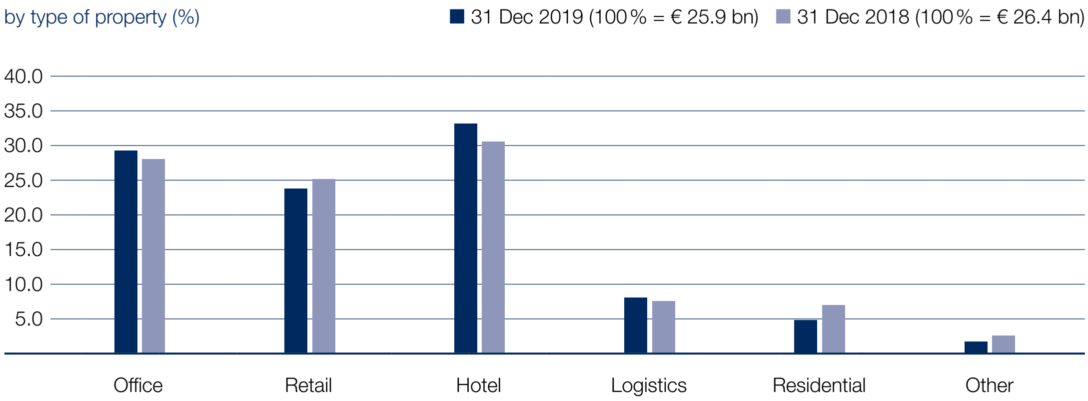
by region (%)



Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings.

Property financing volume[1)] (amounts drawn)

by type of property (%)



[1)] Excluding former WestImmo's private client business and local authority lending business

Average LTV of property financing[1)]

by type of property (%)

Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings.

1) Excluding former WestImmo's private client business and local authority lending business

The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of hotel property increased by 2.6 percentage points compared to year-end 2018, whilst the share of residential property was reduced by two percentage points. The share of financings for office, logistics, and retail property as well as other financings in the overall portfolio remained almost unchanged compared to year-end 2018. Accelerated de-risking in Italy incurred an LTV decrease for housing properties.

All in all, the high degree of diversification by region and property type within the property financing portfolio was maintained during the period under review.

Treasury portfolio

Aareal Bank holds a high-quality treasury portfolio, which fulfils two major tasks as part of the overall management of the Bank. On the one hand, the bulk of the securities are held for the liquidity portfolio, which accounts for a major part of the liquidity reserve from both the economic and normative perspective of risk-bearing capacity. In addition to the liquidity portfolio, part of the Treasury portfolio is also used as a collateral portfolio. We define this mainly as the securities and promissory note loans that are used as collateral for the two Pfandbrief programmes.

Key aspects taken into account for portfolio management are good credit quality and the related value stability, as well as a high degree of liquidity, depending on the intended use.

As at 31 December 2019, the total nominal volume of the Treasury portfolio[1)] was € 7.3 billion (31 December 2018: € 8.7 billion). The previous year's figure was impacted by the initial consolidation of former Düsselhyp at year-end 2018. This temporary increase was compensated mainly by the structural adjustment to the securities portfolio in the year under review.

The portfolio comprises the asset classes public-sector borrowers, covered bonds and bank bonds (financials), with the public-sector asset class accounting for the biggest portion of the portfolio (currently approximately 97 %). The high credit-worthiness requirements are also reflected in the rating breakdown in the portfolio. 99 % of the portfolio has an investment grade rating[2)], and 78 % of the positions have an AAA to AA- rating (2018: 71 %). The share of BBB ratings was reduced to 14 % (2018: 20 %) as a result of the structural adjustment to the securities portfolio.

1) As at 31 December 2019, the securities portfolio was carried at € 8.8 billion (31 December 2018: € 10.6 billion).

2) The rating details are based on the composite ratings.

The portfolio currently comprises almost exclusively (98 %) securities denominated in euros and its average remaining term on the reporting date was 6.4 years.

Given the high requirements as regards the liquidity of the positions as part of their use for the liquidity portfolio, 94 % of the portfolio can be pledged as collateral with the ECB and 79 % fulfils the requirements for "High Quality Liquid Assets" (as defined in the Liquidity Coverage Ratio (LCR)).

Financial position

Money-market liabilities and deposits from the housing industry

Generally, in addition to deposits from housing industry clients and institutional investors, Aareal Bank also uses interbank and repo transactions for short-term refinancing, the latter being used primarily to manage liquidity and cash positions.

As at 31 December 2019, Aareal Bank had € 9.7 billion at its disposal in deposits generated from the business with the housing industry (31 December 2018: € 9.7 billion). Beyond that, there were no repos and no liabilities vis-à-vis Deutsche Bundesbank or the ECB.

Long-term funding and equity

Funding structure

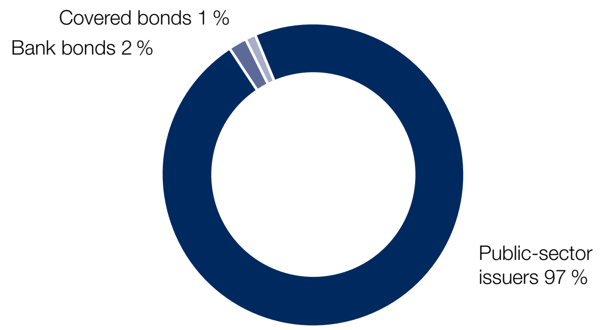
Aareal Bank Group continues to be solidly funded, a development visible by its major share of long-term funding. This encompasses registered and bearer Pfandbriefe, promissory note loans, medium-term notes, other bonds and subordinated issues. The latter include subordinated liabilities and Additional Tier 1 (AT1) bond.

As at 31 December 2019, the notional volume of the long-term refinancing portfolio was € 20.6 billion. The book values of the long-term refinancing portfolio totalled € 22.2 billion.

The Liquidity Coverage Ratio (LCR) at Group level exceeded 150 % on the reporting days during the period under review and was thus above our target value.

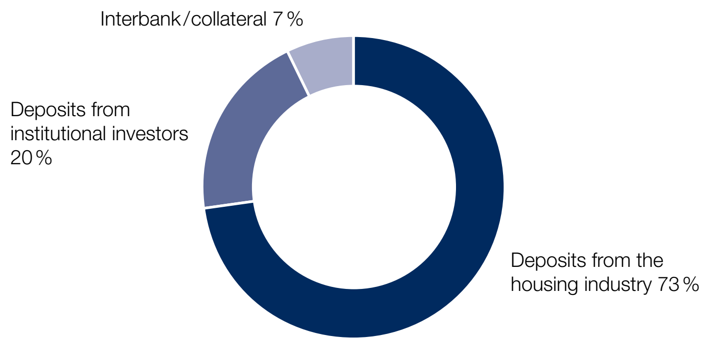
Treasury portfolio as at 31 December 2019

% Total volume (nominal): € 7.3 bn



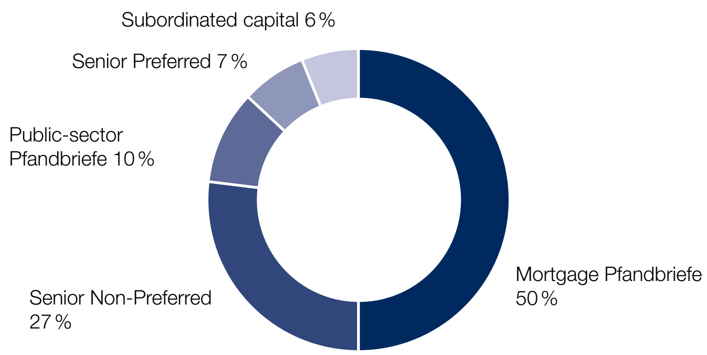
Money market funding mix as at 31 December 2019

% Total volume: € 13.3 bn



Capital market funding mix as at 31 December 2019

% Total volume: € 20.6 bn



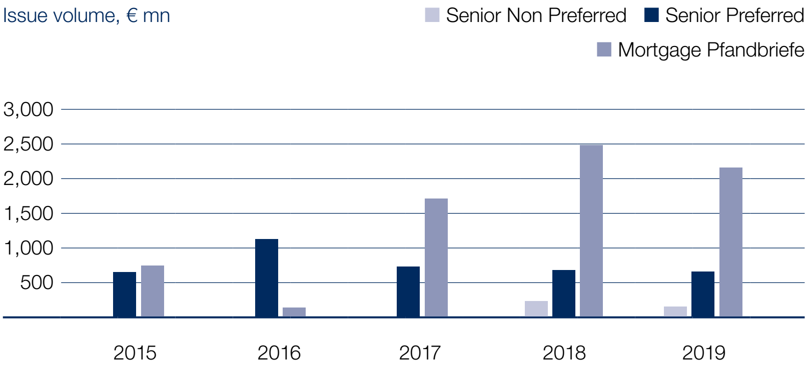
Refinancing activities

Throughout the financial year 2019, Aareal Bank Group was able to raise liquidity in the amount of € 2.9 billion on the capital market. Of this volume, € 2.2 billion are attributable to Pfandbriefe, € 0.6 billion to senior preferred bonds and € 0.1 billion to senior non-preferred bonds. This figure included two euro-denominated bench-mark Mortgage Pfandbrief transactions sized at € 0.75 billion and € 0.5 billion, and one USD 0.6 billion benchmark Mortgage Pfandbrief issue. We also placed a senior preferred € 0.5 billion benchmark issue with national and international investors.

Since we conduct our business activities in a range of foreign currencies, we have secured our foreign currency liquidity over the longer term by means of appropriate measures.

Issuing activities – 2015 to 2019

Issue volume, € mn



Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 2,861 million as at 31 December 2019 (31 December 2018: € 2,928 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Please also refer to the statement of changes in equity, and to our explanations in Note 57.

The Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (estimated) – continued to lie above the target value of 12.5 % in the year under review.

Regulatory indicators[1)]

	31 Dec 2019[2)]	31 Dec 2018
€ mn		
Common Equity Tier 1 (CET 1)	2,191	2,241
Tier 1 (T1)	2,491	2,541
Total capital (TC)	3,343	3,419
%		
Common Equity Tier 1 ratio (CET 1 ratio)	19.6	17.2
Tier 1 ratio (T1 ratio)	22.3	19.5
Total capital ratio (TC ratio)	29.9	26.2
Common Equity Tier 1 ratio (CET 1 ratio) – Basel IV (estimate) –[3)]	13.5	13.2

1) Aareal Bank AG utilises the rules set out in section 2a of the KWG in conjunction with Article 7 of the CRR, pursuant to which regulatory indicators of own funds may only be determined at Group level. In this respect, the following disclosures relate to Aareal Bank Group.

2) When calculating own funds, annual profits were taken into account, based on the Management Board's proposal for appropriation of profits for the 2019 financial year, and incorporating the pro-rata accrual of net interest payable on the AT1 bond. The appropriation of profits is subject to approval by the Annual General Meeting. The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning the NPL inventory as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account for determining regulatory indicators.

3) Underlying estimate, given a 72.5 % output floor based on the final Basel Committee framework dated 7 December 2017. The calculation of the material impact upon Aareal Bank is subject to the outstanding EU implementation as well as the implementation of additional regulatory requirements (CRR II, EBA requirements etc.).

Our Employees

Qualification and training programmes

Qualified and motivated employees make a decisive contribution to our Company's economic performance and are thus a key factor in its success – as well as a competitive advantage. For this purpose, Aareal Bank Group operates a human resources approach aimed at the further qualification of its managers, experts and employees. In line with the corporate strategy, the human resources policy is continuously developed in a targeted way. Aareal Bank Group supports employees in change processes, and promotes lifelong professional learning.

The Group consistently pursued this strategy throughout the year under review. The Bank focused on specific and generic training measures – for example, in the form of qualification programmes for (agile as well as traditional) project management, as well as supporting measures related to organisational and team development, which were tailored to the Group-wide reorganisation efforts. At Aareon, the training focus was on targeted development measures for managers, comprising training, diagnostics and consulting offers, coaching, training for digital leadership, as well as training measures for traditional and agile project management. Both Aareal Bank and Aareon also attached great importance to further building language and communications skills within the scope of internationalisation: to this end, a digital language learning portal is used, which provides instructions for learning English as well as five other European languages. This learning portal allows all employees throughout the Group to improve their language skills, anywhere (even at home) and at any time.

The in-service study course Bachelor of Arts Real Estate offered by EBZ for students training to become qualified housing and property specialists was carried out this way for the first time in 2019.

The fourth cross-mentoring programme was initiated at Aareal Bank and Aareon. Cross-mentoring describes the targeted exchange of employees from different companies; it is a personnel development measure aimed at promoting knowledge transfer.

Promoting the next generation

Promoting the next generation through training is a central element of Human Resources work at Aareal Bank Group. The specialist knowledge required in our business segments requires us to invest continuously – and in a targeted manner – in training the next generation.

Aareal Bank's programme aimed at promoting the next generation comprises not only trainee programmes, but also the dual studies Business Informatics and Business Administration in cooperation with DHBW Mannheim and RheinMain University, as well as the on-the-job Bachelor's degree Business Administration in cooperation with the University of Applied Sciences Mainz. Aareal Bank closely

Employee data as at 31 December 2019

	31 Dec 2019	31 Dec 2018	Change
Number of employees at Aareal Bank Group	2,788	2,748	1.5%
Years of service	11.6 years	12.7 years	-1.1 years
Staff turnover rate	4.6%	5.8%	

The overview of employee key indicators in the "Responsibility" section of the Company's website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/) provides more information, including the breakdown by gender, age and region.

collaborates with universities in the region via various initiatives.

Besides training programmes, Aareon offers the dual courses of study "Business information systems" and "Media, IT and management" as well as various vocational training opportunities for office managers, IT applications developers, or IT systems integrators.

As in previous years, the Bank and Aareon held the Girls' Day as part of its measures for promoting the next generation. Furthermore, Aareon supported the initiative JOBLINGE aimed at socially deprived young citizens. First participants of this programme have meanwhile embarked on their training. To promote trainees and science, Aareon is cooperating with several universities, and supporting students as part of the German scholarship of the Johannes Gutenberg University in Mainz.

Remuneration system

In addition to a fixed remuneration component, all permanent employees receive performance-based variable remuneration. Salaries are reviewed annually, to ensure that individual remuneration packages are appropriate. The objective is to offer a remuneration level that is both appropriate and attractive to all Group employees.

Work-life balance

Aareal Bank Group places great importance on supporting its employees to achieve compatibility between career and family. This is emphasised by a broad range of dedicated support services such as partnerships with childcare institutions or service providers for the provision of private childcare, holiday programmes for employees' children, the availability of parent-child workrooms, flexible working policies, part-time positions and the option of mobile working or alternating teleworking for all employees. Another component of improving the work-life balance of the employees consists of services that make it easier to combine working life with the care of those who require it. This includes, among other things, the offer of counselling and support in the event of illness as well as nursing care for close relatives (available throughout Germany), and the option of participating in various training courses for better compatibility between family, care and work. As an innovative company that promotes the digital transformation process holistically and manages the related process of change for its employees, Aareon had already launched the "work4future" project in 2017. Based on the existing principles of a human resources policy aligned to different phases in life, it focuses on flexible work models, smart and effective employee collaboration, and the digital workplace. The works agreement on mobile working was implemented in 2019, increasing our employees' work flexibility. A digital collaboration tool was introduced for internal communications, and the room concepts are continuously being improved within the scope of internal programmes.

Health

In order to verify the effectiveness and continuous improvement of occupational safety management, occupational safety committees meet quarterly. These include the respective company doctor and occupational safety specialists, in addition to various company officers.

In order to protect and promote the health of its employees in a targeted manner, Aareal Bank Group offers a comprehensive range of health-promoting measures in the areas of information, prophylaxis, exercise and ergonomics, nutrition, mental health and relaxation that are always based on employees' current needs. In the year under review, these included preventative, individual health consultations held in the Bank on various topics, workshops on topics such as relaxation, nutrition and fasciae, stress prevention and management measures, health checks, colon cancer screening, skin screenings and flu vaccinations. In 2019, Aareon's occupational health management implemented numerous measures for supporting employees in a digital working world.

Risk Report

Aareal Bank Group Risk Management

The ability to correctly assess risks, and to manage them in a targeted manner, is a core skill in banking. Accordingly, being able to control risks in all their relevant variations is a key factor for a bank's sustainable, commercial success. This economic motivation for a highly-developed risk management system is continuously increased by extensive regulatory requirements for risk management. For this reason, we implemented the new ECB Guidelines on the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP) at the beginning of the year. The comments set out below in the Risk Report take the new guidelines into account.

Risk management – scope of application and areas of responsibility

Aareal Bank Group's business activities comprise the Structured Property Financing and Consulting/ Services segments. Aareal Bank AG, as the parent entity of the Group, has implemented extensive systems and procedures to monitor and manage the Group's risk exposure.

Uniform methods and procedures are deployed to monitor material risks generally associated with banking business across all entities of Aareal Bank Group. Specific risk monitoring methods have been developed and deployed to suit the relevant risk exposure at the subsidiaries. In addition, risk monitoring for these subsidiaries at Group level is carried out via the relevant control bodies of the respective entity, and Equity Investment Risk Controlling.

Type of risk	Risk management	Risk monitoring
Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG		
Loan loss risks		
Property Financing	Loan Markets & Syndication Credit Risk Project & Credit Portfolio Management Credit Transaction Management Workout	Risk Controlling Second Line of Defence (NPL)
Treasury business	Treasury	Risk Controlling
Country risks	Treasury Credit Risk Credit Transaction Management	Risk Controlling
Interest rate risk in the banking book (IRRBB)	Treasury; Transaction Committee	Risk Controlling, Finance & Controlling
Market risks	Treasury; Transaction Committee	Risk Controlling
Operational risks	Process owners	Risk Controlling
Investment risks	Group Strategy	Risk Controlling, Finance & Controlling, Kontrollorgane
Property risks	Aareal Estate AG	Risk Controlling
Business and strategic risks	Group Strategy	Risk Controlling
Liquidity risks	Treasury	Risk Controlling
Process-independent monitoring: Internal Audit		

Overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank AG. The adjacent diagram (p. 57) provides an overview of the responsibilities assigned to the respective organisational units.

The Management Board formulates the business and risk strategies, as well as the so-called Risk Appetite Framework. For this purpose, "risk appetite" means the maximum risk exposure where the Bank's continued existence is not threatened, even in the event of risks materialising. For individual business units (the "First Line of Defence"), the Risk Appetite Framework defines guidelines for the independent and responsible handling of risks.

The risk monitoring function (the "Second Line of Defence") regularly measures utilisation of risk limits, and reports on the risk situation. In this context, the Management Board is supported by the Risk Executive Committee (RiskExCo). The RiskExCo develops proposals for resolutions in line with delegated tasks, and promotes risk communications and a risk culture within the Bank. The risk management system was supplemented by a recovery plan, in line with regulatory requirements, which comprises the definition of threshold values for key performance indicators – both from an economic and a normative perspective. These are designed to ensure that any negative market developments having an impact upon our business model are identified at an early stage and corresponding action is taken in order to safeguard the sustained continuation of business operations.

On top of this, Group Internal Audit (as the "Third Line of Defence") reviews the organisational structure and procedures, as well as risk processes – including the Risk Appetite Framework – and assesses their appropriateness. Moreover, internal processes provide for the involvement of the Compliance function whenever there are facts which are compliance-relevant.

In order to efficiently perform its control duties, amongst other measures, the Supervisory Board has established a Risk Committee, whose responsibility includes the risk strategies as well as the management and monitoring of all material types of risk.

Strategies

The business policy set by the Management Board, and duly acknowledged by the Supervisory Board, provides the conceptual framework for Aareal Bank Group's risk management. Taking this as a basis, and strictly considering the Bank's risk-bearing capacity, we have formulated detailed strategies for managing the material types of risk. Taken together, these represent the Group's risk strategy. These strategies are designed to ensure a professional and conscious management of risks. Accordingly, these strategies include general policies, to ensure a uniform understanding of risks across all parts of the Group. They also provide a cross-sectional, binding framework applicable to all divisions. The Bank has implemented adequate risk management and risk control processes to implement these strategies, and to safeguard the Bank's risk-bearing capacity.

The business strategy and the risk strategies are subject to review on an ongoing basis, and are updated if necessary. Besides the regular review (and, if appropriate, adjustment) of the business strategy (and consequently, the Group risk strategy), the Bank's risk-bearing capacity is validated at least once a year. For this purpose, the appropriateness of risk measurement methods, processes, and risk limits is examined in particular. During the financial year under review, the strategies were adopted by the Management Board, duly noted, and approved by the Supervisory Board.

The Bank has defined escalation and decision-making processes to deal with limit breaches. Risk Controlling prepares timely and independent risk reports for the Management Board.

Aareal Bank Group maintains a decentralised Internal Control System (ICS), with control activities and results being outlined in the Written Set of Procedural Rules. These describe individual processes of divisions, subsidiaries, or other units. Internal controls may run upstream, downstream, or in parallel to workflows; this applies both to automatic control and monitoring functions as well as to the respective manual steps. Accordingly, the ICS comprises the entire universe of control activities; its objective is to ensure that qualitative and quantitative standards are adhered to (compliance with legal or regulatory requirements, with limits etc.).

The appropriateness and effectiveness of controls is reviewed on an event-driven basis; in any case, at least once a year. The results are discussed with the corresponding units within the Second and Third Lines of Defence (Risk Controlling, Compliance and Internal Audit), and reported to the Management Board and the Supervisory Board. In the event of any irregularities or violations, depending on the severity of the event, the Management Board (as well as the Supervisory Board, if appropriate) must be notified without delay, so that adequate measures or audit activities can be initiated at an early stage.

Risk-bearing capacity and risk limits

The Bank's ability to carry and sustain risk (as determined within the ICAAP framework) is a core determining factor governing the structure of its risk management system. To ensure its uninterrupted risk-bearing capacity, Aareal Bank Group has adopted a dual management approach comprising two complementary perspectives: the normative and the economic perspective. These perspectives replace the two previous management approaches for risk-bearing capacity – namely, the going-concern approach and the gone-concern approach.

The normative perspective aims to ensure Aareal Bank Group's ability to fulfil all of its regulatory requirements over a multi-year period. This perspective thus accounts for all material risks which may impact upon relevant regulatory indicators over the multi-year planning period.

The normative ICAAP perspective is embedded into Aareal Bank Group's planning process, which – in particular – also includes capital planning. Group planning covers three planning years, it comprises both baseline and adverse scenarios. Results of Group planning are shown as a projected consolidated income statement for Aareal Bank Group. Planning also encompasses the balance sheet structure, as well as key regulatory indicators, plus additional internal management indicators.

Besides the planning process itself, intra-year computation adjustments to Aareal Bank Group's planning process also include the ongoing monitoring of management indicators as well as checking whether limits in the normative perspective are being complied with. Management indicators in the normative perspective (which are being monitored, and for which limits have been set) comprise various regulatory ratios.

We are using the ICAAP economic perspective, whose purpose is to safeguard Aareal Bank Group's economic substance and thus, in particular, to protect creditors against economic losses. We predominantly employ proprietary procedures and methods (agreed upon with regulators) in order to identify and quantify potential economic losses, and to determine the required capital backing.

The purpose of internal capital is to serve as a risk-bearing component under the economic perspective. Within Aareal Bank Group, the current regulatory Tier I capital serves as the basis for determining economic aggregate risk cover. Accordingly, available internal capital comprises Common Equity Tier I (CET1) capital, supplemented by Additional Tier I (AT1) capital. Tier 2 capital, as well as projected results to be incurred during the risk analysis horizon, are not taken into account. Moreover, the value-oriented approach adopted under the economic perspective requires suitable adjustments to be made to regulatory Tier I capital, in order to bring aggregate risk cover into line with the economic assessment. Specifically, this may entail adjustments regarding conservative valuation, or a management buffer.

The taxonomy of potential risks under the economic perspective is largely oriented upon the established classification under the previous going-concern/gone-concern approaches. A change was made in

Risk-bearing capacity of Aareal Bank Group (ICAAP – economic perspective)

€ mn	31 Dec 2019	1 Jan 2019[1)]
Tier 1 (T1) capital	2,491	2,541
CVA/hidden encumbrances/management buffer	-111	-162
Aggregate risk cover	**2,381**	**2,379**
Utilisation of freely available funds		
Loan loss risks	525	685
Interest rate risk in the banking book (IRRBB)	93	101
Market risks	360	530
Operational risks	123	116
Investment risks	30	29
Property risks	60	49
Business and strategic risks	81	81
Total utilisation	**1,272**	**1,591**
Utilisation (% of aggregate risk cover)	**53 %**	**67%**

1) adjusted for the new confidence interval of 99.9 %

2019 for credit spread and migration risk in the banking book (CSRBB), which no longer constitutes a separate type of risk but is included in loan loss and market risks, as part of the economic perspective. As a result, the number of risk types for which separate limits are determined has been reduced from eight to seven.

Aareal Bank Group consistently applies a period of 250 trading days as a risk analysis horizon, as well as for the holding period as part of risk models under the economic perspective. To the extent that risks are measured on the basis of quantitative risk models, a uniform observation period of at least 250 trading days (or at least one year) is applied to the risk parameters used. The appropriateness of model assumptions is verified within the scope of validating the corresponding risk models and parameters.

Looking at correlation effects between material types of risk within the framework of the economic ICAAP perspective, Aareal Bank Group has prudently opted for aggregation of risk levels; accordingly, no risk-mitigating correlation effects are being taken into account. Where, for the purposes of calculating risk-bearing capacity, risks are measured on the basis of quantitative risk models, these have been based on a uniform confidence interval of 99.9 % since 1 January 2019. Until 31 December 2018, a value of 95 % had been applied.

Limits for specific risk types are determined in such a manner that aggregate limits do not exceed economic aggregate risk cover, less a risk buffer designed to cover risks not explicitly covered by limits (e.g. those risks which cannot be sensibly quantified), and to also absorb other fluctuations of internal capital over time. Individual limits are set on the basis of existing risk exposures and historical levels of potential risks, and to an extent that is in line with the Bank's business and risk strategy. Specific limits have been set in a way that each limit is sufficient for utilisation in line with planned business development, as well as for common market fluctuations.

A detailed monthly report provides information regarding the utilisation of individual limits for the material types of risk, as well as on the overall limit utilisation. These are being monitored as part of daily reporting. No limit breaches were detected during the period under review.

Utilisation of aggregate risk cover developed during the period under review as shown below.

Since risk cover potential is an inadequate measure to assess the risk-bearing capacity for liquidity risk, we have defined special tools for managing this type of risk. These tools are described in detail in the section "Liquidity risks".

Stress testing

Stress testing, and the analysis of stress test results, form an additional focal aspect of our risk management system. This involves conducting stress tests for all material risks, using both historical parameters as well as hypothetical stress testing scenarios. To also be able to assess cross-relationships between the various types of risk, we have defined multi-factor stress scenarios, so-called "global" stress tests. For instance, the impact of the crisis affecting financial markets and the economy, which broke out in 2007, on individual types of risk and aggregate risk is analysed within the scope of a historical scenario. In the hypothetical scenario, current potential developments are derived from factors such as political developments, and are combined with significant macroeconomic deterioration. The stress testing methodology implemented also takes into account the impact of any risk concentrations. Stress scenarios are analysed both from an economic and a normative perspective, with the respective cross-relationships being taken into consideration – meaning that any economic risks which may materialise (from a normative view) over the analysis period being incorporated in the normative perspective, unless they are sufficiently covered already.

Aareal Bank Group uses a Brexit plan to monitor the impact on Aareal Bank's risk exposures and business activities. In this plan, the Bank has drawn up various options for action designed to minimise the impact upon the Bank.

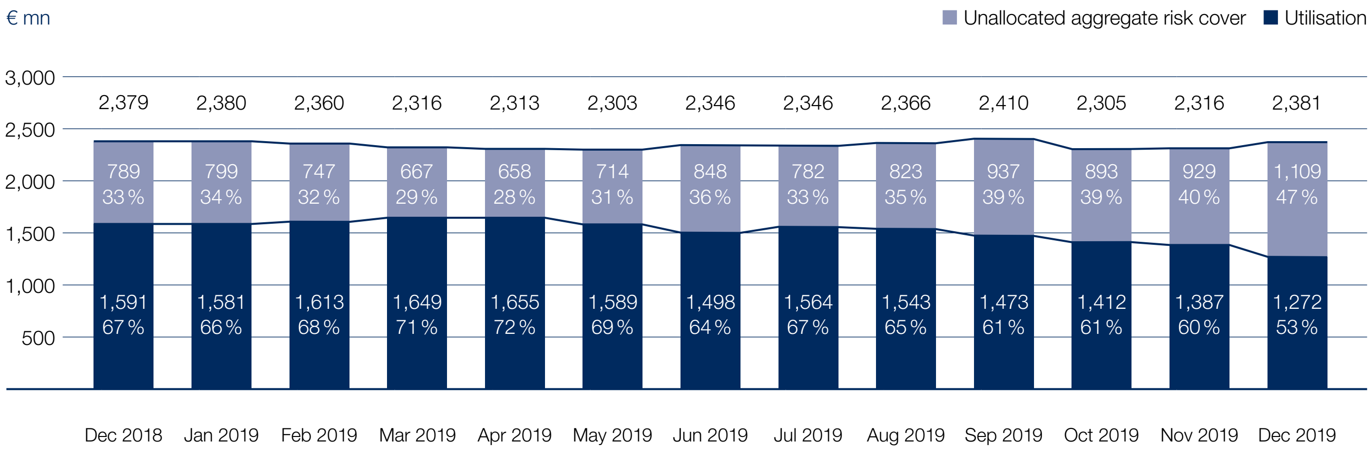
The Management Board and the Supervisory Board are informed of the results of stress analyses and the Brexit Plan on a quarterly basis.

Lending business

Division of functions and voting

Aareal Bank Group's structural organisation and business processes consider regulatory requirements regarding the organisational structure and procedures in the credit business.

Utilisation of aggregate risk cover during the course of 2019



Processes in the credit business are designed to consistently respect the clear functional division of Sales units ("Markt") and Credit Management ("Marktfolge"), up to and including senior management level. In addition, the Risk Controlling division, which is not involved in making lending decisions, is responsible for monitoring all material risks whilst ensuring an adequate and targeted risk reporting system at a portfolio level.

Lending decisions regarding credit business classified as relevant for the Bank's risk exposure require two approving votes submitted by a Sales unit and a Credit Management unit. The Bank's Schedule of Powers defines the relevant lending authorities within Sales units and Credit Management. Where authorised persons are unable to come to a unanimous lending decision, the loan involved cannot be approved, or must be presented to the next-highest decision-making level for a decision.

The RiskExCo, which has delegated authority to the heads of Risk Controlling, Operations, and Project & Credit Portfolio Management (which are independent of Sales units), is responsible for the approval of counterparty, issuer, or country limits. We have implemented and documented the clear separation of Sales and Credit Management processes across all relevant divisions.

Process requirements

The credit process comprises the credit approval and further processing phases, each governed by a control process. Credit exposures subject to increased risks involve supplementary processes for intensified handling, the handling of problem loans, and – if necessary – for recognising allowance for credit losses. The corresponding processing principles are laid down in the Bank's standardised rules and regulations. Important factors determining the counterparty credit risk of a credit exposure are identified and assessed on a regular basis, taking into account sector and (where appropriate) country risks. Critical issues regarding an exposure are highlighted, and analysed assuming different scenarios where appropriate.

Suitable risk classification procedures are applied to evaluate risks for lending decisions, as well as for regular or event-driven monitoring of exposures. This classification scheme is reviewed at least once a year; depending on the risk situations, the review cycle may be shortened significantly. Furthermore, the risk assessment results influence pricing.

The organisational guidelines contain provisions governing escalation procedures and further handling in the event of limit breaches, or of a deterioration in individual risk parameters. Measures involved may include the provision of extra collateral, or an impairment test.

Early risk detection procedures

The early identification of credit risk exposure, using individual or combined (early warning) criteria is a core element of our risk management approach.

In particular, the procedures applied for the early detection of risks serve the purpose of identifying borrowers or exposures where higher risks start emerging, at an early stage. For this purpose, we generally monitor individual exposures and the parties involved (such as borrowers or guarantors) regularly throughout the credit term, assessing quantitative and qualitative factors, using instruments such as periodic monitoring and internal ratings. The intensity of the ongoing assessments is based on the risk level and size of the exposure. The Group's risk management processes ensure that counterparty credit risk is assessed at least once a year.

A CRE Credit Risk Committee (CRC) has been established in order to enhance the Bank's procedures for the early detection of risks. The CRC promotes the risk culture by identifying and addressing risk-relevant issues concerning individual credit exposures; the committee is also involved in each credit exposure with mandatory rating that is subject to higher risk exposure. Specifically, the CRC decides upon the exercise of discretion regarding classification of exposures as "normal", "intensified" or "problem loan" handling, as well as approval of action plans. The transfer of know-how is enhanced through the cross-divisional representation on the CRC.

Extensive IT resources are deployed to identify risk positions, and to monitor and measure risks. Overall, the existing set of tools and methods enables the Bank to adopt suitable risk management measures, where required, at an early stage.

Actively managing client relationships is crucially important in this context: approaching clients in time to jointly develop a solution to any problems which may arise. Where necessary, we muster the support of experts from the independent restructuring and recovery functions.

Risk classification procedures

Aareal Bank employs risk classification procedures tailored to the requirements of the respective asset class for the initial, regular, or event-driven assessment of counterparty credit risk. The rating scales and exposure definitions have been customised to match the respective methods. Responsibility for development, quality assurance, and monitoring implementation of risk classification procedures, and for annual validation, lies with two separate divisions outside the Sales units.

The ratings determined using internal risk classification procedures are an integral element of the Bank's approval, monitoring, and management processes.

Property financing business

The Bank employs a two-level risk classification procedure for large-sized commercial property finance exposures, specifically designed to match the requirements of this type of business.

In a first step, the client's probability of default (PD) is determined using a rating procedure. The method used in this context comprises two main components, a property rating and a corporate rating.

The relative impact of the two components on the rating result is determined by the structure of the exposure concerned. The client's current and future default probability is determined based on specific financial indicators, together with qualitative aspects and expert knowledge.

The second step involves calculating the loss given default (LGD). The LGD estimates the extent of the economic loss in the event of a borrower defaulting. In simple terms, this is the amount of the claim not covered by the proceeds from the realisation of collateral.

When evaluating collateral, haircuts are applied or recovery rates used, depending on the type of collateral involved and specific realisation factors. For financings of domestic properties, recovery rates are taken from a pool of data used across the Bank, whilst recovery rates for international properties are derived using statistical methods, given the low number of realisations.

The expected loss (EL) in the event of default of an exposure is determined as the product of PD and LGD. As a risk parameter related to the financing, EL is used as an input factor for the tools used to manage the property financing business.

Financial institutions

Aareal Bank employs an internal rating procedure for financial institutions, which incorporates qualitative and quantitative factors as well as our client's group affiliation, to classify the risk exposure to banks, financial services providers, securities firms, public-sector development banks, and insurance companies. Financial institutions are assigned to a specific rating grade by way of assessing relevant financial indicators and taking into account expert knowledge.

Sovereign states and local authorities

In addition, Aareal Bank Group employs internal rating methods for sovereign borrowers and regional governments, local and other public-sector entities. In this context, rating grades are assigned using clearly-defined risk factors, such as fiscal flexibility or the level of debt. The expert knowledge of our rating analysts is also taken into account for the rating.

In general, the risk classification procedures employed by the Bank are dynamic methods which are permanently adapted to changing risk structures and market conditions.

Trading activities

Functional separation

We have implemented a consistent functional separation between Sales units and Credit Management for the conclusion, settlement and monitoring of trading transactions, covering the entire processing chain.

On the Sales side, the processing chain comprises the Treasury division, whilst Credit Management tasks are carried out by the independent Operations and Risk Controlling divisions. Beyond this, Finance & Controlling and Audit are responsible for tasks not directly related to processes.

We have laid down organisational guidelines providing for binding definitions of roles and responsibilities along the processing chain; with clearly defined change processes.

The detailed assignment of responsibilities is outlined below.

Treasury is responsible for risk management and trading activities as defined by the Minimum Requirements for Risk Management ("MaRisk"). Treasury is also responsible for asset/liability management, and for managing the Bank's market and liquidity risk exposures. In addition, we have established a Transaction Committee, to develop strategies for the Bank's asset/liability management and proposals for their implementation. The Committee, which comprises the Management Board member responsible for Treasury, the Head of Treasury, and other members appointed by the Management Board, meets on a weekly basis.

Operations is responsible for controlling trading activities, confirming trades to counterparties, and for trade settlement. The division is also responsible for verifying that trades entered into are in line with prevailing market conditions, as well as for the legal assessment of non-standard agreements, and of new standard/master agreements.

To assess counterparty credit risk in the trading business, Operations prepares a rating for all counterparties and issuers on a regular or event-driven basis. The rating is a key indicator used to determine the limit for the relevant counterparty or issuer.

The RiskExCo is responsible for voting on all limit applications. The Committee has delegated corresponding authority to the Heads of Risk Controlling, Operations, and Project & Portfolio Management, who are responsible for conducting annual limit reviews, as well as for reducing (or revoking) counterparty or issuer limits whenever required.

The tasks of the Risk Controlling division comprise identifying, quantifying and monitoring market price, liquidity and counterparty credit risk exposure from trading activities, and the timely and independent risk reporting to senior management.

Process requirements

Processes are geared towards ensuring end-to-end risk management, from conclusion of the trade right through to monitoring portfolio risk. The monitoring and reporting function comprises deploying adequate risk measurement systems, deriving limit systems, and ensuring the transparency of Aareal Bank Group's overall risk exposure from trading activities, in terms of scope and structure.

Change processes (as defined in section AT 8 of the MaRisk) are consistently measured via Group-wide framework directives, with the RiskExCo involved in all cases. Moreover, processes and systems are designed in a way that allows to incorporate new products into the risk monitoring system swiftly and adequately, in order to ensure the flexibility of the Sales units in their business activities.

A standardised process exists for the intensified handling of counterparties and issuers, and for dealing with problems. This process comprises identifying early warning indicators, applying them for the purposes of risk analysis, as well as determining further action to be taken. In the event of counterparty or issuer default, the RiskExCo will be involved in devising an action plan, in cooperation with the Bank's divisions involved.

Escalation and decision-making processes have been set out to deal with limit breaches.

Loan loss risks

Definition

Aareal Bank defines loan loss risk as the risk of losses being incurred due to (i) a deterioration in a business partner's credit quality (migration risk); (ii) a business partner defaulting on contractual obligations; (iii) collateral being impaired; or (iv) a risk arising upon realisation of collateral. Both credit business and trading activities may be subject to counterparty credit risk. Counterparty credit risk exposure from trading activities may refer to risk exposure vis-à-vis counterparties or issuers. Country risk is also defined as a form of counterparty credit risk.

Credit risk strategy

Based on the Bank's overall business strategy, Aareal Bank's credit risk strategy sets out all material aspects of the Group's credit risk management and policies. The credit risk strategy serves as a strategic guideline for dealing with each respective category of risk within Aareal Bank Group; it also provides a binding, overarching framework applicable to all divisions.

The credit risk strategy will be reviewed, at least once a year, as to its suitability regarding the Bank's risk-bearing capacity and its business environment; amendments will be made as necessary. The associated process is instigated by senior management, and implemented by Risk Controlling, which submits a proposal, which has been agreed upon with all divisions to senior management. The Supervisory Board then duly acknowledges and approves the credit risk strategy adopted.

Designed in principle for a medium-term horizon, the credit risk strategy is adapted when necessary to reflect material changes in the Group's credit risk and business policies, or in the Group's business environment (as in the case of the financial markets crisis).

Risk measurement and monitoring

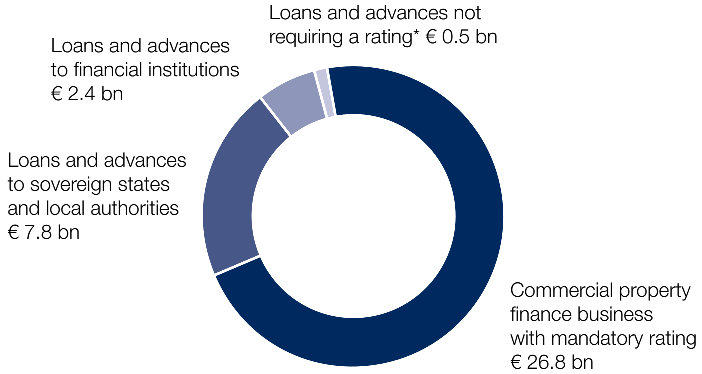
Regulatory requirements are taken into account for the organisation of operations and workflows in the credit and trading businesses.

Processes in the credit and trading businesses are designed to consistently respect the clear functional division of Sales units ("Markt") and Credit Management ("Marktfolge"), up to and including senior management level. The independent Risk Controlling division is responsible for identifying, quantifying and monitoring all material risks at portfolio level, and for maintaining a targeted risk reporting system.

Aareal Bank employs different risk classification procedures tailored to the requirements of the respective type of business for the initial, regular, or event-driven assessment of counterparty credit risk. Forward-looking as well as macro-economic information is taken into consideration for risk

Breakdown of on-balance sheet and off-balance sheet business

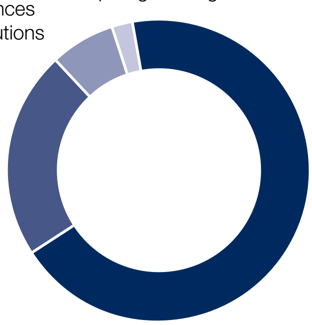
by rating procedure, € bn 31 Dec 2019



* Including the private client business of former WestImmo

Breakdown of on-balance sheet and off-balance sheet business

by rating procedure, € bn 31 Dec 2018



* Including the private client business of former WestImmo

classification procedures, and in the valuation of collateral. The respective procedures and parameters are subject to regular review and adjustment. Responsibility for development, quality assurance, and monitoring implementation of procedures, is outside the Sales units.

Methods used to measure, control and monitor concentration and diversification effects on a portfolio level include two different credit risk models. Based on these models, the Bank's decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business with financial institutions. The models in question allow the Bank to include in particular, rating changes and correlation effects in the assessment of the risk concentrations.

Within the process-oriented monitoring of individual exposures, the Bank uses various tools to monitor exposures on an ongoing basis: besides the tools already described, this includes rating reviews, the monitoring of payment arrears, and the regular, individual analysis of the largest exposures. The intensity of loan coverage is oriented upon the credit risk exposure. Intensified handling triggers recognition of loss allowance, in the amount of lifetime expected credit loss for the financial instrument concerned (Stage 2).

The tables on the following pages provide a breakdown of gross carrying amounts of on-balance sheet as well as off-balance sheet credit business, money-market business, and capital markets business, by rating class and loss allowance stages, in line with credit risk management at Group level. Figures are based on Aareal Bank Group's internal default risk rating classes. The default definition follows the definition pursuant to Article 178 of the CRR, which is decisive for management purposes. Qualitative default definitions were further refined during the year under review, without any material impact. Accelerated de-risking led to a reduction in defaulted commercial property finance business with mandatory rating by approximately € 0.6 billion.

Monthly reporting covers the material aspects of credit risk; it is supplemented by detailed information – which also fully covers specific credit portfolio developments (broken down by country, property and product type, risk classes, and collateral categories, for example), in line with regulatory requirements – at least on a quarterly basis. Risk concentrations are being taken into account in particular.

Trading activities are restricted to counterparties for whom the requisite limits are in place. All trades are immediately taken into account for the purposes of borrower-related limits. Compliance with limits is monitored in real time by Risk Controlling. Persons holding position responsibility are informed about relevant limits and their current usage, regularly and without delay.

In principle, Aareal Bank pursues a "buy and manage" strategy in managing its credit portfolio – with the primary objective of holding the majority of loans extended on its balance sheet until maturity; at the same time, targeted exit measures are deployed for actively managing the portfolio and the risks involved.

In summary, during the period under review, the existing set of tools and methods continued to enable the Bank to adopt suitable risk management or risk mitigation measures, where required, at an early stage.

On-balance sheet commercial property finance business with mandatory rating

	31 Dec 2019					31 Dec 2018				
€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1										
Class 2	62				**62**	117				**117**
Class 3	430			2	**432**	255				**255**
Class 4	1,368				**1,368**	1,486				**1,486**
Class 5	3,447			495	**3,942**	3,566			94	**3,660**
Class 6	4,300	20		64	**4,384**	3,966	21		256	**4,243**
Class 7	3,872			75	**3,947**	3,420				**3,420**
Class 8	6,051	35		209	**6,295**	5,166	112		181	**5,459**
Class 9	2,936			56	**2,992**	3,463	42		116	**3,621**
Class 10	860	344			**1,204**	1,510	28			**1,538**
Class 11	174				**174**	285	91		39	**415**
Class 12	1	16			**17**	531	62			**593**
Class 13		60			**60**		66			**66**
Class 14										
Class 15									3	**3**
Defaulted			935	149	**1,084**			1,564	22	**1,586**
Total	23,501	475	935	1,050	25,961	23,765	422	1,564	711	26,462

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs)

Off-balance sheet commercial property finance business with mandatory rating

	31 Dec 2019					31 Dec 2018				
€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Classes 1-2										
Class 3	22				**22**					
Class 4	25				**25**	39				**39**
Class 5	63			17	**80**	32			6	**38**
Class 6	117				**117**	190			25	**215**
Class 7	141			25	**166**	175				**175**
Class 8	271	4			**275**	312	5			**317**
Class 9	101				**101**	120				**120**
Class 10	34				**34**	75				**75**
Class 11	1				**1**	5				**5**
Class 12						29				**29**
Classes 13-15										
Defaulted			2		**2**			78		**78**
Total	775	4	2	42	823	977	5	78	31	1,091

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs); commitments for loan portions earmarked for syndication

On-balance sheet loans and advances to financial institutions

€ mn	31 Dec 2019 Stage 1	Stage 2	Stage 3	fvpl[1]	Total	31 Dec 2018 Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1	815				**815**	1,242				**1,242**
Class 2						32				**32**
Class 3	172				**172**	15				**15**
Class 4	82				**82**	85				**85**
Class 5	49				**49**	514				**514**
Class 6						100				**100**
Class 7	836				**836**	387			35	**422**
Class 8	417				**417**	284				**284**
Class 9	35				**35**	16			43	**59**
Class 10	26				**26**	25			26	**51**
Classes 11-18										
Defaulted										
Total	**2,432**	**–**	**–**	**–**	**2,432**	**2,700**	**–**	**–**	**104**	**2,804**

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs)

On-balance sheet loans and advances to sovereign states and local authorities

€ mn	31 Dec 2019 Stage 1	Stage 2	Stage 3	fvpl[1]	Total	31 Dec 2018 Stage 1	Stage 2	Stage 3	fvpl[1]	Total
Class 1	2,505				**2,505**	2,621				**2,621**
Class 2	2,680			65	**2,745**	2,666			76	**2,742**
Class 3	739			67	**806**	797			70	**867**
Class 4	100				**100**	145			32	**177**
Class 5	176				**176**	239			62	**301**
Class 6	262				**262**	436				**436**
Class 7	189				**189**	163			105	**268**
Class 8	6				**6**					
Class 9	925	125			**1,050**	711	805		89	**1,605**
Classes 10-20										
Defaulted										
Total	**7,582**	**125**	**–**	**132**	**7,839**	**7,778**	**805**	**–**	**434**	**9,017**

[1] fvpl = at fair value through profit and loss (in accordance with IFRSs)

Credit risk mitigation

The Bank accepts various types of collateral to reduce default risk exposure. This includes impersonal collateral, such as liens on immobile (property) and mobile assets; liens on receivables, such as rents; and third-party undertakings, such as guarantees.

As an international property finance house, Aareal Bank focuses on property when collateralising loans and advances. As a rule, loans are granted and the security interest perfected in accordance with the jurisdiction in which the respective property is located.

Mortgage lending values or fair values are set or determined in accordance with the responsibilities for decision-making on lending, and form an integral part of the lending decision. The values to be determined by the Bank are generally pegged on the valuation prepared by a valuer, which is subject to an internal plausibility check. Any diverging assessment must be substantiated in writing. In any case, the market and mortgage lending values determined by the Bank must not exceed the values assessed by independent internal or external valuers.

To mitigate credit risk, the Bank also accepts collateralisation through a pledge of shareholdings in property companies or special purpose entities not listed on a stock exchange. The Bank has set out detailed provisions governing the valuation of such collateral.

The Bank also accepts guarantees or indemnities as well as financial collateral (such as securities or payment claims) as standard forms of collateral. The collateral value of the indemnity or guarantee is determined by the guarantor's credit quality. For this purpose, the Bank differentiates between banks, public-sector banks, and other guarantors. The value of financial collateral is determined according to the type of collateral. Haircuts are generally applied when determining the value of guarantees/indemnities and financial collateral.

The defined credit processes provide for the regular review of collateral value. The risk classification is adjusted in the event of material changes in collateral value. An extraordinary review of collateral is carried out where the Bank becomes aware of information indicating a negative change in collateral value. Moreover, the Bank ensures that disbursement is only made after the agreed conditions for payment have been met.

Collateral is recorded in the Bank's central credit system, including all material details.

Credit risk mitigation for trading activities

To reduce counterparty risk in Aareal Bank's trading business, the master agreements for financial derivatives and master agreements for securities repurchase transactions (repos) used by the Bank[1)] provide for various credit risk mitigation techniques, via mutual netting framework agreements.

The master agreements for financial derivatives used by the Bank contain netting framework agreements at a single transaction level (so-called "payment netting"), and arrangements for the termination of individual transactions under a master agreement (so-called "close-out netting").

In general, all master agreements are based on the principle of a common agreement. This means that, in the case of a termination, the individual claims are netted, and that only such net amount can and may be claimed with regard to the defaulted counterparty. This claim must not be affected by any insolvency, i.e. it must be legally valid and enforceable. This, in turn, means that the jurisdictions concerned must recognise the concept of a common agreement which protects the net amount of the claim from imminent access by the insolvency administrator.

[1)] Any comments below referring to the German Master Agreement on Financial Derivatives (Deutscher Rahmenvertrag für Finanztermingeschäfte – "DRV") also pertain to the master agreement issued by the International Swaps and Derivatives Association Inc. (ISDA) (the "ISDA Master Agreement"). Both agreements are standardised agreements recommended by leading associations – among others, by the Association of German Banks (Bundesverband deutscher Banken – "BdB").

Above all, the close-out netting is subject to (international) legal risks. The Bank reviews these legal risks by reference to legal opinions regarding the validity and enforceability of mutual netting framework agreements in the case of a counterparty's insolvency. These legal opinions are evaluated based on various criteria such as product type, jurisdiction of the registered office and branch office of the counterparty, individual contract supplements and other criteria, and using a database developed for this purpose. In doing so, the Bank decides for each individual transaction whether or not netting is possible. The Bank uses eligible bilateral netting framework agreements within the meaning of the CRR for all transactions with financial institutions; in many cases there are additional collateral agreements which further reduce the relevant credit risk.

The Bank enters into repo transactions both on a bilateral basis and via Eurex Clearing AG as a central counterparty. For repo transactions, depending on the counterparty, payment or delivery netting is agreed upon. Master agreements for repo transactions generally contain provisions on close-out netting. The Bank does not use the option permitted by regulatory authorities to reduce capital requirements for repo transactions.

Furthermore, counterparty risk is reduced through derivatives settlement via central counterparties (CCPs): Aareal Bank uses Eurex Clearing AG and LCH.Clearnet Limited.

The Bank uses an internal rating system to assess the credit quality of counterparties. Operations is responsible for the daily valuation of the Bank's trades, including collateral accepted or pledged, and using validated valuation procedures.

Cash collateral only is accepted for derivatives transactions; such collateral is pledged in regular intervals, as set out in the individual agreements. Repo transactions are usually collateralised through securities, pledged on a daily basis.

Some collateral agreements provide for higher collateral levels in the event of material downgrade to a contracting party's rating.

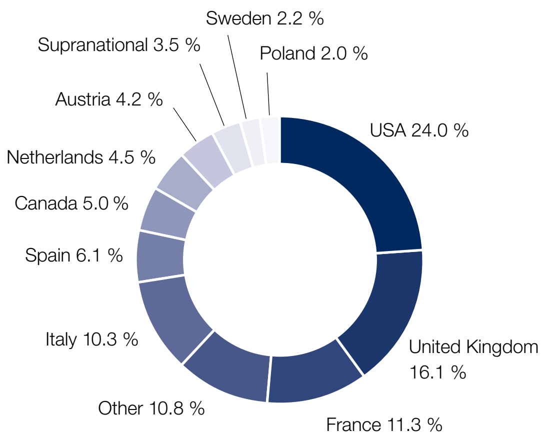
Country risks

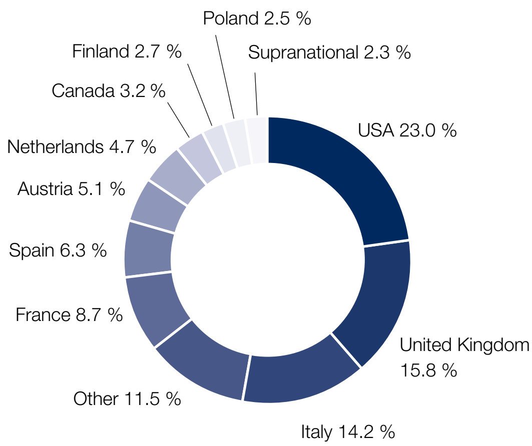
Our comprehensive approach to risk management also includes measuring and monitoring country risk exposure. When defining country risk, in addition to the risk of sovereign default or default of state entities, Aareal Bank also considers the risk

Breakdown of country exposure in the international business

%

31 Dec 2019 | 31 Dec 2018





that a counterparty could become unable to meet its payment obligations as a result of government action, despite being willing and able to pay, due to restrictions being imposed on making payments to creditors (transfer risk). Country risk exposure is managed using a cross-divisional process. The respective country limits are determined on the basis of a country risk assessment by the Bank's senior management. The Risk Controlling division is responsible for the continuous monitoring of country limits and limit utilisation, and for periodical reporting.

The diagram on page 70 illustrates the risk exposure by country (comprising receivables and off-balance sheet obligations) in the Bank's international business, at year-end. In the property financing business, country exposures are allocated by location of the property used as collateral. For exposures not collateralised by property, the allocation is based on the borrower's country of domicile. This reflects the exposure of the property finance business, as well as the activities of Treasury.

Interest rate risk in the banking book

Definition

Interest rate risk in the banking book (IRRBB) is defined as the risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, caused by yield curve shifts.

Specifically, for Aareal Bank this includes:

- risks arising from maturity transformation in the event of yield curve shifts (so-called gap risk), which, in turn, are broken down into:
  - risks from cash flows which are sensitive to interest rates, relative to the general yield curve (interest rate risk or repricing risk);
  - risks arising from the valuation of future cash flows, relative to the general yield curve (yield curve risk);
- risks from cash flows which are sensitive to interest rates, in terms of spreads to the general yield curve (basis risk);
- risks from explicit and implied options (option risk);
- risks arising from changing valuation of pension liabilities (pension risk);
- risks from fluctuations in the value of fund assets (fund risk); and
- risks from changes in Aareal Bank's specific funding spreads (funding risk).

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and the exposure to interest rate risk in the banking book on a daily basis.

The VaR concept has been broadly accepted as the predominant method for measuring economic interest rate risk in the banking book. VaR quantifies risk as the maximum loss that will occur within a certain period of time, and given a defined probability.

A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9 % confidence interval under the economic perspective.

By their very nature, VaR calculations are based on numerous assumptions regarding the future development of the business, and the related cash flows. Key assumptions used include current account balances and deposits at notice which are factored into calculations for a period of up to ten years, using the average residual amount of deposits observed in the past. Loans are taken into account using their fixed-interest period (for fixed-rate exposures), or using their expected maturity (variable-rate exposures). Aareal Bank Group's consolidated equity is not taken into account as a risk-mitigating item. This tends to overstate VaR, demonstrating the conservative approach adopted in our risk measurement processes.

Interest rate sensitivity

An additional instrument used to quantify interest rate risk exposure is the calculation of interest rate sensitivity, expressed by the so-called "delta" parameter. The first step to determine this parameter requires calculating the present values of all asset and equity/liability items on the statement of financial position. In a second step, the interest rates of yield curves used for this calculation are subjected to a one basis point parallel shift up (a method known as the "key rate method"). Delta is the present value of the profit or loss resulting from this yield curve change.

Present-value impact of an interest rate shock

The tables beside show the changes in present value as prescribed by BaFin circular 06/2019, applying EBA guidelines EBA/GL/2018/02 on controlling interest rate risk in the banking book (IRRBB).

The standard test prescribed therein outlines present value changes in the banking book in the event of a maximum 200 basis point parallel shift for each currency. As in the previous years, the ratio of the aggregate results to Aareal Bank Group's regulatory capital is clearly below the prescribed threshold of 20%.

Furthermore, present value changes are determined (and their ratio to Tier I capital shown) for six early-warning indicators, applying the prescribed scenarios. The ratio of the aggregate result to Aareal Bank Group's Tier I capital is clearly below the prescribed threshold of 15 %.

Changes in present value

	31 Dec 2019		31 Dec 2018	
	-200 bp	+200 bp	-200 bp	+200 bp
€ mn				
EUR	37	5	-140	204
GBP	-20	21	-12	-12
USD	-28	18	-10	-10
Other	-13	8	-12	-12
Total	**-24**	**52**	**-174**	**170**
Percentage ratio to regulatory capital	**0.7**	**1.6**	**5.3**	**5.2**

	31 Dec 2019
€ mn	
Parallel shock up	-30
Interest rate coefficient for parallel shock up (%)	1.2
Parallel shock down	52
Interest rate coefficient for parallel shock down (%)	2.1
Steepener shock	38
Interest rate coefficient for steepener shock (%)	1.5
Flattener shock	-44
Interest rate coefficient for flattener shock (%)	1.8
Short rates shock up	-40
Interest rate coefficient for short rates shock up (%)	1.6
Short rates shock down	51
Interest rate coefficient for short rates shock down (%)	2.0
Tier 1 (T1) capital	**2,491**

Market risks

Definition

Market risks are broadly defined as the threat of losses due to changes in market parameters; this refers to market risks which are not assigned to the IRRBB. In particular, this also encompasses any type of spread risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, and which are neither included in IRRBB nor in counterparty credit risk. Specifically, for Aareal Bank this includes:

- risks resulting from fluctuations of spot foreign exchange (FX) rates (spot FX risk);
- risks resulting from fluctuations of forward foreign exchange rates (forward FX risk); and
- risks from the regulatory review of the trading book (Financial Risk in the Trading Book – FRTB).

Being authorised to maintain a trading book, Aareal Bank AG is the Group entity that is in a position to assign transactions to the trading portfolio as defined by the CRR. Given that no such trades were concluded during the financial year under review, trading book risks played a negligible role in the overall risk scenario during the period.

Commodities are irrelevant for the Bank's business. Exchange rate risks are largely eliminated through hedges.

Various risks previously shown under CSRBB have been included under market risks upon introduction of the economic perspective for risk-bearing capacity under the ICAAP. Specifically, for Aareal Bank this includes:

- valuation risks due to changes in credit spreads (credit spread risk);
- specific price risks from the bond portfolio, wherein the bonds are mainly sovereign bonds (sovereign risk);
- risks from adjustments to the credit valuation of OTC – derivatives (CVA risk).

Risks from the rating migration of loans (migration risk), previously also included in CSRBB, are now part of credit risks. To differentiate spread risks (credit spread risk and sovereign risk) in terms of their credit risk exposure, reported market risk is adjusted accordingly.

Risk measurement and monitoring

Risk Controlling informs the members of the Management Board responsible for Treasury and risk monitoring about the risk position and exposure to other market risks on a daily basis.

The VaR concept has been broadly accepted as the predominant method for measuring economic market risk. VaR quantifies risk as the maximum loss that will occur within a certain period of time, and given a defined probability.

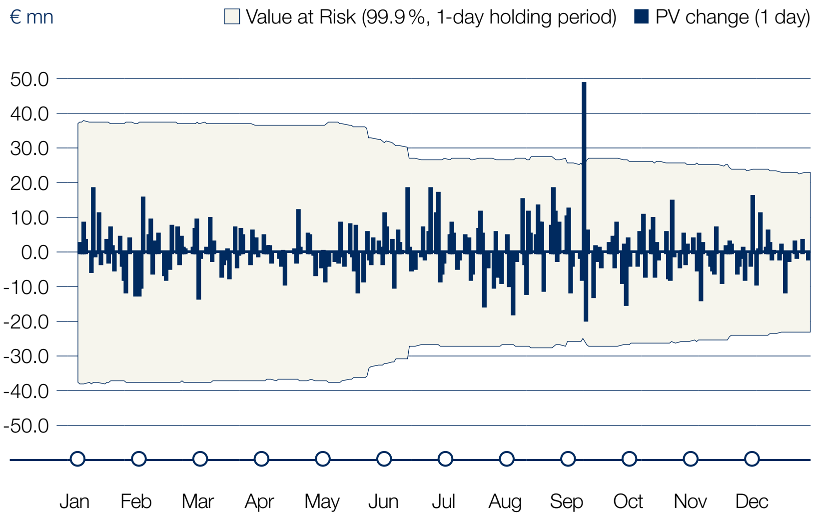
A variance-covariance approach (delta-normal method) is used throughout the Group to determine the VaR indicator. Determined on a daily basis for the Group and all its operating units, the VaR figure takes into account the correlation between individual risk types. Statistical parameters used in the VaR model are calculated directly from a 250-day historical data pool maintained within the Bank. The loss potential is determined applying a 99.9 % confidence interval.

Furthermore, in addition to the risk category limit, a separate trading limit has been determined for Aareal Bank AG, as an institution authorised to maintain a trading book.

Backtesting

The quality of forecasts made using statistical models is checked through a monthly backtesting process. The quality of the statistical procedure used to measure risk is checked using a binomial test, whereby daily profits and losses from market

Presenet values and 1-day VaR during the course of 2019



Group Management Report | Consolidated Financial Statements | Transparency fluctuations are compared with the upper projected loss limit (VaR) forecast on the previous day (known as "clean backtesting"). In line with the selected confidence level of 99.9 %, only a small number of events are expected to break out of the VaR projection (≤ 1 for a 250-day period).

The backtesting exercise shown below comprises all risk positions subject to daily changes from the "Market risks" category.

No negative outliers were observed at Group level during the past 250 trading days, affirming the high forecasting quality of the VaR model we use.

Operational risks

Definition

The Bank defines operational risk as the threat of losses caused by inappropriate internal procedures, human resources and systems (or their failure), or through external events. This definition also includes legal risks. To the extent that they are caused by operational risks, model and reputational risks are also taken into consideration within this type of risk. Systemic risks (or their impact on operational risks) are not affected by this.

Risk measurement and monitoring

It is the objective of the policy pursued by Aareal Bank to achieve a risk-minimising or loss-limiting effect at an early stage by employing a pro-active approach.

The Bank currently uses the following risk control tools to manage operational risks:

- Self-assessments: analysis thereof can provide management with indicators of any potential risks within the organisational structure.
- Risk inventories that include a periodic systematic identification and compilation of all relevant risks.
- A loss database, in which relevant damages incurred are reported, and in which they can be monitored until they are officially closed.

By means of this control toolkit, decentralised data capture as well as centralised and timely compilation of all material operational risks across the Group are ensured.

The three tools described above are used to prepare the regular risk reporting to the Bank's senior management. The responsibility for implementing operative risk-reducing measures rests with those responsible for the Bank's risk management. The utilisation of freely available funds for operational risks – as part of the Bank's risk-bearing capacity – are determined using the regulatory standardised approach.

In addition to the reports prepared from the tools stated above, suitable and plausible stress tests are conducted every quarter. These are hypothetical and historical scenarios as well as sensitivity analyses on the risk inventories. The results of the stress tests are reported regularly to the Management Board and serve as an indicator for potential developments within the operational risks that could jeopardise the continued existence of the Group.

Aareal Bank's legal department deals with any litigation the Bank is involved in, as well as with any legal issues of fundamental importance – where necessary, using the support of external lawyers.

Legal also compiles all information concerning any legal disputes involving Aareal Bank Group, whether in or out of court. To this extent, the involvement of the legal department is based on corresponding Group-wide guidelines. The Bank's decentralised operating legal entities, as well as the legal departments of subsidiaries submit quarterly reports on legal risks identified to Aareal Bank's legal department; where particular risks have occurred, such reports are submitted on an event-driven basis. When required, Aareal Bank's legal department discusses and coordinates any concrete measures with the reporting unit.

The legal department reports to the Management Board, (at least) on a quarterly basis, as well as on an event-driven basis. Moreover, information about legal risks is included in operational risk reporting.

Analyses conducted using the instruments employed have shown that the Bank is not exposed to disproportionate operational risks; nor did they indicate any material risk concentration. Even though loss cases were recorded in the loss database during the financial year under review, the aggregate impact of such losses amounted to less than 10 % of the regulatory capital to be maintained for operational risks.

Further to these tools, the Bank reviews relevant individual scenarios, and implements any measures required, on the basis of external data. Taken together, these tools for managing operational risks result in an integrated control circuit which leads to risk identification, evaluation, and management – through to risk control.

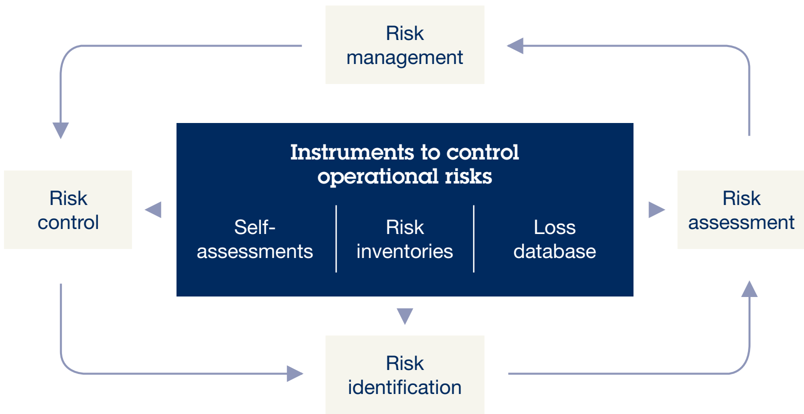
Tools to control operational risk are supplemented by a system to manage and monitor outsourced activities and processes (outsourcing), whereby the relevant organisational units regularly assess the performance of outsourcing providers, using defined criteria. The results of this process, and actions taken, are communicated to the Bank's senior management within the scope of operational risk reporting, thus allowing for risk-mitigating steps to be taken where needed.

Investment risks

Definition

Aareal Bank defines investment risk as the threat of unexpected losses incurred due to an impairment of the investment's carrying amount, or a default of loans extended to investees. The concept of investment risk also encompasses additional risks arising from contingencies vis-à-vis the relevant Group entities.

Management of operational risks



Risk measurement and monitoring

All relevant Group entities are subject to regular audits, including a review and assessment of their risk situation within the framework of risk measurement and monitoring. Due to the special character of some exposures (e.g. marketing risks), special methods and procedures are employed to deal with investment risk. The Bank uses an internal valuation method to quantify investment risk, and to include it in the calculations of the Bank's ability to carry and sustain risk, and for the purpose of limitation. The limit defined for investment risk was always complied with during the financial year under review.

The existing procedures used to measure and monitor risk exposure are supplemented by subjecting the equity portfolio to regular stress testing. Strategy Development, as well as Finance & Controlling and Risk Controlling, are responsible for measuring and monitoring investment risk exposure.

Risk Controlling is responsible for submitting a quarterly equity investment risk report to the Bank's Management Board.

Property risks

Definition

We define property risk as the threat of unexpected losses arising from changes in the value of property held by the Bank, or by fully-consolidated subsidiaries.

Due to the special character of property risk (involving marketing risks, for example), special methods and procedures are employed to deal with investment risk. All relevant property holdings are subject to regular audits, including a review and assessment of their risk situation. Property risks increased during the period under review, as a result of the acquisition of property SPVs from former credit exposures to Italy.

Risk measurement and monitoring

In order to measure and monitor risks, property yields are analysed for different regions, and over the time horizons available: on this basis, potential yield increases over a one-year horizon are determined applying a 99.9 % confidence interval. The loss in a property's value results from the difference between the current market value and the property value adjusted for the yield increase.

Business and strategic risks

Definition

Business and strategic risk is defined as the risk of unexpected losses, usually brought about by a decline in profits due to income falling short of expectations, whereby the shortfall cannot be compensated for by cost reductions. Strategic risk may emerge from changes in the competitive or regulatory environment, or due to unsuitable positioning in the macroeconomic environment.

Risk measurement and monitoring

In this context, we distinguish between investment risk and allocation risk, whereby allocation risk is already covered by various planning scenarios, and is thus incorporated in aggregate risk cover.

Investment risk is measured across segments: it is quantified assuming that additional upfront investment is required to establish an investment opportunity which was previously unavailable. Such upfront investment is assumed to represent potential risk.

Liquidity risks

Definition

Liquidity risk in the narrower sense is defined as the risk that current or future payment obligations cannot be met in full or on time. Aareal Bank Group's liquidity risk management system is designed to ensure that the Bank has sufficient cash and cash equivalents to honour its payment obligations at any future point in time. The risk management and monitoring processes have been designed to cover refinancing and market liquidity risks in addition to liquidity risk in the narrower sense.

Risk measurement and monitoring

Treasury is responsible for managing liquidity risks, whilst Risk Controlling ensures the continuous monitoring, including a daily liquidity report submitted to Treasury, and a contribution to the monthly risk report to the entire Management Board. The following tools are used for this purpose:

Cash flow forecast

We have developed a cash flow forecast, tracking cash flows from all balance sheet items and derivatives, on a daily basis, over a ten-year period. This liquidity risk information helps to assess the Bank's short-term liquidity position, broken down by currency or product. Strategic liquidity is taken into account using this ten-year cash flow profile. We use statistical modelling to incorporate the expected cash flow profile of products without a fixed contractual lifetime.

Liquidity run-off profile

The appropriateness of the Bank's liquidity is assessed using a liquidity run-off profile: the aggregate of all potential cash inflows and outflows over a three-month period is compared to the liquidity stock. This liquidity stock comprises all assets that can be liquidated at very short notice. The difference of both figures (in absolute terms) indicates excess liquidity, once all claims assumed in the run-off profile have been fulfilled through the liquidity stock. There were no liquidity shortages throughout the period under review.

Stress testing

Moreover, we employ stress tests and scenario analyses to assess the impact of sudden stress events onto the Bank's liquidity situation. The various standardised scenarios used are evaluated on the basis of the liquidity run-off profile.

We generally consider the withdrawal of deposits from the housing industry as the most significant scenario. Even in this stress scenario, liquidity is sufficient to cover the expected liquidity needs under stress conditions.

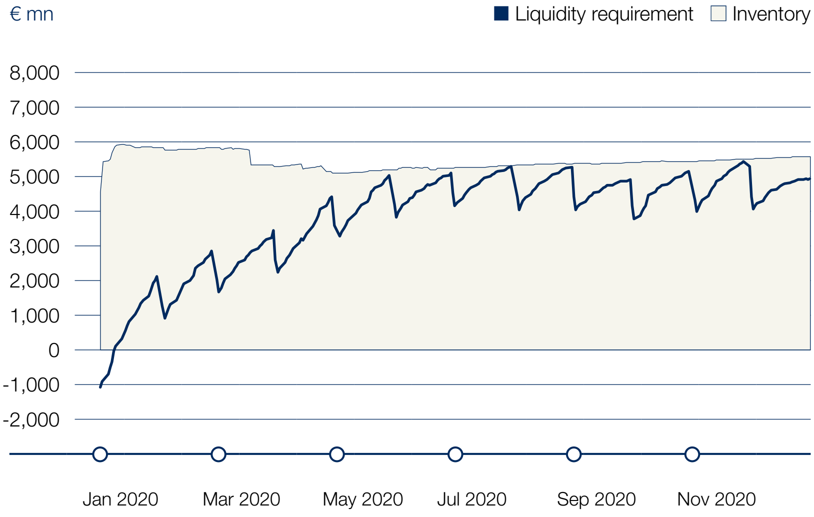
Time to illiquidity

To safeguard adequate liquidity beyond the three-month horizon covered by the liquidity run-off profile, we use the concept of time to illiquidity as a parameter. For this purpose, a liquidity run-off profile was developed which compares liquidity requirements occurring with the liquidity stock, for a one-year period. Time to illiquidity ("TtI") denotes the remaining period (expressed in days) during which Aareal Bank Group can be regarded as sufficiently liquid, even under adverse conditions. In other words, liquidity requirements (including security add-on for adverse future events) do not exceed the liquidity stock.

The calculations are based on contractual cash flows and the short-term risk assessment methodology (liquidity run-off profile), as well as the portfolio development within the current plan scenario.

The following chart shows the projected development of the liquidity stock, together with aggregate liquidity requirements (incorporating planned portfolio developments, and including security add-ons for adverse future events) until the end of 2020. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions.

Liquidity development



Further details are provided in the comments on the Bank's liquidity in the section on the "Financial position".

Funding profile

Diversifying the Bank's refinancing profile by type of investor, and by product, represents a further key aspect of our approach to liquidity risk management. Core sources of funding such as customer deposits and funds invested by institutional clients – alongside covered and uncovered bond issues – constitute the foundation of our liability profile. In this context, we refer to the comments regarding the breakdown of funding between money markets and capital markets, as set out in the description of financial position.

Concentration limits

Besides the pure measurement of risk indicators, we also monitor concentrations of liquid assets and of funding sources, determining the percentage share of the ten largest counterparties and/or positions, relative to the total portfolio.

A limit is set for each indicator in order to restrict the dependency upon individual positions or counterparties.

LCR forecast

We have developed the LCR forecast as a measurement tool designed to ensure that we maintain compliance with the regulatory Liquidity Coverage Ratio. A preview of the Liquidity Coverage Ratio is calculated over a horizon of up to three years, determining the ratio of highly liquid assets to cumulative net cash outflows for various end-of-month dates – thus identifying any potential liquidity shortfalls or reserves.

NSFR forecast

The NSFR forecast, which is a projection of the Net Stable Funding Ratio over a period of up to three years, represents another important component of our liquidity management. This measurement tool allows us to forecast the regulatory Net Stable Funding Ratio for future dates, thus identifying any potential liquidity shortfalls or reserves in terms of the NSFR at an early stage.

Accounting-Related Internal Control and Risk Management System

Tasks of the accounting-related Internal Control System (ICS) and the Risk Management System (RMS)

The accounting-related Internal Control and Risk Management System includes principles, procedures and measures to ensure the effectiveness and the efficiency of internal and external accounting, in accordance with applicable legal provisions. The tasks of the accounting-related Internal Control System mainly include ensuring proper conduct of business activities, guaranteeing proper internal and external accounting, as well as ensuring compliance with relevant statutory and legal requirements applicable to the Company.

The objective of the accounting-related Risk Management System is to identify, assess and limit risks which may impede the compliance of the financial statements with applicable rules and regulations. As with any other Internal Control System, the accounting-related ICS and RMS may only provide reasonable – but not absolute – assurance with regard to achieving this objective, regardless of how much care is used to design and operate this system.

Organisation of the accounting-related ICS and RMS

The Internal Control System of Aareal Bank takes into account the principles established by the Minimum Requirements for Risk Management (MaRisk) related to the company-specific design of the ICS. The design of this Internal Control System comprises organisational and technical measures to control and monitor the Company's activities, covering all entities of Aareal Bank Group. The Management Board of Aareal Bank AG is responsible for designing, implementing, applying, further developing and reviewing an appropriate accounting-related Internal Control System. The Management Board makes decisions as regards the scope and the design of specific requirements; it has defined the responsibilities for the individual process steps in connection with accounting by means of organisational guidelines, and has delegated these responsibilities to individual organisational units.

Aareal Bank prepares its financial statements in accordance with the German Commercial Code (Handelsgesetzbuch – "HGB"), and its consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) as applicable in the European Union. The Finance & Controlling division controls accounting processes and is responsible for ensuring conformity with legal requirements, as well as with any further internal and external provisions. The accounting-related requirements that have to be applied are documented in guidelines. Furthermore, the Finance & Controlling division is responsible for developing IT guidelines.

During the period under review, Aareal Bank fully migrated large parts of its core banking system, including the general ledger and sub-ledgers for loans, investments, creditors and debtors to SAP S/4 HANA, the latest SAP software version. In addition to enhanced processing speed, the Bank thus benefits from innovative functions, and from simpler and more efficient systems maintenance.

For the consolidated financial statements in accordance with IFRSs, the companies that form part of the Group create an IFRS package as at the respective reporting date. This includes financial statements prepared under IFRSs and in accordance with the IFRS Group Accounting Manual, as well as the Notes and consolidation information (intercompany balances). All packages are recorded by the Finance & Controlling division in a consolidation software and aggregated for the purpose of preparing the consolidated financial statements.

The Supervisory Board is responsible for monitoring the Management Board. Within the scope of financial reporting, it approves the single-entity financial statements of Aareal Bank AG as well as the consolidated financial statements and group management report Measures taken by the Supervisory Board to ensure an efficient performance of its control functions include the establishment of an Audit Committee, which is primarily responsible for financial reporting issues and monitors the effectiveness of Aareal Bank's Internal Control System. It analyses and assesses the presented financial statements and internal risk reports as well as the annual report submitted by Internal Audit. In addition, the Audit Committee is responsible for determining the focal points of the audit, as well as for evaluating the auditors' findings. The Audit Committee includes an expert in the fields of accounting or auditing, pursuant to section 100 (5) of the German Public Limited Companies Act (Aktiengesetz – "AktG").

Internal Audit also assumes a monitoring function not related to the process. It reports directly to the Management Board, and provides auditing and consulting services which are designed to optimise Aareal Bank's business processes with regard to accuracy, safety and efficiency. The Internal Audit division supports the Management Board by evaluating the effectiveness and appropriateness of the process-dependent Internal Control System and of the Risk Management System in general. Any detected weaknesses regarding the identification, evaluation and reduction of risks are reported and addressed within the context of specific action plans.

Internal Audit also performs Group audit functions for Aareal Bank's subsidiaries, within the context of the Group's risk management. The review of the risk management's effectiveness and appropriateness covers the risk management and risk control systems, reporting, information systems, and the accounting process. To perform its tasks, Internal Audit has full and unrestricted information rights with respect to activities, processes and IT systems of Aareal Bank AG and its subsidiaries. Internal Audit is informed on a regular basis about material changes related to the Internal Control and Risk Management System.

The review of process-integrated controls conducted by Internal Audit is based on a set of internal regulations, procedural instructions and guidelines of Aareal Bank Group. The audit activities of Internal Audit comprise all of the Group's operational and business processes, and are carried out using a risk-based approach.

Components of the accounting-related ICS and RMS

Within Aareal Bank, various measures related to the Bank's organisational structures and procedures help to fulfil the monitoring duties within the framework of its Internal Control System.

A prerequisite for the monitoring system to work efficiently is a Written Set of Procedural Rules governing the distribution of tasks between the individual divisions and the scope of the respective activities. The organisational structure of the Finance & Controlling division is set out in the Bank's organisational guidelines. Aareal Bank's accounting system is structured observing the principle of separation of functions, which makes for a split between operative and administrative roles, and is designed to ensure a sufficient level of control.

Various guidelines exist for activities and processes. These guidelines are set out in the Written Set of Procedural Rules of Aareal Bank and available for inspection to all employees. There are requirements as regards data entry and control – as well as data storage – which have to be observed in general by all of the Bank's posting units. If necessary, results are reconciled across divisions or companies. Uniform accounting methods and measurement techniques are guaranteed through guidelines applicable throughout the Group. The requirements of these Group-wide guidelines substantiate legal provisions, and are adjusted on an ongoing basis to take current standards into account. The valuation techniques used, as well as the underlying parameters, are controlled regularly, and adjusted if necessary.

In addition, the Bank's Risk Manual summarises the material elements of Aareal Bank Group's Risk Management System. Specifically, the Manual describes the organisational workflows as well as methods and instruments used in the context of risk management. In this context, reference is made to our explanations in the Risk Report.

Clearly-defined rules as regards delegation of authorities facilitating the allocation of professional responsibilities also contribute to reliable financial reporting. Any decisions taken are always based on relevant authorities. Internal controls defined on the basis of risk considerations are embedded in the accounting process. Compliance with the principle of dual control in all material processes is one of the principles for ensuring accurate accounting. Where no integrated approval system/dual control feature has been implemented in the accounting IT systems for material transactions, this has been integrated and documented in the manual process workflows.

Adherence of accounting to generally accepted accounting principles is ensured by both preventive and detective controls, as well as through a review of processed data. The preparation of the consolidated financial statements is characterised by multiple analyses and plausibility checks. Besides the evaluation of individual accounting issues, these include comparisons of periods, and between plan and actual data. Control processes have been implemented for both manual and automated accounting transactions.

In order to increase the level of control quality, all relevant divisions are involved in the reconciliation process. An example of cross-divisional reconciliation is the process for the preparation of annual and interim reports. All divisions involved must ensure and (prior to preparation by the Management Board) confirm the quality of the sections of the reports they are responsible for. This represents an additional control level for the data to be disclosed.

In terms of organisational workflows, the accounting-related Internal Control and Risk Management System is based on a comprehensive standardisation of processes and software. Aareal Bank Group uses both standard and customised software. The consolidation software provides technical support to the reconciliation of Group-internal relationships, in a clearly-defined process. The data of the units included is reported using a uniform standardised chart of accounts. The Group's accounting-related IT systems were designed in such a way that both manual controls and automatic plausibility checks are performed for material technical and procedural system steps of the applications used. The controls in relation to processing within the IT systems are also integrated in the processes, as well as being independently performed. Process-integrated controls comprise, for example, the review of error and exception reports or the regular analysis of internal service quality. In contrast, Internal Audit conducts IT reviews independently from processes.

Data and IT systems must be protected from unauthorised access. A differentiated access authorisation concept is in place for the systems used for finance and accounting, preventing manipulation of data. Authorisations are allocated to the responsible employees, reviewed regularly, and adjusted if necessary in accordance with internal criteria.

Aareal Bank reviews its accounting-related Internal Control and Risk Management System on an ongoing basis. Necessary adjustments are made with respect to the accounting process based on the Bank's reviews. Adjustments may have to be made, for example, in connection with changes in the Group structure, to the business model, or new legal requirements.

Aareal Bank has to comply with legal requirements. If these requirements change, for example in the form of new laws or changes in accounting standards, the processes or IT systems will be adjusted as required in separate projects across divisions – based on a clearly-defined allocation of functions, and the accounting-related Risk Management System will be adjusted to take the amended rules into account. Current developments of statutory and legal provisions applicable for Aareal Bank are constantly monitored and reported, not only by the responsible division, but also by a steering committee established by the Bank. This committee also initiates any required adjustments to be made to systems and processes, and reports the results to the Management Board.

Report on Expected Developments and Opportunities

Macro-economic environment

Developments for the economy, as well as for financial and capital markets, are exposed to diverse major risks and threats – which also have an impact on the commercial property markets. The economic forecast is defined by significant uncertainty. The key factors in this regard relate to geopolitical risks, protectionist economic policy and a less dynamic economy.

Sudden or excessive changes in interest rates may trigger revaluations and changes in investor behaviour, potentially leading to a decline in asset prices arising from a change in capital allocation. Emerging economies in particular will have to face capital outflows, and may have to raise their own interest rates. The economies were rendered vulnerable due to the protracted period of low interest rates caused by a lack of effort to reform and consolidate and increased levels of private debt. On the other hand, a longer-lasting period of low interest rates complicates an exit from such an environment, heightening the risks for the financial and capital markets. In this context, traditional central bank policy may lose its impact.

Protectionist measures, particularly those adopted by the US, pose a threat to both economic performance and the financial markets. An open trade war cannot currently be ruled out this year (it has already started in part), which, in addition to the reduction in trade in goods and services, could also cause turbulence on the financial markets.

Geopolitical conflicts can also cause shock jumps, in for example the price of oil, which can lead to a recession in less robust economic conditions.

The rapid spread of the coronavirus at the beginning of 2020 might have a negative impact upon many economies, and thus on the development of Aareal Bank Group's business and profitability for the full year, and perhaps beyond.

However, the political shift away from European cohesion not only represents the greatest threat for the EU but for Europe too. This is substantiated by Brexit, regional pro-secession efforts for example in Catalonia, and in particular by nationally focused governments in Central and Eastern Europe. This could also have a negative impact on the economy.

Higher and, in parts, continuing high levels of indebtedness in combination with a lack of reform efforts pose further risks in many countries and regions. In this context, changes in monetary policy may have a negative impact upon market confidence, triggering crises. Furthermore, private debt has risen considerably, especially in the emerging markets, and could lead to market corrections and systemic crises.

Economy

Global economic growth in 2020 is expected to be lower than in 2019. However, the weak economic phase from the second half of 2019 is expected to persist until mid-year 2020. The second half of the year will likely benefit from an expansionary monetary and financial policy. Survey-based indicators currently suggest that the economic weakness should bottom out in 2020. In view of the information to hand, a recession in 2020 is not predicted up to now, even though it cannot be ruled out entirely.

We expect real gross domestic product in the euro zone to grow by around 0.8 % in 2020. This is 0.4 percentage points lower than in 2019, which we view as being a noticeable decline. This is implied by survey-based indicators and expectations of lagging effects, for example on the labour market, but the global effects of the coronavirus are also expected to have a negative impact.

We expect an economic growth of 1.0 % in the UK for the current year. Supported by fiscal and monetary policy, quarter-on-quarter growth in the current year should improve gradually. However, the unregulated relationship with the EU will inhibit further positive developments. Of importance here is whether the prospect of a trade agreement with the EU at the end of the year or unregulated trade relations for the end of the transition phases will be the most likely development.

Real economic growth of 1.6 % is expected in the US in 2020. Consumer spending will support growth, with the contribution made by investments and trading playing a somewhat lesser role. Economic growth of 1.2 % for the current year is expected in Canada.

In China, we expect economic growth of 5.4 % in the current year, negatively impacted by the coronavirus pandemic. The risks arising from the trade conflict with the US are likely to ease, which should stabilise growth. However, the high levels of corporate debt represents a risk for future economic development. In addition, the coronavirus pandemic may further dampen growth.

Real economic growth of 1.9 % is expected in Australia in 2020. Growth in 2020 is burdened by lower commodity prices, slower credit growth and lower expectations of tourism due to the long-lasting bush fires.

Financial and capital markets, monetary policy and inflation

These risks and uncertainties listed above are also impacting on financial markets in the current year. Were they to materialise to a significant extent, they might cause turbulence on capital markets as well. Under these conditions, volatility is expected to be higher overall than the year before. We continue to believe that the financial markets will remain receptive towards refinancing and new securities issues.

With the relaunch of its asset purchase programme, the ECB will remain on an expansionary path. Even the change at the head of the ECB will not lead to any fundamental changes. In the US, the Fed could respond to low inflation and economic growth below the previous year's level by cutting the key interest rate once more. In the UK, the Bank of England has tied its monetary policy orientation to the effects of Brexit. As the uncertainties persist, further interest rate increases are not expected in 2020.

Changes to monetary policy and economic weakness would tend to lead to a decline in long and short-term interest rates. However, as the central bank measures will be less powerful than in the past, long and short-term interest rates are likely to remain stable in 2020. On the other hand, short-term interest rate in the US are likely to be lower at the end of the year, as the FED's purchase programme is aimed more at the short-term interest rate corridor.

Inflation could rise overall by a few basis points in 2020, not least due to higher energy prices. Geopolitical risks, e.g. in Iran, can impact on oil prices and hence on inflation to a certain extent. Lower economic momentum is likely to cap the increase in the relevant currency areas.

Regulatory environment

The trend towards a tighter regulatory framework in the banking business is set to persist during the coming years. For instance, the finalisation of the Basel III framework, adopted by the Basel Committee's Group of Governors and Heads of Supervision (GHOS), will bring about extensive changes to the approaches used for determining risk-weighted capital requirements (a concept known as "Basel IV").

The new requirements of CRR II, CRD V and BRRD II were also finalised and still have to be transposed into national law, where relevant. In addition, EBA has passed guidelines on PD and LGD estimates, the treatment of risk exposures, and the determination of downturn LGDs – which will need to be implemented.

The EBA guidelines on granting and monitoring loans will place further demands on the banks' internal governance (incl. in risk culture and strategy) and on the credit processes (incl. documentation, credit rating review) as well as the monitoring framework (e.g. monitoring the credit terms).

The requirements are supplemented at a European level by another MaRisk amendment at national level, which is awaiting consultation in 2020.

Furthermore, supervisory authorities are increasingly focusing on the topic of sustainable finance – not least due to BaFin's Guidance Notice on Dealing with Sustainability Risks.

To facilitate the timely implementation, we have already continued to pursue the individual issues in numerous projects, devoting considerable resources to this task.

The volatility of requirements presents an additional challenge for institutions: besides the new requirements mentioned by way of example, this volatility is particularly a function of the concrete specifications for instruments implemented by the ECB and/or the national supervisory authorities. For instance, the capital buffers to be set on a national level (the anticyclical buffer and the buffer for systemic risks), or the annual results of the Supervisory Review and Evaluation Process (SREP) for individual banks, can only be planned to a certain extent. Moreover, these instruments may lead to changes in a bank's individual capital requirements, at short notice.

Sector-specific and business developments

Structured Property Financing segment

Demand for commercial properties will vary in 2020, depending on the region and property type. A shortage of top-class properties, along with reticence among different investors to invest in specific markets (such as the UK with a view to the trade relations that still exist with the EU) or in specific property types (such as retail, with regard to the changes brought about by online trading, among other things), will make itself felt in global transaction volumes. These are unlikely to exceed the previous year's levels.

Commercial property markets, as well as the economy, are exposed to major risks and threats. Besides economic influences, individual shifts in the interest rate environment can have a negative impact on market values. Moreover, other uncertainty factors and risks in the macro-economic environment are also relevant for commercial property markets.

Several factors will influence the market value of commercial property over the course of the year. While the economy and historically low interest rates are likely to support property values, political uncertainty, economic downturns or investor reticence can have an adverse effect on values. Despite the persistent economic cycle, the market cycle is still intact, therefore also potentially leading to cyclical downturns in the commercial property market.

Based on the conditions described above, we therefore anticipate a largely stable development[1] on average of ± 2.5 % in the market values of commercial property in many markets this year.

We expect a stable development of market values of ± 2.5 % in 2020 in most European countries, such as Finland, France, Germany, the Netherlands, Poland, Russia and Sweden. For Spain, on the other hand, we consider positive growth 2.5 % to be possible. Uncertainties persist in the UK due to the as yet unresolved issue surrounding the contractual relations with the EU at the end of the transition period. An exit with a quick solution should have a positive effect on market values, while a protracted and unclear process would likely drive down market values by more than 2.5 %. Political uncertainty in Italy could have a negative impact on property values. Despite the stable development overall, we could see declining values in some European sub-markets or for some property types.

We assume property values in the US will remain stable at ± 2.5 % on the whole. A stable performance of ± 2.5 % 2020 also looks likely for Canada in 2020.

In Australia and China, stable market values of ± 2.5 % on average for commercial property are expected.

These developments should also tend to apply to office and logistics properties. The performance of retail property on average could be negative overall.

As was the case last year, the European hotel markets are for the most part expected to report positive growth in average revenues per available room. Occupancy rates in most markets are expected to be higher, historically.

Some market participants expect a less dynamic economy to lead to stagnating (or falling less than 1 %) occupancy rates and average room rates on the US hotel market. In Canada, the stable development of average revenue per available room is likely to continue. As we see it, the risk of a decline is a more likely prospect than an increase due to lower year-on-year economic growth. The increase in the number of rooms available should also lead to a further decline in the occupancy rate.

For the Asia/Pacific region, we anticipate occupancy ratios and average revenues per available room for 2020 as a whole to remain in line with the previous year in the hotel markets of many metropolitan areas.

The competition for commercial property financing, which is described as intense, is likely to persist on many markets this year, whereby we consider the readiness of lenders to reduce their margins as a given, even though a plateau might be about to emerge, particularly in Europe. Banks are expected to continue adhering to their preference for financing first-class properties in prime locations with stable loan-to-value ratios.

We have incorporated various market aspects and our business strategy, which are reflected in the motto of "Aareal Next Level", in our assessment of anticipated new business volumes for the current year. For the Structured Property Financing segment, we are targeting new business of between € 7 billion and € 8 billion for the 2020 financial year, whereby the focus is set to remain on the higher-margin US market and Western Europe. Aareal Bank Group's property financing portfolio should amount to between € 26 billion and € 28 billion at the end of 2020, subject to currency fluctuations. To manage our portfolio and risk exposure, we also use syndications which facilitate larger-sized financing solutions.

The forecasts are based on the assumption that the macro-economic risks and uncertainty factors described above will not materialise to a significant extent, or only in a manageable manner: otherwise, they might influence business development, for example, in terms of new business.

[1] The performances of individual property types or of individual markets and sub-markets may deviate from the expectations referred to above.

Consulting/Services segment

Bank division Housing Industry

The German housing and commercial property industries are expected to continue showing solid development in 2020, on the back of rising rental income and a high degree of stability in property values.

The companies will continue to optimise and develop existing portfolios, driven especially by political and socio-political aspects, such as refurbishing buildings to make them suitable for the elderly, district development or the significantly underdeveloped urban centres. The demands of climate protection targets for Germany and the decisive bearing on the property industry to achieve them is putting serious demands on resources. The fact that the necessary investments are not economically feasible is posing a problem and will lead to political tension in the years ahead. Political decisions and their impact on the profitability of the measures, as well as greater expectations of the energy retrofitting ability and increasing regulatory requirements may be affecting future corporate investment activities.

The stable development on the residential property market is expected to prevail in 2020. Regional differences are likely to increase further. Due to the ongoing urbanisation trend, we expect demand for apartments to rise further, especially in economically strong conurbations. Property investors and potential sellers within the housing and commercial property industries should continue to benefit from these market developments.

We see good opportunities during 2020 to acquire new clients and to intensify the business relationships with our existing client base. This also applies to utilities and the waste disposal industry. In addition, in line with our strategic orientation, we continue to invest in the expansion of the ”Housing Industry Ecosystem”, the cross-sector development of interface products, and the expansion to adjacent ecosystems. The focus here is on, for example, the functional expansion of the Aareal Portal corporate client platform as regards the digitalisation of client communication and account processing.

In our view, the range of services that connect alternative online payment solutions to existing systems, thus helping to overcome process breaks (even across industry sectors), are particularly interesting. The Aareal Exchange & Payment Platform, which integrates alternative payment processes in existing accounting systems should be market ready in 2020. We also see potential in technical solutions for automating billing processes as part of electromobility in the network of charging stations. A corresponding product was also tested already in 2019.

Besides these future technologies, we also see growth in established processes and procedures, such as incorporating the offers of plusForta GmbH, which was acquired in the financial year, in deposit management.

Against this background, we are aiming for net commission income growth of approximately 15 % year-on-year (2019: € 23 million), expecting an average deposit volume from the housing industry of € 10 billion to € 11 billion. The persistently low interest rate environment, which is relevant for the results from our deposit-taking business, will continue to burden segment results. However, the importance of this business goes way beyond the interest margin generated from the deposits, which is under pressure in the current market environment. This is because the deposits from the housing industry represent a strategically important additional source of funding for Aareal Bank.

Aareon

Aareon will continue in 2020 to pursue the growth strategy based on its strategy programme integrated in Aareal Bank’s strategic orientation. Overall, sales revenue is expected to rise significantly.

Aareon expects a slight increase in sales revenue in the ERP business, anticipating new customer gains and an increasing business volume with existing clients to contribute. Various customer projects will be rolled out in 2020, thus generating higher revenues from maintenance and SaaS. Overall, a shift from licence revenues to recurring revenues continues to be expected, due to the increased conclusion of maintenance and SaaS contracts. The new cloud-based Tobias 365 ERP product generation in the Netherlands will lead to a decline in the revenues to be realised with this product, as migrations from the formerly in-house to the cloud solution will result in a shift in revenues to the future. This effect will be felt especially in 2020 and 2021, but will lead to higher revenues in the future. The migration business in Germany will ease slightly and the business with existing clients will continuously be driven forward. As at 31 December 2020, most clients using the GES product will have migrated to Wodis Sigma or SAP® solutions and BlueEagle. Sales revenue in the energy utility market is expected to rise sharply. Developing further capacity should allow more projects to be implemented. Marked increases are also expected in the commercial property market. Additional customer acquisition is expected in the DACH region with the RELion products and in the Netherlands with REMS.

The digital solutions are the main drivers of organic sales growth in Aareon. Besides the organic sales growth through further market penetration with existing and new solutions, the acquisition of the CalCon Group as at 1 January 2020 will lead to a significant increase in digital solutions revenue. Furthermore, Aareon plans to make further significant investments in expanding its range of digital solutions related to new technologies, and to participate in the start-up scene, to accelerate organic growth. Aareon expects the first sales revenues from these measures in 2020. The CRM (customer relationship management) and WRM (workplace relationship management) products from the existing portfolios will contribute primarily to these. There is still very strong demand among clients to digitalise their processes.

Based on the explanations outlined above, Aareon envisages a marked overall increase in sales revenue to between € 272 million and € 276 million (2018: € 252 million). The company estimates an adjusted EBITDA[1)] in a range of 68 million to € 71 million (2018: € 64 million). We have adjusted the performance indicator in line with a standard target figure often applied to software companies within the scope of developing a value proposition independently of Aareal Bank.

Business strategy

Aareal Bank Group's strategy focuses on sustainable business success. In an environment characterised by technological change, further growing regulatory requirements, altered client needs and fiercer competition, its aim is to secure the foundation while also leveraging new revenue potential. Following on from the "Aareal 2020" programme for the future, the medium-term strategic development process will continue under the motto of "Aareal Next Level". The general strategic orientation will continue – with large-volume, international commercial property financing on the one hand and consulting and services for the housing sector in Europe and related industries on the other. The individual business activities will be developed in a targeted manner, in order to sharpen their own independent profiles, accelerate the Group's growth overall and create value for the shareholders and other stakeholders.

The emphasis in the Structured Property Financing segment is to ensure the Bank's success of previous years and secure its existing position in an adverse environment. To do so, Aareal Bank makes systematic use of the flexibility gained in recent years regarding regions, asset classes, structures, and exit channels, as well as expanding the activities along the value creation chain. In the former Consulting / Services segment, both areas – the banking business and Aareon – will continue to grow in the years ahead. The objective is to gradually reduce the overlaps and cross-dependencies, while strengthening the independence of the individual brands and business models – whilst securing existing synergies at the same time.

[1)] Earnings before interest, taxes, depreciation and amortisation, excluding strategic investments and non-recurring effects

Group targets

Aareal Bank Group believes the market and competitive environment will remain challenging in the current year. It also expects ongoing political and economic uncertainties. No relief is to be expected either from regulatory pressures or from the low interest rate environment. As a result of the spread of the coronavirus and the efforts to combat it, considerable volatility and serious implications can currently be observed on the capital markets, but also in the overall economic environment. At present, it is impossible to assess to what extent these may influence the business and earnings development, hence they are not included in the forecasts.

We will – as stated in "Aareal Next Level" – introduce measures in the current year to stabilise and optimise the existing business, and will expedite investments in new products and in future growth.

We anticipate a slightly lower net interest income, compensated by a higher contribution from Aareon to net commission income, and thus overall stable net interest and net commission income (2019: € 762 million). Loss allowance is expected to decline to a risk cost level of just under 30 basis points (in terms of the property financing portfolio), and thus below the figure for 2019 (€ 90 million). Administrative expenses are expected to rise slightly year-on-year (2019: € 488 million), whereby the effects from Aareon's business growth are likely to more than offset lower expenses incurred by the Bank.

For the current year, we expect consolidated operating profit and a return on equity (before taxes) at similar levels compared to 2019 (€ 248 million and 8.7 %, respectively). The forecasts for loss allowance and operating profit do not include any effects from a potential, selective continuation of accelerated de-risking activities. Consolidated net income allocated to ordinary shareholders of Aareal Bank and earnings per share (EpS) are anticipated to be stable compared to the previous year's figures of € 145 million and € 2.42 – even considering possibly accelerated de-risking.

Assuming a more positive environment, the initiatives undertaken in the context of "Aareal Next Level" will permit to achieve RoE before taxes of around 12 % over the medium term.

As in the previous year, new business volume for the current year is expected to range between € 7 billion and € 8 billion. Subject to exchange rate fluctuations and market conditions permitting, the property financing portfolio will continue to remain in a range between € 26 billion and € 28 billion.

We are aiming for net commission income growth of 15 % year-on-year (2019: € 23 million) in the Bank's Housing Industry division segment, expecting an average deposit volume from the housing industry of € 10 billion to € 11 billion.

Aareon, which in future will be reported as an individual segment, is expected to increase its revenue by a low double-digit figure, to between € 272 million and € 276 million (2019: € 252 million), and generate an also higher adjusted EBITDA[1] of € 68 million to € 71 million (2019: € 64 million).

Subject to further regulatory changes, Aareal Bank considers a target CET1 ratio (post-finalisation of Basel III – so-called "Basel IV") of around 12.5 % fully phased to be appropriate. The CET1 ratio is expected to slightly exceed the target ratio at year-end.

Remuneration Report

Remuneration is a key element of managing the business, and of managing risk. The remuneration strategy at Aareal Bank Group forms part of the Company's efforts to ensure that employees' remuneration is in line with market conditions and the performance achieved. At the same time, it helps to align the Group's remuneration intentions with cur-

[1] Earnings before interest, taxes, depreciation and amortisation, excluding strategic investments and non-recurring effects

rent regulatory requirements. When setting remuneration, Aareal Bank Group therefore pays attention to ensuring that the proposed remuneration motivates employees to achieve the Group's strategic business and earnings targets whilst remaining within the boundaries set by the Group's risk appetite and corporate values. Whilst good performance is remunerated accordingly (through a bonus), any breaches of internal or external rules are penalised through sanctions (penalties).

The Chairman of the Supervisory Board and Aareal Bank AG's shareholders discuss remuneration transparency and the remuneration system on a regular basis. To increase the transparency, the current Remuneration Report was revised. The Supervisory Board will continue to address potential adjustments to the remuneration system for the Management Board and related reporting, discussing it with major stakeholders.

Remuneration system for the Management Board

Overview

The Supervisory Board of Aareal Bank AG designs a remuneration system which provides incentives to Management Board members for achieving the Bank's strategic goals and targets, within the framework of the defined risk appetite, risk strategies and in line with the corporate and risk culture, and the values determined in the Code of Conduct. As a "significant institution" which is subject to direct supervision by the European Central Bank, Aareal Bank's scope in setting remuneration is subject to tight restrictions, pursuant to the specific regulatory requirements for banks, pursuant to the EU Capital Requirements Regulation (2013/575/EU), the German Banking Act (Kreditwesengesetz – KWG), and the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – InstVergV).

Remuneration structure

Total target remuneration comprises a fixed component (including ancillary benefits and contributions to retirement provisions) and a variable component, the structure of which is governed by law.

The amount of variable remuneration is based on previously agreed targets. The assessment period for target achievement must be at least three years long, adding a five-year deferral period for at least 60 % of variable remuneration, and – pursuant to section 20 (5) of the InstitutsVergV – 50 % of variable remuneration shall be disbursed into financial instruments used by companies, i. e., especially shares or share-based instruments to be held for a minimum period of one year. Aareal Bank uses virtual shares as such an instrument. This way, members of the Management Board participate in the Bank's development for up to six years. Performance of virtual shares is capped at 300 %.

Due to the target determination period of at least three years, all Aareal Bank's remuneration targets qualify as long-term incentives (LTIs). 50 % of the entire variable remuneration is paid in form of share-based instruments.

Aareal Bank cannot merely provision for a holding period for shares after the targets have been achieved – as the German Corporate Governance Code for instance recommends. Regulatory requirements mandate that 60 % of variable remuneration is retained. Taking the target determination period together with the deferral and holding periods, the actual amount of variable remuneration for a given financial year is determined over an aggregate period of nine years. Given this very long period, which is prescribed by regulations, the Supervisory Board has refrained from imposing any further conditions or disbursement modalities.

There is no need for an agreement requiring Management Board members to enter into any proprietary investments in Aareal Bank shares, since the Supervisory Board believes that the existing system meets the purpose of such an investment.

Remuneration element	Description	Reference to strategy and long-term development
Fixed remuneration elements		
Fixed annual salary	– Fixed contractually agreed remuneration, paid monthly in the amount of 45 % of the target total remuneration of the Management Board members – Chairman of the Management Board: € 1,425,000 – Ordinary Management Board members € 900,000 – Members of the Management Board for whom the so-called "newcomer rule" applies: 80 % of an ordinary Management Board member's fixed annual salary	Guaranteeing the fixed income in the form of a fixed annual salary and ancillary benefits equivalent to scope and complexity of the business and the role and responsibility of the individual members of the Management Board, and competitive on the market.
Ancillary benefits	– Company car, which may also be used for private purposes or a flat rate payment if a company car is not opted for – Group accident insurance – Specific costs for security measures	
Pension obligations	– Defined contribution commitment – Annual contributions of 15 % of overall target remuneration of the Management Board members – Members of the Management Board who were appointed prior to 1 January 2013 entitled to claim pension benefits as of the time at which they turn 60 – For members of the Management Board who were appointed after 1 January 2013: entitled to claim pension benefits as of the time at which they turn 62 – In the event of permanent disability, a Management Board member is entitled to claim benefits prior to turning 60 or 62, respectively	Granting of pension commitments for financial security in retirement and protection in case of death and disability that are in line with market requirements.
Variable remuneration elements		
	– 40 % of the Management Board members' total target remuneration – The reference value for 100% target achievement amounts to € 1,250,000 for the CEO, and to € 780,000 for ordinary Management Board members – Variable remuneration is determined via the achievement of targets strictly derived from the business and risk strategies (incl. ESG), and which are in line with Aareal Bank's corporate and risk culture – Group (70 %), sectional (15 %) and individual (15 %) targets – Performance measurement based on criteria whose performance is determined over a three-year period – No discretionary components besides the targets derived from the strategy – 80 % of the variable remuneration is paid out on a deferred basis (60 % must be retained for five years; 50 % each of deferred and non-deferred com-ponents are converted into virtual shares, to be held additionally for one year) – Maximum overall target achievement level is capped at 150 % of the target value – Maximum variable remuneration cannot exceed fixed remuneration	Provision of a variable remuneration on the basis of annual financial and non-financial performance criteria that are relevant for Aareal Bank AG's strategy. Provides incentives to Management Board members for implementing the business priorities of Aareal Bank and to act in the interest of the long-term and sustainable positive business development. Group performance targets account for 70 % of overall target achievement, hence prioritising the entire Company's interest, including shareholder expectations. By granting the variable remuneration, Aareal Bank meets the regulatory require-ments to which it is subject.
Other rules		
Risk-bearing capacity	Before disbursing the variable remuneration, the Supervisory Board reviews it regarding its compatibility with the risk-bearing capacity.	Disbursing variable remuneration is not meant to threaten Aareal Bank's financial solidity.
Penalty and clawback	– All components of the variable remuneration are subject to penalty and clawback provisions. – Admission of an adjustment to outstanding remuneration and/or clawback of remuneration already disbursed in case of clawback events.	Within the meaning of responsible and sustainable corporate governance, and for the purpose of implementing the regulatory requirements, penalty and clawback rules are a mandatory part of good corporate governance, which in turn is firmly enshrined in Aareal Bank's strategy.

By granting 50 % of variable remuneration in the form of virtual shares, together with the fact that variable remuneration – assuming a target achievement level of 100 % – is nearly equivalent to the fixed annual salary, Management Board members will have regularly earned virtual shares equivalent to a fixed annual salary level after three years. Given the long deferral periods and the holding periods, this is a value which they usually retain until the end of their term on the Management Board (cf. section "(Virtual) shareholdings of Management Board members **(share ownership)** and share-based remuneration").

Achievement of initial targets is regularly reviewed during the deferral period **(back-testing)**, and the level of target achievement originally agreed upon and, as a result, the amount of the variable remuneration is adjusted ex-post if necessary. Variable remuneration for a given financial year may be reduced in the event of inappropriate behaviour, or behaviour in breach of duties – in other words especially due to wilful breaches of internal or external rules, including Aareal Bank Group's Code of Conduct and the values determined therein. In the case of negative performance contributions, as defined in detail by the Supervisory Board, in the form of significant losses or material regulatory sanctions, variable remuneration must be reduced to zero **(penalty review)**. Where a portion of variable remuneration for such financial year has already been disbursed, this portion may be reclaimed on the basis of corresponding provisions in Management Board contracts **(clawback)**. Variable remuneration will no longer be paid in the event of any threats to the Bank's risk-bearing capacity, sufficient capitalisation or liquidity, or if certain minimum profitability indicators are not achieved.

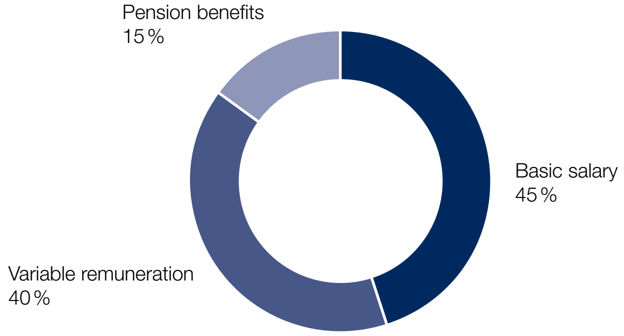
Pursuant to section 25a (5) of the German Banking Act (KWG), the variable remuneration must not exceed the fixed remuneration component for Management Board members, even in the event of maximum target achievement. The option of allowing the Annual General Meeting to approve higher variable remuneration corresponding to up to 200 % of the fixed remuneration component, as set out in section 25a (5) sentence 5 KWG, has not been used for the Management Board members.

The maximum overall target achievement level for determining performance-related, variable remuneration is additionally capped at 150 %. Hence, variable remuneration determined cannot exceed 150 % of the reference level.

The diagram below illustrates the ratio between the fixed and variable components of the remuneration of all members of the Management Board since the 2019 reporting year:

Management Board remuneration structure

%



Fixed remuneration component

The fixed remuneration component of a Management Board member consists of three components – the fixed annual salary, ancillary benefits, and contributions to retirement provisions.

Fixed annual salary

Within Aareal Bank AG's corporate governance system, the members of the Bank's Management Board discharge operative functions in addition to their managerial duties. They prepare and implement strategic objectives in cooperation with their employees. Management Board members are remunerated in line with this comprehensive set of duties.

In order to prevent any motivation for Management Board members to enter into inappropriate risks, in accordance with Aareal Bank Group's risk culture, fixed remuneration accounts for a significant portion of the total remuneration package, which amounts to € 1,425,000 for the Chairman of the Management Board and to € 900,000 for ordinary Management Board members.

Ancillary benefits

Aareal Bank AG provides a company car to Management Board members, which may also be used for private purposes. Management Board members are covered by group accident insurance in case of death or invalidity. In addition, Aareal Bank AG bears the costs incurred for certain security expenses.

Pensions and retirement benefits

The benefit regulations as agreed in the service contract apply to the members of the Management Board. All members of the Management Board are granted a defined contribution commitment:

This amounts to € 464,000 p.a. for the Chairman of the Management Board, € 293,000 p.a. in general for ordinary members of the Management Board and thus accounts for 15 % of the target remuneration structure of the Management Board members.

Management Board members who were appointed prior to 1 January 2013 are entitled to claim pension benefits as of the time at which they turn 60. For members of the Management Board who were appointed on or after 1 January 2013, claims arise as of the time at which they turn 62. In the event of permanent disability, a Management Board member is entitled to claim benefits prior to turning 60 or 62, respectively.

The amounts are subject to a guarantee adjustment of 1 % p.a. The pension paid to widows amounts to 60 % of the pension of the member of the Management Board, while pensions to half-orphans and orphans amount to 10 % and not more than 25 %, respectively.

Performance-related variable remuneration

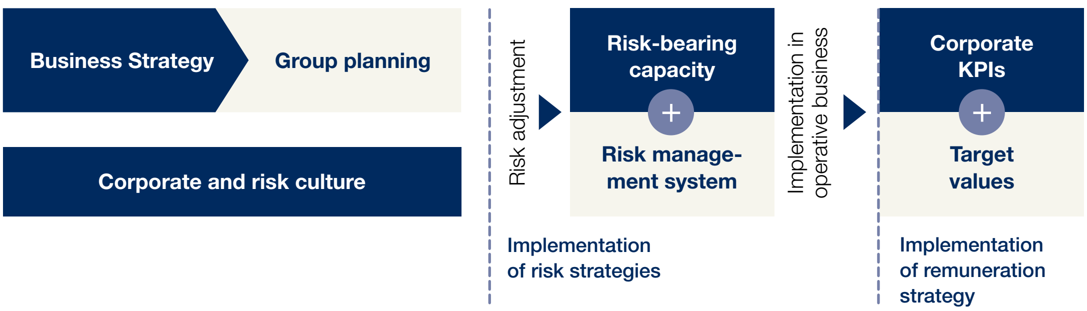
Remuneration and target derivation system

As a matter of principle, Aareal Bank derives remuneration targets from its strategic planning for the following years, which was already verified as to its compatibility with the corporate and risk culture, as well as with the Bank's risk strategies, and adjusted if necessary. Hence, the target parameters (KPIs) derived from the strategy are therefore geared towards the long-term and sustainable development of Aareal Bank Group – as opposed to short-term successes – and are thus aligned with the interests of shareholders, employees and other stakeholders.

Remuneration parameters (ex-ante risk adjustment)

A significant part of Aareal Bank's variable remuneration is governed by law: besides the general requirement – pursuant to the German Public

Derivation of remuneration strategy, indicators, and target values



Limited Companies Act (Aktiengesetz – "AktG") – that the remuneration system be focused on a sustainable company development, sections 19 and 20 of the German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstVergV") require that target achievement be determined on the basis of at least three target levels, and over a minimum assessment period of three years. Accordingly, Aareal Bank AG's remuneration system for the Management Board provides for three target levels of:

- Group performance;
- sectional performance; and
- individual performance.

Target achievement for each target level is determined on the basis of a three-year assessment period.

All targets for Management Board members are geared towards achieving the long-term and sustainable objectives set out in the Bank's business and risk strategies **(pay-for-performance principle)**. To measure and monitor target achievement, KPIs are determined annually for the long-term and sustainable targets, and their degree of achievement is assessed at the end of the financial year. The target achievement level for each target level is thus determined by the respective KPI achievement of the past financial year and by the degrees of KPI achievement of the two previous financial years **(three-year assessment basis)**.

When setting targets, the Supervisory Board pays attention to defining ambitious yet realistic targets, which are in line with Aareal Bank's risk appetite as well as the corporate and risk culture. The targets comprise quantitative and qualitative components, which are also related to non-financial parameters. Annual target achievement is reported on an ex-post basis (cf. Remuneration of the Management Board, subsection Target achievement).

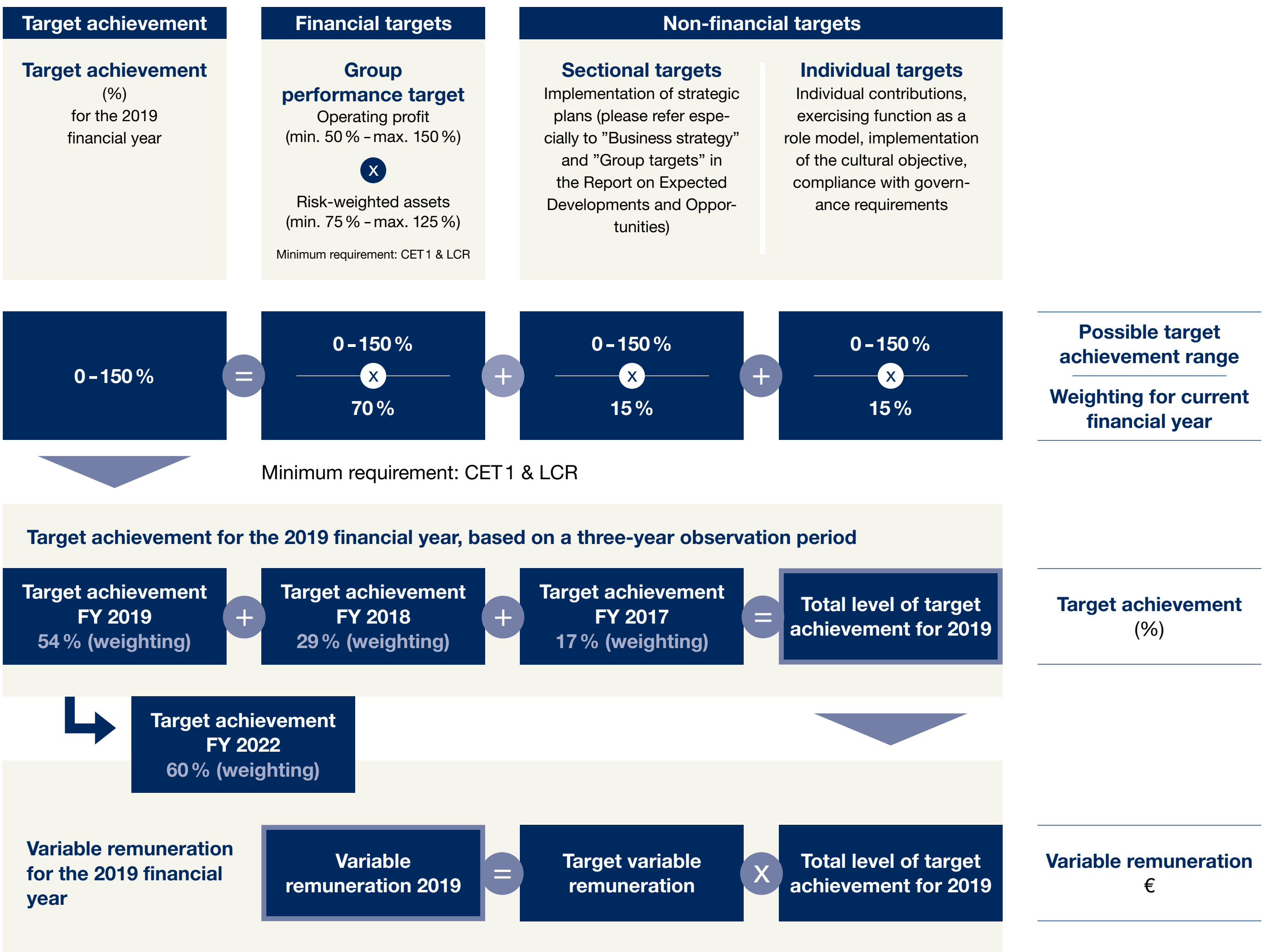
Amongst other things, the Company's interests are duly taken into account by the fact that **Group targets** are geared towards the KPIs used for corporate management purposes. Consolidated operating profit before taxes is generally chosen as an income target, whereas risk-weighted assets (RWAs) are used as a risk-adjusted target. Specific values are determined annually for both target components, which correspond to a 100 per cent target achievement. These targets at least complied with the corporate objectives communicated to the capital markets in the past, and will continue to do so in the future. The maximum achievement level for target consolidated operating profit is 150 %; for the RWA target, it is 125 %. The overall target achievement level is calculated by multiplying both target values; it is capped at a target achievement level of 150 %.

Sectional targets are related to the respective Management Board member's area of responsibility pursuant to the schedule of responsibilities. Accordingly, the Supervisory Board sets targets which the organisational units assigned to the respective Management Board members need to fulfil in order to achieve the strategic objectives of the Company as a whole. These targets may comprise income and budget targets, target values for specific risk indicators, or for implementation of key strategic projects. In line with Aareal Bank Group's management system, sectional targets for Management Board members responsible for Sales units comprise growth enhancement and development of main strategic fields of business and are measured, for example, by the level of specific property portfolio increases or the revenue generated with digital products. In accordance with Aareal Bank Group's risk management system, these income parameters must not exceed the risk appetite as determined by reference to certain limits; hence, there is no incentive to enter into inappropriate risks. Sectional targets for Management Board members responsible for central staff functions or control units are based on other indicators, such as the amount of the administrative expenses. Moreover, within the framework of sectional targets, all members of the Management Board are required to fulfil specific projects in order to implement the Company's strategy – such as projects for the digitalisation of processes and products, and other targets described in the (Group) Management Report (cf. Report on Expected Developments and Opportunities, chapters Business strategy and Group targets).

Individual targets refer to the Management Board members' individual performance; in this respect, Management Board members are required in particular to exercise their function as role models vis-à-vis staff and the general public (tone from the top). They also need to achieve material sustainability aspects, including organisational and cultural measures, contributing to more cooperation and thus to Aareal Bank's efficiency.

The business and risk strategies reflect the sustainability approach pursued by Aareal Bank with specific measures which the Supervisory Board requires the Management Board to implement. Hence, sectional as well as individual targets also include **ESG targets** (environmental, social, governance), which includes taking ESG opportunities, managing and reporting on corresponding risks, and developing specific ESG criteria to be considered in the core business. In its targets, Aareal Bank does not separately reflect compliance with statutory regulations, since adherence to internal and external provisions is deemed to be a necessary condition for confidential cooperation; as such, separate target-setting within the scope of variable remuneration is obsolete. Wilful breaches of internal

Target achievement and variable remuneration for the 2019 financial year under review



and external rules may rather trigger a so-called penalty-triggering event which in turn can lead to variable remuneration no longer being paid at all, or even to an ex-post reduction or clawback of already granted deferred remuneration components.

Performance measurement on individual target levels for the last financial year

The members of the Management Board are responsible – and epitomise – the Company's success. This is also reflected in the **weighting of the target levels.** Accordingly, achieving Group performance targets accounts for the clear majority (70 %) of target achievement. This target level is determined solely on a quantitative basis; performance is therefore calculated based on whether the target value specified by the Supervisory Board for the two components consolidated operating profit before taxes and risk-weighted assets has been achieved.

The other two target levels, the sectional and individual target levels, are weighted at 15% each. Three to four targets are determined per level. As previously described, they are mainly measured against qualitative KPIs, and additional quantitative KPIs only implemented for the Management Board member responsible for Sales units. When assessing the respective KPI, the Supervisory Board does not only simply evaluate whether the target has been achieved, but also whether the performance rendered is in line with the defined corporate and risk culture. In the event that this aspect has a positive or negative influence, the Supervisory Board would disclose it accordingly to the shareholders when talking about target achievement (cf. Remuneration of the Management Board › Target achievement). The following diagram gives a concise overview of performance measurement.

Performance measurement on individual target levels

Target	KPI (FY)	Actual achievement	Assessment	Target achievement level (FY)
Group performance target level				
Cons. operating profit before taxes	quantitative	X %		X %
Risk-weighted assets	quantitative	X %		
Divisional target level (exemplary)				
Growth target	quantitative	X %	Performance in line with the defined corporate and risk culture	X %
ESG target	qualitative	X %		
Strategic project	qualitative	X %		
Individual target (exemplary)				
ESG target	qualitative	X %	Performance in line with the defined corporate and risk culture	X %
Efficiency target	qualitative	X %		

Overall target achievement (3-year measurement)

The principle of multiple-year assessment was applied only to the Group performance targets until 2018, and initially extended to remuneration determined at all target levels for the 2019 financial year. To set ambitious targets and a strong incentive for successful Management Board work, target achievement levels are incorporated at different levels over time. Following a transition period, the most recent reporting year will be weighted at 60 %, the preceding one at 30 %, and the oldest year in the assessment period at 10 %. The transition phase ends with the variable remuneration for the 2021 financial year. With regard to the variable remuneration for the year under review, reporting year 2019 is weighted at 54 %, financial year 2018 with 29 % and financial year 2017 with 17 %.

Deferred disbursement, through retention of variable remuneration components and virtual shares

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is awarded at the end of the financial year, according to the following principles:

- After confirmation of the total target achievement level by the Supervisory Board, 20 % of the variable remuneration are disbursed in cash **(cash bonus).**

- After confirmation of the total target achievement level by the Supervisory Board, a further 20 % of the variable remuneration is granted in the form of virtual shares **(share bonus with holding period)** and forms part of the share bonus plan.

- 30 % of the variable remuneration is retained **(cash deferral),** and disbursed in cash – pro rata temporis – over a five-year deferral period.

- The remaining 30 % of the variable remuneration is credited, as a cash amount, to a virtual account maintained on behalf of each Management Board member, and forms part of the Share Deferral Plan **(share deferral with holding period).**

This means that deferred disbursement applies to 80 % of variable remuneration determined, for up to six years.

Five-year retention period

For the portion of performance-related remuneration that is deferred initially as a cash deferral or a share deferral, the Supervisory Board makes a decision regarding the granting of one fifth of the amount in the five years following the determination of the performance-related remuneration (cf. "Ex-post review of target achievement and behaviour of the Management Board").

Until the end of each respective deferral period, there is no right to the relevant remuneration components. No interest or dividends will accrue. Once the deferred remuneration components for Management Board members are vested, the cash deferral is paid out in cash and the share deferral is converted into virtual shares, subject to a one-year holding period.

Share bonus with holding period

The portion of the performance-related remuneration which is subject to the share bonus plan will be converted into an equivalent number of virtual shares. The calculation of the number of virtual shares is based on the weighted average price on the basis of five (Xetra®) exchange trading days after publication of the preliminary results for the financial year for which the share bonus is granted (subscription price). The date of publication of the preliminary results is used as the reference date.

The virtual shares so determined are posted to a virtual account and are held for one year. They will be converted, automatically and without delay, into a cash amount and disbursed immediately after the Supervisory Board meeting which passes the resolution on the adoption of the annual financial statements for the first financial year following the financial year for which the virtual shares were granted ("holding period"). The conversion will be effected using the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the year preceding the payout.

The payout amount of the share bonus of a given financial year may vary depending on the share price development and has been limited to a maximum of 300 % of the agreed initial value (ceiling).

Share Deferral Plan

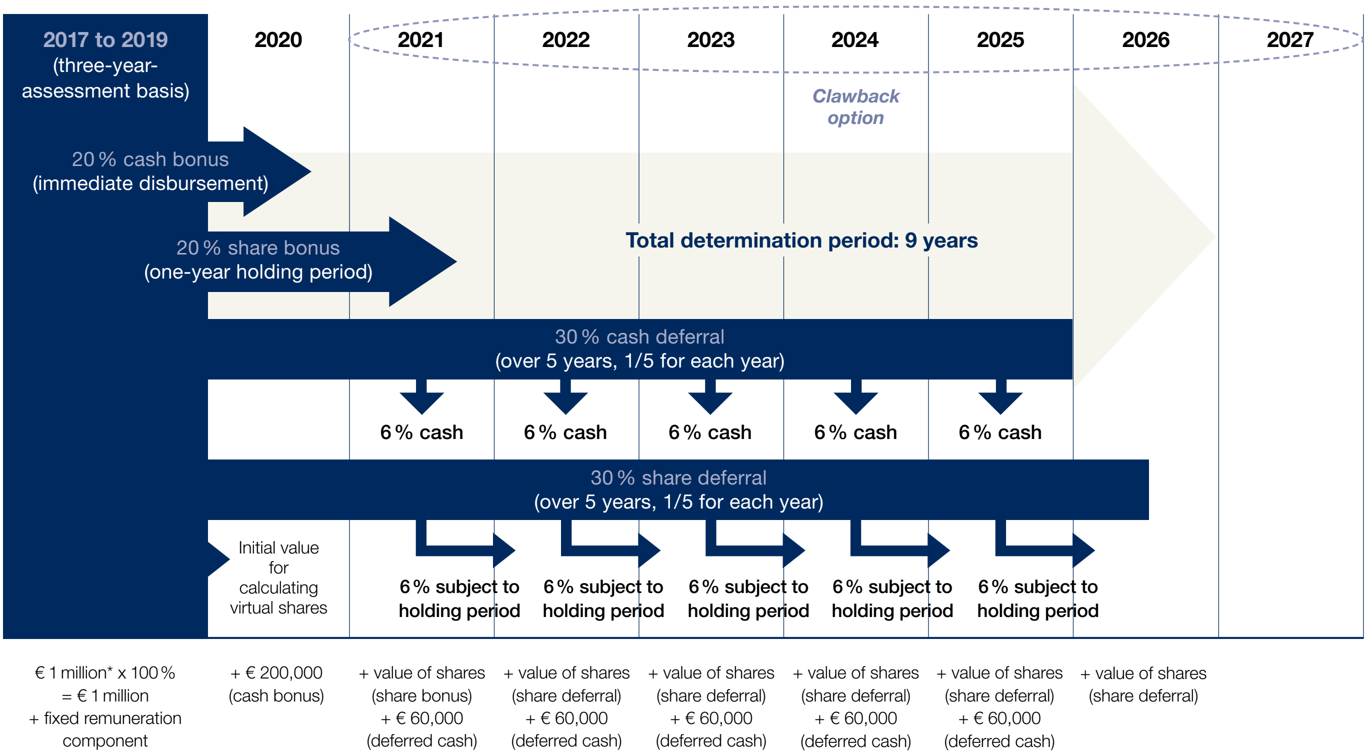
In the five years following determination of performance-related remuneration (deferral period), the Supervisory Board decides whether in each case a fifth of the share deferral should be converted into virtual shares.

The rules of the Share Bonus Plan are applicable to the calculation of the number of virtual shares, subject to the proviso that the weighted average price calculated on the basis of the five (Xetra®) exchange trading days following the publication of the preliminary results for the financial year in respect of which variable remuneration was determined. This is designed to preserve the reference to the original assessment period.

The ceiling value is applicable for the conversion of the virtual shares, with the proviso that the payout amount following the conversion of the virtual shares of a tranche into a cash payment must not exceed 300 % of the share deferral (30 % of the initial value of performance-related remuneration)

Sample disbursement methodology, based on 100 % target achievement for the 2019 financial year

The Supervisory Board regularly examines, at the beginning of each year and prior to disbursement or conversion into virtual shares, whether the original target achievement still applies, and whether a penalty-triggering event has occurred which requires reduction or clawback of variable remuneration.



*For the sake of simplicity of this sample presentation, variable remuneration for a 100 % target achievement level was set to a notional value of € 1 million.

set for the financial year in question (which may have been reduced following the application of a penalty rule or as a result of an instruction by BaFin).

Ex-post review of target achievement and behaviour of the Management Board

Backtesting regarding retained remuneration components

Before the Supervisory Board decides on conversion or disbursement of retained remuneration components, it reviews whether the target achievement level originally agreed upon is still held to be correctly determined, based on current knowledge. For example, where an indicator used to determine remuneration needs to be adjusted ex-post, this can also reduce the variable remuneration determined – and hence, result in a reduction in the amount retained. If it turns out, at a later date, that a project did not achieve the objectives on which the original remuneration calculation was based, then the variable remuneration can also be reduced ex-post.

Penalty review

When determining variable remuneration, as well as prior to every disbursement of cash components or conversion into virtual shares, the Supervisory Board verifies whether there are any reasons, besides the achievement of targets, for reducing variable remuneration, possibly to zero.

Such **penalty-triggering events** include inappropriate behaviour, behaviour in breach of duties, or negative performance contributions of Management Board members, which cannot be offset through positive performance contributions at other levels. For example, wilful breaches of the Code of Conduct, the corporate values determined therein and/or internal and/or external rules, conduct that damages the Bank's reputation, or other misconduct may give rise to a penalty. If any retained performance-related remuneration components are not awarded, or only in part, the remaining sum is forfeited, i. e. it is not carried forward into subsequent years. In the case of **negative performance** contributions in the form of significant losses or material regulatory sanctions, variable remuneration must be reduced to zero.

Clawbacks

Starting with variable remuneration for the 2018 financial year, agreements with Management Board members ensure that any variable remuneration already disbursed must be reclaimed in the event of negative performance contributions (penalty review).

Restrictions and additional provisions

Impact of special external conditions (modifiers)

The Supervisory Board is entitled to increase or decrease the level of target achievement for the Group component by up to 20 percentage points (a so-called modifier) in the event of unforeseeable changes to the economic environment which are beyond the Management Board's influence or control (i. e. only on the basis of external conditions). This will not affect the restrictions set out below, especially the 150 % cap, which cannot be circumvented by the modifier.

Hedging ban

The contracts of Management Board members prohibit them from undertaking to limit or override the risk orientation of their remuneration by initiating personal protection or countermeasures (hedging ban).

Additional constraints regarding target achievement

For the purpose of additional risk adjustment, for each financial year, the Supervisory Board sets lower thresholds in order to secure adherence of the regulatory capital adequacy and liquidity (Liquidity Coverage Ratio – LCR). For capital adequacy, this comprises a target ratio for Common Equity Tier 1 capital (CET 1 ratio), for liquidity the adherence to the statutory Liquidity Coverage Ratio (LCR). No variable remuneration will be determined for any financial year where any of these two targets has not been achieved.

Risk-bearing capacity and parallel interest with shareholders

To preserve the Company's continued survival (and hence, shareholders' investment), variable remuneration is generally subject to a review performed by the Supervisory Board pursuant to section 7 of the InstVergV. This review is based on the Recovery Plan (which is mandatory for Aareal Bank as a significant institution) and the thresholds defined therein. These thresholds include achieving minimum profitability indicators such as the return on equity. In the event of these so-called "early warning thresholds" being reached, the Supervisory Board will decide, in its reasonable discretion, whether variable remuneration for the Management Board needs to be reduced. The total amount of variable remuneration is set to zero if Aareal Bank's risk-bearing capacity is no longer sufficiently ensured. In addition, pursuant to section 45 (2) sentence 1 no. 5a KWG, the German Federal Financial Supervisory Authority (BaFin) may impose further conditions or restrictions, or may instruct that the total amount of variable remuneration be cancelled.

Rules governing severance pay

The agreements concluded with members of the Management Board do not include any obligation to make severance payments in cases involving the early termination of employment relationships **(rescission of the agreement without good cause).** However, severance payments may be included in individual termination agreements, provided that these are specified in accordance with regulatory requirements, in particular with the InstVergV. The agreements concluded with members of the Management Board state that, in the event of the premature termination of their term on the Management Board without good cause, payments, including ancillary benefits, made to the Management Board member in question must not exceed twice the annual remuneration (severance cap) and must not constitute remuneration for more than the remaining term of the employment contract.

In the case of a compulsory loss of a Management Board position **(change of control),** the Management Board members are to be paid the fixed remuneration component, the performance-based remuneration, as well as the contractually agreed benefits for the remainder of the term of the contract. The performance-related remuneration is subject to the above-mentioned conditions; that is, in particular the deferral periods, the holding periods and the penalty rules are applicable.

In addition, the extent to which sectional and individual targets were achieved on average during the last three years prior to the termination of the Management Board position will be used as a basis to determine the target achievement level for the remaining term of the contract. In the case of a voluntary termination of the Management Board position following a change of control, the members of the Management Board merely receive the fixed remuneration and the contractually agreed benefits for the remainder of the contractual term. In this case, there is no entitlement to the variable remuneration component.

The total amount of payments in the case of termination due to a change of control is limited to 150% of the severance cap of an employment contract.

Newcomer rule

The Supervisory Board intends to remunerate newly-appointed members who have not previously held a position on the Management Board of a comparable institution in line with an entry level of 80% of fixed and variable remuneration for ordinary members of the Management Board, reflecting lack of experience. If the Management Board member is re-appointed, the Supervisory Board will also decide upon the potential increase of remuneration to the normal level. However, since the Supervisory Board decided upon the specific selection as well as remuneration of individual Management Board members, within its reasonable discretion, and taking the Company's specific needs into account, it is possible to diverge from this rule.

When implementing the InstVergV, as amended on 3 July 2017, the Supervisory Board decided to only gradually build up the three-year assessment period; in the Supervisory Board's view, newly-appointed members of the Management Board should not be held accountable for past developments. In accordance with the regulatory requirements pursuant to the InstVergV, the deferral period is extended for periods with a shortened assessment period. Hence, for the first year, the assessment period is only one year, with the deferral period extended from five to seven years. For the second year, the assessment period is extended to two years and the deferral period shortened to six years. The remuneration system for the Management Board will be applied, as provided, from the third year onwards.

Annual examination of appropriateness

The Supervisory Board regularly (at least annually) checks, whether Management Board and employee remuneration is appropriate (cf. remuneration governance). To evaluate whether the Management Board's specific total remuneration is in line with common practice/that of other companies, the Supervisory Board has set two comparison groups. The companies are selected based on Aareal Bank's market position (particularly sector, size, country). Therefore, the comparison groups are MDAX companies and banks of a similar size.

Remuneration of the Management Board

Measures in the 2019 financial year

Remuneration increase for two Management Board members

In the 2019 financial year, the two ordinary Management Board members Christiane Kunisch-Wolff and Christof Winkelmann began their second term of office as Management Board members. Since they had previously both been subject to the newcomers rule, their remuneration was correspondingly increased with effect from their second term of office.

Realignment of the total remuneration structure

As mentioned above, the Supervisory Board has decided to realign the remuneration structure for Management Board members as of 2019; as such, basic remuneration will account for 45 %, retirement benefits for 15 %, and variable remuneration for 40 % of total target remuneration. Within the scope of these changes, the fixed remuneration elements were increased for all members of the Management Board, whilst their target variable remuneration elements were lowered. No total target remuneration change was associated with these amendments.

Target achievement in the 2019 financial year

Target achievement

The assessment of the single targets regarding variable remuneration in the year under review yielded the following results.

Group performance targets 2019

As mentioned, consolidated operating profit (as communicated to shareholders) and a target

%		Hermann J. Merkens	Marc Hess[1]	Dagmar Knopek	Christiane Kunisch-Wolff	Thomas Ortmanns	Christof Winkelmann
2019	**Overall Bank performance**			**100.0**			
	Sectional targets	100.0	100.0	100.0	100.0	100.0	100.0
	Individual targets	110.0	110.0	100.0	100.0	100.0	110.0
Overall target achievement for 2019, based on a three-year observation period		**103.1**	**101.1**	**100.4**	**102.2**	**102.1**	**103.3**
Amount of variable remuneration (€)		**1,289,126**	**788,190**	**783,354**	**768,770**	**796,224**	**733,882**

[1] Given that Mr Hess joined the Bank in 2018, no target achievement levels for the year 2017 are considered in his case.

value for RWAs were chosen as income targets, both of which boasted 100 % target achievement.

Sectional and individual targets 2019

Notwithstanding the Management Board's overall responsibility for the Bank's management, specific sectional and individual targets were agreed upon for each Management Board member. Whilst the individual targets reflect especially the individual contributions of each Management Board member, the sectional targets are meant to reflect the target achievement of the respective Management Board member's area of responsibility. Thus, the strategic initiatives and measures defined and implemented in the respective area of responsibility are the main basis for determining sectional targets. Furthermore, various ESG targets (derived from the business strategy) have been agreed upon on both levels.

Within the scope of their sectional and individual targets, all Management Board members were required to interlink the different processes in their areas of responsibility to an even greater extent (for Mr Merkens, e. g., the even more efficient interlinking of strategy and risk processes), to adhere to cost plans, and to promote the risk and corporate culture. The latter was reviewed within the course of a broad-based employee survey conducted in 2019, leading to measures aimed at promoting the Bank's risk and corporate culture. Implementation of these measures shall be reviewed within the scope of the individual targets 2020.

Apart from that, the following sectional and/or individual targets were defined for the individual Management Board members:

Hermann-Josef Merkens

Mr Merkens' targets include: increasing flexibility and efficiency of the Group organisation, improving the statement of financial position and strengthening equity, whilst expanding the business along the strategic benchmark, strengthening and developing the Aareal 2020 strategy, and preparing the strategic programme following Aareal 2020. The latter was achieved through "Aareal Next Level".

Marc Hess

Mr Hess' sectional and individual targets included integrating Düsseldorfer Hypothekenbank AG (now DHB Verwaltungs AG) – achieved during the year –, developing the concept for and implementing the process to select a new external auditor to be proposed to the Annual General Meeting (appointment to review, if applicable, the first-quarter interim financial information 2021), and adjusting the funding mix.

Christiane Kunisch-Wolff

Ms Kunisch-Wolff's targets comprised achieving closer links with supervisory authorities, optimising risk management-related management impulses relevant to the Group, and setting up Aareal Bank to anticipate (and plan in a timely manner) future and existing requirements, including the implementation of core regulatory projects.

Dagmar Knopek

Ms Knopek targeted the reduction of the NPL portfolio and the promotion of digitalisation initiatives in her area of responsibility.

Thomas Ortmanns

Mr Ortmanns' targets concerned, among other things, implementing the digitalisation strategy, measures to expand the commission-based business in the housing industry, improving Aareon's results, and managing the implementation of various IT projects.

Christof Winkelmann

Mr Winkelmann's sectional targets included implementing the business plan in the business division he is responsible for, and further improving the syndication process. These targets were measured, among other things, by considering specific country or property type portfolio volumes.

No penalty-triggering events

In addition, compliance with governance provisions, i. e., with internal and external rules, as well as with the corporate values determined in Aareal Bank Group's Code of Conduct, is assessed within the scope of the annual penalty review. However, no such penalty-triggering events were found.

Total remuneration

In accordance with German commercial law in conjunction with GAS 17, the following table shows fixed and other remuneration for members of the Management Board, variable remuneration determined for the respective financial year (total amount, plus a breakdown into its components), as well as the total target achievement levels, as determined by the Supervisory Board.

No benefits were granted to any member of the Management Board by third parties with respect to his/her Management Board activities during the year under review. Payments to former Management Board members of Aareal Bank AG and their surviving dependants totalled € 2 million (2018: € 3 million).

(Virtual) shareholdings of Management Board members and share-based remuneration

Within Aareal Bank's remuneration system for Management Board members, the reference value for 100 % target achievement is slightly below the respective basic salary. Given that 50 % of variable remuneration is disbursed in the form of virtual shares, Management Board members typically earn virtual shares amounting to more than 100 % of their fixed annual salary at the latest after three years of service, provided that they also earn variable remuneration in subsequent years, the equivalent value of the virtual shares will not fall below this 100 % threshold until the end of their term on the Management Board.

The table on page 102 shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2019 and 2018, respectively – as well as the number of virtual shares already held as at the reporting date.

	Current year	Fixed remuneration	Variable remuneration						Ancillary benefits	Total remuneration
			Cash component		Share-based component		Target achievement level[2]	Total		
€			Cash bonus	Cash-deferral[1]	Share bonus	Share deferral[1]				
Hermann J. Merkens	2019	1,425,000	257,825	386,738	257,825	386,738	103.1 %	1,289,126	36,079	2,750,205
	2018	1,300,000	304,248	456,372	304,248	456,372	108.7 %	1,521,240	34,024	2,855,264
Marc Hess[3]	2019	900,000	157,638	236,457	157,638	236,457	101.1 %	788,190	39,855	1,728,045
	2018	220,000	40,329	60,493	40,329	60,493	100.0 %	201,644	3,244	424,888
Dagmar Knopek	2019	900,000	156,671	235,006	156,671	235,006	100.4 %	783,354	56,012	1,739,366
	2018	880,000	164,256	246,384	164,256	246,384	102.7 %	821,280	19,598	1,720,878
Christiane Kunisch-Wolff	2019	859,957	153,754	230,631	153,754	230,631	102.2 %	768,770	34,797	1,663,524
	2018	704,000	139,085	208,627	139,085	208,627	108.7 %	695,424	25,466	1,424,890
Thomas Ortmanns	2019	900,000	159,245	238,867	159,245	238,867	102.1 %	796,224	40,678	1,736,902
	2018	880,000	173,856	260,784	173,856	260,784	108.7 %	869,280	18,504	1,767,784
Christof Winkelmann	2019	802,000	146,776	220,165	146,776	220,165	103.3 %	733,882	38,245	1,574,127
	2018	704,000	139,085	208,627	139,085	208,627	108.7 %	695,424	70,329	1,469,753
Total	**2019**	**5,786,957**	**1,031,909**	**1,547,864**	**1,031,909**	**1,547,864**	**102.1 %**	**5,159,546**	**245,666**	**11,192,169**
	2018	**4,688,000**	**960,859**	**1,441,287**	**960,859**	**1,441,287**	**107.2 %**	**4,804,292**	**171,165**	**9,663,457**

[1] The deferrals shown are subject to the criteria on retention of variable remuneration components and penalty criteria, as set out above.
[2] 2018: excluding the positive non-recurring effect (negative goodwill) from the acquisition of former Düsselhyp
[3] Marc Hess was appointed to the Management Board on 1 October 2018.

	Year	Share-based payment Value (€)	Share-based payment Quantity (number)[1]	Total quantity of virtual shares held (31 December) Quantity (number)
Hermann J. Merkens	2019	644,563	21,308	58,753
	2018	760,620	28,182	55,340
Mark Hess[2]	2019	394,095	13,028	1,405
	2018	100,822	3,736	–
Dagmar Knopek	2019	391,677	12,948	35,689
	2018	410,640	15,215	36,772
Christiane Kunisch-Wolff	2019	384,385	12,707	18,504
	2018	347,712	12,883	9,726
Thomas Ortmanns	2019	398,112	13,161	35,942
	2018	434,640	16,104	38,112
Christof Winkelmann	2019	366,941	12,130	15,751
	2018	347,712	12,883	7,659
Gesamt	**2019**			**166,044**
	2018			**147,609**

[1] The stated number of virtual shares granted for 2019 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2019 (€ 30.25). The final conversion rate may only be determined after publication of preliminary results for 2019. The stated number of virtual shares granted for 2018 differs slightly from the previous year's figure since the former was calculated using a final conversion rate of € 28.71.
[2] Marc Hess was appointed to the Management Board on 1 October 2018.

Target remuneration granted

The following table shows the target remuneration (fixed annual salary and variable remuneration based on a 100 % target achievement) for the year under review, in accordance with articles 4.2.4 and 4.2.5 of the German Corporate Governance Code:

Remuneration granted	Hermann J. Merkens – Chairman of the Management Board			
€	2018	2019	2019 (min)[1]	2019 (max)[2]
Fixed remuneration	1,300,000	1,425,000	1,425,000	1,425,000
Ancillary benefits	34,024	36,079	36,079	36,079
Total	**1,334,024**	**1,461,079**	**1,461,079**	**1,461,079**
One-year variable remuneration	280,000	250,000	–	375,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	420,000	–	–	–
Share bonus 2018 (March 2019)	280,000	–	–	–
Share deferral 2018 (March 2024)	420,000	–	–	–
Cash deferral 2019 (March 2025)	–	375,000	–	562,000
Share bonus 2019 (March 2020)	–	250,000	–	375,000
Share deferral 2019 (March 2025)	–	375,000	–	562,000
Total	**1,400,000**	**1,250,000**	**–**	**1,874,000**
Benefit expense	847,178	2,297,353	2,297,353	2,297,353
Total remuneration	**3,581,202**	**5,008,432**	**3,758,432**	**5,632,432**

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review

Remuneration granted	Mark Hess[3]			
	2018	2019	2019 (min)[1]	2019 (max)[2]
€				
Fixed remuneration	220,000	900,000	900,000	900,000
Ancillary benefits	3,244	39,855	39,855	39,855
Total	**223,244**	**939,855**	**939,855**	**939,855**
One-year variable remuneration	40,329	156,000	–	234,000
Multi-year variable remuneration				–
Cash deferral 2018 (March 2026)	60,493	–	–	–
Share bonus 2018 (March 2019)	40,329	–	–	–
Share deferral 2018 (March 2026)	60,493	–	–	–
Cash deferral 2019 (March 2026)	–	234,000	–	351,000
Share bonus 2019 (March 2020)	–	156,000	–	234,000
Share deferral 2019 (March 2026)	–	234,000	–	351,000
Total	**201,644**	**780,000**	**–**	**1,170,000**
Benefit expense	148,056	754,139	754,139	754,139
Total remuneration	**572,944**	**2,473,994**	**1,693,994**	**2,863,994**

Remuneration granted	Dagmar Knopek			
	2018	2019	2019 (min)[1]	2019 (max)[2]
€				
Fixed remuneration	880,000	900,000	900,000	900,000
Ancillary benefits	19,598	56,012	56,012	56,012
Total	**899,598**	**956,012**	**956,012**	**956,012**
One-year variable remuneration	160,000	156,000	–	234,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	240,000	–	–	–
Share bonus 2018 (March 2019)	160,000	–	–	–
Share deferral 2018 (March 2024)	240,000	–	–	–
Cash deferral 2019 (March 2025)	–	234,000	–	351,000
Share bonus 2019 (March 2020)	–	156,000	–	234,000
Share deferral 2019 (March 2025)	–	234,000	–	351,000
Total	**800,000**	**780,000**	**–**	**1,170,000**
Benefit expense	488,691	780,217	780,217	780,217
Total remuneration	**2,188,289**	**2,516,229**	**1,736,229**	**2,906,229**

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review
[3] Marc Hess was appointed to the Management Board on 1 October 2018.

Remuneration granted	**Christiane Kunisch-Wolff**			
	2018	**2019**	**2019 (min)[1]**	**2019 (max)[2]**
€				
Fixed remuneration	704,000	859,957	859,957	859,957
Ancillary benefits	25,466	34,797	34,797	34,797
Total	**729,466**	**894,754**	**894,754**	**894,754**
One-year variable remuneration	128,000	150,400	–	225,600
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	192,000	–	–	–
Share bonus 2018 (March 2019)	128,000	–	–	–
Share deferral 2018 (March 2024)	192,000	–	–	–
Cash deferral 2019 (March 2025)	–	225,600	–	338,400
Share bonus 2019 (March 2020)	–	150,400	–	225,600
Share deferral 2019 (March 2025)	–	225,600	–	338,400
Total	**640,000**	**752,000**	**–**	**1,128,000**
Benefit expense	422,142	826,324	826,324	826,324
Total remuneration	**1,791,608**	**2,473,078**	**1,721,078**	**2,849,078**

Remuneration granted	**Thomas Ortmanns**			
	2018	**2019**	**2019 (min)[1]**	**2019 (max)[2]**
€				
Fixed remuneration	880,000	900,000	900,000	900,000
Ancillary benefits	18,504	40,678	40,678	40,678
Total	**898,504**	**940,678**	**940,678**	**940,678**
One-year variable remuneration	160,000	156,000	–	234,000
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	240,000	–	–	–
Share bonus 2018 (March 2019)	160,000	–	–	–
Share deferral 2018 (March 2024)	240,000	–	–	–
Cash deferral 2019 (March 2025)	–	234,000	–	351,000
Share bonus 2019 (March 2020)	–	156,000	–	234,000
Share deferral 2019 (March 2025)	–	234,000	–	351,000
Total	**800,000**	**780,000**	**–**	**1,170,000**
Benefit expense	621,605	1,610,588	1,610,588	1,610,588
Total remuneration	**2,320,109**	**3,331,266**	**2,551,266**	**3,721,266**

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review

Remuneration granted	Christof Winkelmann			
	2018	2019	2019 (min)[1]	2019 (max)[2]
€				
Fixed remuneration	704,000	802,000	802,000	802,000
Ancillary benefits	70,329	38,245	38,245	38,245
Total	**774,329**	**840,245**	**840,245**	**840,245**
One-year variable remuneration	128,000	142,115	–	213,173
Multi-year variable remuneration				
Cash deferral 2018 (March 2024)	192,000	–	–	–
Share bonus 2018 (March 2019)	128,000	–	–	–
Share deferral 2018 (March 2024)	192,000	–	–	–
Cash deferral 2019 (March 2025)	–	213,173	–	319,759
Share bonus 2019 (March 2020)	–	142,115	–	213,173
Share deferral 2019 (March 2025)	–	213,173	–	319,759
Total	**640,000**	**710,576**	**–**	**1,065,864**
Benefit expense	498,191	1,435,786	1,435,786	1,435,786
Total remuneration	**1,912,520**	**2,986,607**	**2,276,031**	**3,341,895**

[1] Minimum amount of the remuneration component granted in the year under review
[2] Maximum amount of the remuneration component granted in the year under review

Remuneration paid

The following table shows the remuneration disbursed in the year under review, as defined in sections 4.2.4 and 4.2.5 of the German Corporate Governance Code. It also outlines disbursements under variable remuneration components related to multiple years which expired during the year under review:

Remuneration paid	Hermann J. Merkens Chairman of the Management Board		Marc Hess[1]		Dagmar Knopek		Christiane Kunisch-Wolff	
	2019	2018	2019	2018	2019	2018	2019	2018
€								
Fixed remuneration	1,425,000	1,300,000	900,000	220,000	900,000	880,000	859,957	704,000
Ancillary benefits	36,079	34,024	39,855	3,244	56,012	19,598	34,797	25,466
Total	**1,461,079**	**1,334,024**	**939,855**	**223,244**	**956,012**	**899,598**	**894,754**	**729,466**
One-year variable remuneration	304,248	343,994	40,329	–	164,256	196,568	139,085	157,254
Multi-year variable remuneration	–	–	–	–	–	–	–	–
Cash deferral 2014 (April 2018)	–	103,957	–	–	–	103,711	–	–
Cash deferral 2015 (April 2018)	–	151,605	–	–	–	107,621	–	–
Cash deferral 2016 (April 2018)	–	189,653	–	–	–	106,606	–	67,939
Share bonus 2014 (April 2018)	–	199,945	–	–	–	199,471	–	–
Share deferral 2012 (April 2018)	–	249,699	–	–	–	–	–	–
Share deferral 2013 (April 2018)	–	135,779	–	–	–	79,204	–	–
Share deferral 2014 (April 2018)	–	100,872	–	–	–	100,633	–	–
Cash deferral 2015 (April 2019)	152,530	–	–	–	108,278	–	–	–

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[1] Marc Hess was appointed to the Management Board on 1 October 2018.

Remuneration paid	**Hermann J. Merkens Chairman of the Management Board**		**Marc Hess[1]**		**Dagmar Knopek**		**Christiane Kunisch-Wolff**	
	2019	**2018**	**2019**	**2018**	**2019**	**2018**	**2019**	**2018**
€								
Cash deferral 2016 (April 2019)	190,450	–	–	–	107,054	–	68,224	–
Cash deferral 2017 (April 2019)	172,613	–	–	–	98,638	–	78,910	–
Share bonus 2015 (April 2019)	312,384	–	–	–	221,754	–	–	–
Share deferral 2013 (April 2019)	101,264	–	–	–	59,071	–	–	–
Share deferral 2014 (April 2019)	74,734	–	–	–	74,557	–	–	–
Share deferral 2015 (April 2019)	157,145	–	–	–	111,553	–	–	–
Dividends	128,964	138,349	2,950	–	78,046	91,929	41,361	24,316
Total	**1,594,332**	**1,613,853**	**43,279**	**–**	**1,023,207**	**985,743**	**327,580**	**249,509**
Benefit expense	2,297,353	847,178	754,139	148,056	780,217	488,691	826,324	422,142
Total remuneration	**5,352,764**	**3,795,055**	**1,737,273**	**371,300**	**2,759,436**	**2,374,032**	**2,048,658**	**1,401,117**

Remuneration paid	**Thomas Ortmanns**		**Christof Winkelmann**		**Dr Wolf Schumacher[2]**		**Dirk Große Wördemann[3]**	
	2019	**2018**	**2019**	**2018**	**2019**	**2018**	**2019**	**2018**
€								
Fixed remuneration	900,000	880,000	802,000	704,000	–	–	–	–
Ancillary benefits	40,678	18,504	38,245	70,329	–	–	–	–
Total	**940,678**	**898,504**	**840,245**	**774,329**	**–**	**–**	**–**	**–**
One-year variable remuneration	173,856	194,168	139,085	159,174	–	–	–	–
Multi-year variable remuneration	–	–	–	–	–	–	–	–
Cash deferral 2014 (April 2018)	–	103,135	–	–	–	181,493	–	–
Cash deferral 2015 (April 2018)	–	106,973	–	–	–	139,658	–	–
Cash deferral 2016 (April 2018)	–	107,249	–	42,739	–	–	–	–
Share bonus 2014 (April 2018)	–	198,365	–	–	–	349,075	–	–
Share deferral 2012 (April 2018)	–	249,699	–	–	–	421,271	–	202,720
Share deferral 2013 (April 2018)	–	135,779	–	–	–	229,075	–	–
Share deferral 2014 (April 2018)	–	100,075	–	–	–	176,108	–	–
Cash deferral 2015 (April 2019)	107,626	–	–	–	140,510	–	–	–
Cash deferral 2016 (April 2019)	107,669	–	42,918	–	–	–	–	–
Cash deferral 2017 (April 2019)	97,434	–	79,874	–	–	–	–	–
Share bonus 2015 (April 2019)	220,419	–	–	–	287,767	–	–	–
Share deferral 2013 (April 2019)	101,264	–	–	–	170,844	–	–	–
Share deferral 2014 (April 2019)	74,144	–	–	–	130,475	–	–	–
Share deferral 2015 (April 2019)	110,882	–	–	–	144,761	–	–	–
Dividends	78,565	95,279	35,240	19,149	31,001	88,048	–	–
Total	**1,071,859**	**1,290,722**	**297,117**	**221,062**	**905,358**	**1,584,728**	**–**	**202,720**
Benefit expense	1,610,588	621,605	1,435,786	498,191	–	–	–	–
Total remuneration	**3,623,125**	**2,810,831**	**2,573,148**	**1,493,582**	**905,358**	**1,584,728**	**–**	**202,720**

[1] Marc Hess was appointed to the Management Board on 1 October 2018.
[2] Dr Wolf Schumacher resigned with effect from 30 September 2015.
[3] Dirk Große Wördemann resigned with effect from 31 May 2013.

Pensions

€ 000's	2019 Pension claims p.a.[1]	2019 Balance of pension obligations (IFRS) as at 31 Dec 2019	2019 Increase of pension obligations (IFRS) in 2019	2018 Pension claims p.a.[1]	2018 Balance of pension obligations (IFRS) as at 31 Dec 2018	2018 Increase of pension obligations (IFRS) in 2018
Hermann J. Merkens	371	9,567	2,297	345	7,270	847
Marc Hess[2]	35	902	754	7	148	148
Dagmar Knopek	127	3,290	780	110	2,510	489
Christiane Kunisch-Wolff	75	1,998	826	54	1,172	422
Thomas Ortmanns	294	7,967	1,610	284	6,357	622
Christof Winkelmann	92	2,664	1,436	65	1,228	498
Total	**994**	**26,388**	**7,703**	**865**	**18,685**	**3,026**

[1] The pension claims mentioned refer to old-age pension earned as at 31 December of the year under review, based on the Company's contributions, if retired at the pertinent retirement age. To enhance comparability with other disclosures, the overview in the year under review and the previous-year figures were adjusted.
[2] Marc Hess was appointed to the Management Board on 1 October 2018.

Service cost (in accordance with IFRSs) incurred in the 2019 financial year in connection with the pension claims of members of the Management Board totalled € 3.6 million (2018: € 2.7 million). The pension obligations for current members of the Management Board as well as for former members of the Management Board and their surviving dependants increased by € 10.3 million in the year under review (2018: € 2.8 million). The stronger increase in pension obligations year-on-year is mainly due to the significantly lower imputed rate of interest. The total amount of pension obligations was € 61.8 million (2018: € 51.5 million). Of that amount, € 35.4 million related to former members of the Management Board and their surviving dependants (2018: € 32.8 million).

Remuneration system for members of the Supervisory Board

Remuneration for the services of the Supervisory Board members is specified in Article 9 of the Memorandum and Articles of Association of Aareal Bank AG. Remuneration for the services of the Supervisory Board members comprises exclusively fixed remuneration, plus an attendance fee. Where membership in the Supervisory Board falls short of an entire financial year, said remuneration shall be paid on a pro rata temporis basis. Furthermore, the Supervisory Board members will be reimbursed for their expenses. Any value-added tax invoiced will also be deemed to be a refundable expense.

Remuneration of the Supervisory Board comprises the following (p. 108).

The remuneration for any financial year shall be due and payable one month after the end of the respective financial year.

Remuneration element	Description	Structure
Fixed remuneration	Remuneration for activities in the Supervisory Board; Depending on the role of the respective Supervisory Board member (e.g. Chairman)	– € 50,000 p.a. per Supervisory Board member – € 150,000 p.a. for the Chairman – € 75,000 p.a. for the Deputy Chairman
Committee remuneration	Remuneration for activities and duties on the Supervisory Board committees also depends on the role of the respective Supervisory Board member in the respective committee (e.g. a committee chairman)	– € 20,000 p.a. each for membership in the Risk Committee and/or the Audit Committee – € 40,000 p.a. each for the chairmanship in the two committees – € 15,000 p.a. each for membership in other committees – € 30,000 p.a. each for the chairmanship in other committees
Attendance fees	Remuneration for participation in Supervisory Board meetings and on the committees of the Supervisory Board	– € 1,000 per meeting

Supervisory Board remuneration

€	Year	Fixed remuneration	Attendance fees	Total remuneration
Marija Korsch Chairman	2019	265,000	37,000	302,000
	2018	265,000	36,000	301,000
Prof. Dr Stephan Schüller Deputy Chairman	2019	125,000	23,000	148,000
	2018	125,000	27,000	152,000
Klaus Novatius Deputy Chairman (since 1 January 2019)	2019	105,000	21,000	126,000
	2018	–	–	–
Dieter Kirsch, Deputy Chairman (31 March to 31 December 2018)	2019	–	–	–
	2018	100,000	20,000	120,000
York-Detlef Bülow Deputy Chairman (until 31 March 2018)	2019	–	–	–
	2018	31,250	9,000	40,250
Thomas Hawel	2019	65,000	13,000	78,000
	2018	65,000	12,000	77,000
Petra Heinemann-Specht (since 1 April 2018)	2019	70,000	15,000	85,000
	2018	52,500	10,000	62,500
Richard Peters	2019	100,000	25,000	125,000
	2018	100,000	23,000	123,000
Dr Hans-Werner Rhein	2019	85,000	21,000	106,000
	2018	85,000	16,000	101,000
Sylvia Seignette	2019	90,000	15,000	105,000
	2018	90,000	13,000	103,000
Elisabeth Stheeman[1)]	2019	85,000	19,000	104,000
	2018	85,000	17,000	102,000
Hans-Dietrich Voigtländer	2019	115,000	25,000	140,000
	2018	115,000	26,000	141,000

1) Income tax plus solidarity surcharge for the Supervisory Board member subject to limited tax liability was declared pursuant to section 50a (1) no. 4 of the German Income Tax Act (Einkommensteuergesetz – "EStG"), and paid to the German Central Tax Offfice (Bundeszentralamt für Steuern, BZSt).

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€	Year	Fixed remuneration	Attendance fees	Total remuneration
Prof. Dr Hermann Wagner	2019	110,000	21,000	131,000
	2018	110,000	19,000	129,000
Beate Wollmann	2019	70,000	15,000	85,000
	2018	65,000	12,000	77,000
Total	**2019**	**1,285,000**	**250,000**	**1,535,000**
	2018	**1,288,750**	**240,000**	**1,528,750**

Remuneration system for employees

When it comes to the structure of the remuneration system for employees, a general distinction is made between three groups of employees. First of all, Aareal Bank has employees whose remuneration is governed by collective agreements. Then, there are employees whose remuneration is not governed by collective agreements. These employees who are not covered by collective agreements are then split into two further groups. First, there are those employees whose duties have a material impact on the overall risk profile of Aareal Bank (risk takers) or of Aareal Bank Group (Group risk takers). The variable remuneration paid to these "risk takers" is subject to very stringent regulatory requirements. The other employees who are not covered by collective agreements and are not risk takers either are not subject to these provisions and make up the third group.

The report below starts by explaining the remuneration system for risk takers and then addresses the differences compared with the other groups.

Remuneration system for risk takers

In order to identify those employees who are classed as "risk takers", Aareal Bank carries out an annual independent risk analysis, identifying the employees in question based on a uniform set of criteria whilst taking regulatory requirements into account.

The remuneration system for risk takers is subject to the same basic conditions as the remuneration system for Management Board members, and is also aligned with the business and risk strategy of Aareal Bank AG and Aareal Bank Group respectively. As is the case with the Management Board remuneration, risk takers receive both fixed and variable remuneration. The fixed component comprises a fixed annual salary and ancillary benefits.

Performance-related variable remuneration

Remuneration parameters and target level weighting

As with the Management Board members, the variable remuneration is measured based on targets derived from the corporate strategy. One difference compared with the Management Board system is that the assessment period for the target achievement is one year. The targets set for risk takers are split into three components that are added together, as is the case for the remuneration paid to the Management Board: a Group component, an organisational unit component (referring to the organisational unit that the risk taker works for) and an individual component (individual target achievement). The performance of the organisational unit for divisions allocated to Sales is measured using the Structured Property Financing segment operating result, as well as in terms of risk weighted assets. The performance of the Housing Industry division is measured by reference to the segment operating result of the Consulting/Services segment. The other organisational units, i. e. in particular central staff functions and control units, as well as the Treasury division, are measured based on their cost target. The remuneration system also takes account of the risk taker's position in the organisation's hierarchy, reflecting the influence that he/she can exert over the Group's/Bank's success. This results in differences in the weighting attached to the three additive components depending on an individual's responsibility within the Company: The Group component payable to risk takers assigned to the management level below the Management Board (Managing Directors) is 35 %. By contrast, it is 25 % for the other risk takers. For further information on the individual targets and possible resulting KPIs, we refer to the information on Management Board remuneration.

Deferred disbursement, through retention of variable remuneration components and virtual shares

To ensure that the remuneration system provides long-term incentives, the initial value for variable remuneration – as determined according to the principles set out above – is generally paid out on a deferred basis after the end of the financial year. The payout terms are based on those that apply to the Management Board remuneration system but once again vary depending on the risk taker's position within the organisational structure.

60 % of the variable remuneration paid to risk takers on the Managing Director level is subject to a five-year deferral period. As with the variable Management Board remuneration, 50 % each of deferred and non-deferred components are converted into virtual shares that are held for a minimum period of one year. Unlike with the Management Board remuneration system, risk takers can, however, opt to select when they want their virtual shares to be converted into cash after the end of the one-year holding period, selecting a conversion date that falls within a period of up to three years.

By contrast, 40 % of the variable remuneration paid to the other risk takers is subject to deferral over a period of three years.

All other aspects relating to the calculation of virtual shares are explained in the section on the Management Board remuneration system.

Ex-post review of target achievement and behaviour of the risk takers

As in the Management Board remuneration system, the original target achievement level is back-tested and, where appropriate, reduced before virtual shares are paid out/granted. Penalty-triggering events can also result in reductions or in the forfeiture of the variable remuneration entitlement in full and, as a result, also in variable remuneration that has already been paid out being clawed back. Details can be found in the information on the Management Board remuneration system.

Remuneration system for employees who are not classed as risk takers

Aareal Bank AG is a member in Germany of the Arbeitgeberverband des privaten Bankgewerbes e. V. (association of employers in private banking) and bound by the collective agreements for private banks. As of the 2019 financial year, variable remuneration for employees not classified as risk takers has been split into two components, too: the Group component (25 % of target variable remuneration) and the individual component (75 % of target variable remuneration). As a result, the variable remuneration of all employees is directly linked to Aareal Bank Group's performance, and the employees are directly involved in reaching the communicated targets. The individual component paid to those employees whose remuneration is governed by a collective agreement is based on an annual appraisal. The initial value for measuring the variable remuneration corresponds to 0.75 gross monthly salaries for employees covered by a collective agreement. The individual component paid to those employees who are not covered by a collective agreement is based on contractually agreed target-variable remuneration and is measured based on an annual overall appraisal that also takes the target achievement level for the individual targets that have been set for the employee in question into account.

Restrictions and link to risk-bearing capacity for all employee remuneration systems

All employee remuneration systems feature provisions corresponding to those found in the Management Board remuneration system regarding the impact of special external conditions (modifiers). In cases involving risk takers, the ban on hedging also applies. There are, however, differences with regard to the caps and the safeguarding of the risk-bearing capacity. The contracts of employment with those employees below Management Board level do not include contractual provisions on severance pay.

Caps and proportion of variable remuneration

The core components and – for risk takers – the organisational components are capped at 150 % in the target achievement level. The individual targets are capped at a target achievement level of 200 %. If the individual target achievement level is 0 %, no variable remuneration is paid at all. Performance of virtual shares is capped at 300 %.

In order to comply with the requirements set out in section 25a (5) KWG, the reference value for the variable remuneration in cases involving a target achievement level of 100 % generally corresponds to a maximum of 50 % of the fixed remuneration. This means that, even if an employee achieves the maximum target achievement level, the variable remuneration does not exceed the fixed remuneration. Consequently, if an employee receives fixed annual remuneration of € 80,000, for example, the reference value for the variable remuneration paid out if that employee achieves 100 % target achievement is limited to a maximum of € 40,000. It is very common, however, for variable remuneration to account for a smaller proportion of an employee's total remuneration. Furthermore, it has been ensured in line with regulatory requirements that the variable remuneration for control unit employees amounts to no more than one-third of total remuneration.

In 2014, the Annual General Meeting of Aareal Bank AG approved exemptions from this 1:1 rule for certain groups of employees. In order to ensure that the remuneration paid by Aareal Bank AG and its international subsidiaries is competitive in an international comparison, employees working in international sales at Aareal Bank AG, as well as executives and employees working for the subsidiaries Aareal Capital Corporation, New York, and Aareal Bank Asia Ltd., Singapore, have to be paid remuneration in line with local market standards. This applies to fewer than 25 positions.

Material amendments to the remuneration systems last year

The material amendment to the remuneration systems for employees in the financial year under review concerned the aforementioned introduction of a Group component for the employees that were not identified as risk takers. In addition, this had the effect of reorganising the managing director level, whereby previously different positions were combined to create a uniform Managing Directors' level. This was accompanied by a standardisation in relation to the composition of the individual components of the target variable remuneration.

Reporting on quantitative disclosure requirements

This report only covers the qualitative disclosure requirements regarding employee remuneration set out in Article 450 of the EU's Capital Requirements Regulation 2013/575 (CRR) and section 16 InstVergV. The quantitative disclosure requirements relating to the provisions set out above are published in a separate report entitled "Disclosure of Remuneration Indicators", which can be found on the website of Aareal Bank AG. This report will be made available within six months of the end of the financial year: www.aareal-bank.com/en/investors-portal/finance-information/regulatory-disclosures/archive/2019/

Remuneration governance

Governance of Supervisory Board remuneration

The role of the Annual General Meeting

Given the Supervisory Board's role as a supervisory body, remuneration for its members must not provide any incentives which would counter this surveillance function. The Annual General Meeting (AGM) determines the remuneration of the Supervisory Board, in Aareal Bank AG's Memorandum and Articles of Association; the AGM therefore also resolves on any adjustments to Supervisory Board remuneration (cf. Article 9 (4) and (5) of the Memorandum and Articles of Association).

In the implementation of the Second Shareholder Rights Directive in the German Public Limited Companies Act (AktG), as of the first ordinary Annual General Meeting following the 2020 financial year, the AGM will need to discuss Supervisory Board remuneration at least every four years, even without any concrete proposals for amendments, and will need to resolve whether it still approves it.

The role of the Supervisory Board

The Supervisory Board shall review the appropriateness of remuneration for its members at least once a year. Every four years, it shall retain an external remuneration advisor to obtain an opinion as to the appropriateness of its remuneration – and especially, on whether remuneration is in line with common practice and comparable. The Supervisory Board shall present the results of this review as part of its report to the AGM. Where appropriate, the Supervisory Board will prepare recommendations for adjustments to its remuneration, and will submit them to shareholders at the next AGM.

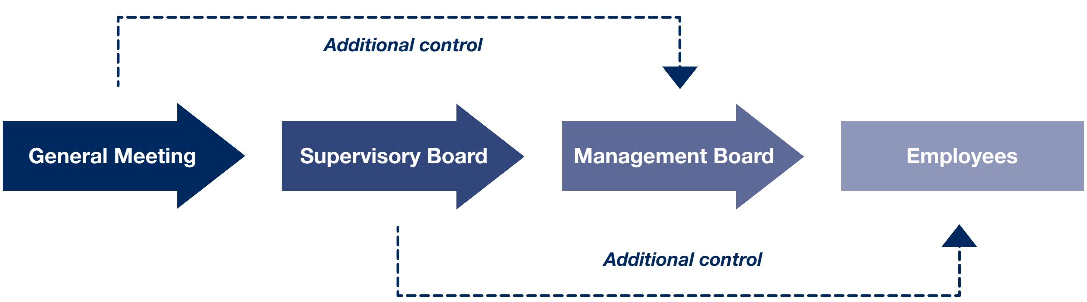
Governance of Management Board remuneration

The role of the Supervisory Board

The Supervisory Board shall act in the Company's interests; accordingly, it shall ensure that Management Board remuneration is geared towards the Company's sustainable development (cf. section 87 of the AktG). The Supervisory Board decides on Management Board remuneration, monitors appropriateness, defines targets for determining variable remuneration, and decides on target achievement. During the years following determination of variable remuneration], the Supervisory Board shall review, within the framework of backtesting/penalty reviews, whether variable remuneration determined originally must be adjusted or reclaimed (clawback).

As part of examining appropriateness of Management Board remuneration, the Supervisory Board shall review whether the remuneration system for the Management Board (as well as the corresponding targets for Management Board members derived therefrom) is consistent with the Company's business and risk strategies, the objectives derived from these strategies, the corresponding risk management, as well as with the defined risk appetite and the corporate values. As further elements of this examination of appropriateness, a vertical comparison with the average remuneration of relevant employees and the top management level below the Management Board is to be carried out, as well as a horizontal comparison with the remuneration of management board members of comparable enterprises. These components reflect the orientation of Management Board remuneration towards sustainable Company development, meaning that remuneration is aligned with the long-term interests of Aareal Bank's stakeholders.

Determination and control of remuneration systems



When taking decisions concerning the structure of the remuneration system for the Management Board, the Supervisory Board shall take the views of Aareal Bank AG's relevant shareholders and of proxy advisors into account.

The role of the Remuneration Control Committee

The Remuneration Control Committee supports the Supervisory Board in its monitoring duties and prepares the plenary meeting's resolutions concerning remuneration. The Committee monitors the appropriateness of the structure of Management Board remuneration, proposes targets for variable remuneration and for target achievement at the end of the year, and also monitors the levels of target achievement during the course of each year. Moreover, the Committee assesses the effects of the remuneration systems on the Group's risk, capital and liquidity management. In the run-up to determining remuneration, in cooperation with the Audit Committee, it reviews whether there are any backtesting or penalty-triggering events which may result in a reduction of variable remuneration.

The role of the Risk Committee

The duties of the Risk Committee with regard to remuneration are unaffected by the assessment by the Remuneration Control Committee, as set out above. The Risk Committee verifies whether the incentives created by the remuneration system take the Company's risk, capital and liquidity structure into account, as well as the probability and timing of income.

The role of the Audit Committee

Circumstances where variable remuneration may be reduced may occur where Management Board members fail to fulfil any of their duties, or where they breach external or internal requirements. To the extent that any such events have occurred, these are identified in the reports prepared by Compliance, addressed to the Audit Committee as well as to the plenary meeting of the Supervisory Board. Internal conduct rules are also defined in a Code of Conduct which must be presented to the Audit Committee at least once a year.

The role of the Annual General Meeting

Under current legislation, Management Board remuneration may be submitted to the AGM for approval. Implementing the Second Shareholder Rights Directive in the German Public Limited Companies Act (AktG), as of the first ordinary Annual General Meeting following the 2020 financial year the AGM will address Management Board remuneration at least every four years as well as in the event of any material change to Management Board remuneration (say-on-pay).

Governance of staff remuneration

The role of the Management Board

The Management Board is responsible for structuring the remuneration system for employees. As an element of appropriate and effective risk management, staff remuneration is monitored as to whether it is consistent with the corporate and risk culture, and with Aareal Bank's risk appetite. Especially with respect to the remuneration of material risk takers, the Management Board will take care to adjust remuneration parameters to such employees' influence on the Bank's risk exposure.

The role of the Supervisory Board/ the Remuneration Control Committee/ the Risk Committee

The Supervisory Board and its Remuneration Control Committee monitor the structure of staff remuneration. In this context, the Remuneration Control Committee also assesses the criteria for, and the actual selection of, Aareal Bank Group's material risk takers. Together with the Risk Committee, and in line with the rules for Management Board remuneration, the Remuneration Control Committee monitors whether the remuneration system for employees is consistent with the Company's business and risk strategies, the objectives derived from these strategies, its risk appetite and the risk management.

Further information on the Supervisory Board and its committees

The composition and responsibilities of the Supervisory Board committees, and of the plenary meeting, are described in the Corporate Governance Statement/the Corporate Governance Report and in the Notes.

The Supervisory Board presents the remuneration-related activities of its plenary meetings and of its committees as part of its report to the AGM. This report also provides details regarding the number of meetings, and on the participation of the members of the committees and the Supervisory Board.

The role of the Remuneration Officer

Following consultation of the Supervisory Board, the Management Board of Aareal Bank AG shall appoint a Remuneration Officer in order to ensure appropriate, sustained and effective monitoring of staff remuneration. Aareal Bank has appointed a Remuneration Officer, to carry out duties in accordance with section 24 of the InstVergV. These duties include supporting the Supervisory Board and the Remuneration Control Committee in structuring and monitoring the remuneration system. The Remuneration Officer is obliged to respond to queries of the Remuneration Control Committee's Chairman.

The Remuneration Officer reports on the appropriate structure of the remuneration systems for employees in the form of a Remuneration Report at least once a year. Due to the responsibility of monitoring the appropriateness of the remuneration systems on a continuing basis, the Remuneration Officer is being included in the conceptional new drafting (and future development), as well as in the application of the remuneration systems. In particular, the Remuneration Officer plays an active part in the process for the determination of the total amount available for variable remuneration, the annual review of penalty rules, the regular (at least spot checks) review of appropriate compliance structures, the monitoring of the hedging ban (and potential violations), the drafting of the annual remuneration report (pursuant to section 16 of the InstVergV in connection with Article 450 of the CRR) as well as the review of the risk taker analysis.

Involvement of external remuneration advisors

As a matter of principle, the executive bodies of Aareal Bank decide upon remuneration themselves; they also come to an independent assessment of appropriateness. Especially for the purpose of examining whether remuneration is in line with common practice, compared with other companies, Aareal Bank retains external remuneration advisors.

Takeover Disclosures in Accordance with Section 315a of the German Commercial Code (HGB)

Composition of subscribed capital, and rights and obligations attached to shares

The composition of Aareal Bank AG's subscribed capital is shown in the Note "Equity" to the consolidated financial statements. Each share casts one vote at a General Meeting. There are no shares with special rights granting supervisory powers to any shareholder or shareholder group. The Company currently does not hold any treasury shares, which would not be entitled to vote.

Restrictions affecting voting rights or the transfer of shares

The transfer and exercise of voting rights is governed exclusively by legal restrictions. Voting rights are not limited to a certain number of shares, or of votes. All shareholders who have registered to attend a General Meeting in good time, and who have provided the Company with evidence of their shareholding and their right to vote, are entitled to attend the General Meeting, and to exercise their voting rights from all shares held and so registered. The exercise of voting rights from the shares concerned is precluded by law in the cases where section 136 of the German Public Limited Companies Act (Aktiengesetz – "AktG") applies. Where the Company holds treasury shares, section 71b of the AktG prohibits the exercise of rights vested in such shares. We are not aware of any other restrictions affecting voting rights or the transfer of shares.

Shareholdings exceeding 10 % of voting rights

Details regarding any shareholdings exceeding 10 % of voting rights are provided in the Note "Disclosures pursuant to section 160 (1) no. 8 of the AktG".

Shares with special rights granting the holder supervisory powers

Aareal Bank AG's Memorandum and Articles of Association do not grant any shareholder the right to nominate members to the Supervisory Board, nor are there any other shares with special rights granting the holder supervisory powers.

Type of control of voting rights regarding shares held by employees with their rights of control not being directly exercised

There are no Aareal Bank AG shares held by employees where the rights of control cannot be directly exercised.

Statutory provisions, and provisions in the Memorandum and Articles of Association regarding the appointment and removal of members of the Management Board, and regarding amendments to the Memorandum and Articles of Association

The appointment and removal of members of the Management Board of Aareal Bank AG is carried out in accordance with sections 84 and 85 of the AktG and Article 7 of the Memorandum and Articles of Association, according to which the Management Board must have a minimum of two members. The Supervisory Board shall appoint the Members of the Management Board and determine their number. The Supervisory Board may appoint deputy members, and may appoint one member of the Management Board to be the Chairman of the Management Board. The members of the Management Board are appointed for a maximum term of five years. This term of office may be renewed or extended for a maximum of five years in each case.

Pursuant to section 179 of the AktG, the Memorandum and Articles of Association may be amended by way of resolution passed by the General Meeting. Resolutions of the General Meeting regarding amendments to the Memorandum and Articles of Association are passed by a simple majority of the votes cast, or – to the extent permitted by law – by the majority of the issued share capital present at the Meeting. In accordance with section 181 (3) of the AktG, such amendments become effective upon their entry in the Commercial Register. In the event of a capital change, the Supervisory Board is authorised to modify the wording of the Articles of Association in line with the amount of the capital change (Article 5 (7) of the Memorandum and Articles of Association).

Authorisation of the Management Board to issue or repurchase shares

Authorised capital

The Annual General Meeting held on 31 May 2017 resolved to authorise the Management Board to increase, on one or more occasions, the Company's share capital, subject to the approval of the Supervisory Board, by up to a maximum total amount of € 89,785,830 by issuance of new shares for contribution in cash or in kind; the Management Board is also authorised, within defined limits, to disapply pre-emptive rights, given the fulfilment of certain conditions. This authorisation will expire on 30 May 2022. When exercising this authorisation, the Management Board will restrict the exclusion of shareholders' pre-emptive rights to a total of 20% of the Company's share capital – including treasury shares and any shares issued during the term of this authorisation, under the authorisation under agenda item no. 6 of the Annual General Meeting held on 21 May 2014. The authorised capital has not been utilised to date.

Conditional capital

Based on a resolution passed by the Annual General Meeting on 22 May 2019, the Management Board was authorised to issue, on one or more occasions until 21 May 2024, profit-participation certificates with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of up to € 900,000,000. The profit-participation certificates must be structured in such a way that the funds paid upon issuance are eligible as regulatory capital pursuant to the legal regulations applicable as at the time of issuance. Profit-participation certificates and other hybrid promissory note loans to be issued according to this authorisation shall be connected with conversion rights, entitling or compelling, in accordance with their respective conditions, the holder to purchase Company shares. Conversion rights or obligations may only be issued or created for no-par value bearer shares of the Company with a proportionate amount of the Company's share capital of up to € 71,828,664.00. The sum of shares to be issued so as to service conversion or option rights or conversion obligations from profit-participation certificates or hybrid promissory note loans issued pursuant to this authorisation, including shares issued during validity of this authorisation as a result of another authorisation (especially from the Authorised Capital 2017), may not exceed an amount of € 71,828,664.00 (which equals approx. 40 % of the current share capital). Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

Accordingly, the Company's share capital is subject to a conditional capital increase not exceeding € 71,828,664.00 by issuance of up to 23,942,888 new no-par value bearer shares ("Conditional Capital 2019"). The purpose of the conditional capital increase is to grant shares to holders or creditors of convertible bonds issued in accordance with the aforementioned authorisation. The new no-par value bearer shares may only be issued at a conversion price in line with the resolution passed by the General Meeting on 22 May 2019. The conditional capital increase shall only be carried out insofar as conversion rights are exercised or as conversion obligations from such convertible bonds are fulfilled or as the Company makes use of alternative performance and insofar as no cash compensation is granted or treasury shares are used to service the rights. The new shares shall be entitled to a share in the profits from the beginning of the financial year in which they come into existence through the exercise of conversion rights or the fulfilment of conversion obligations The Management Board is authorised to determine the details of the conditional capital increase. The Management Board is also authorised to determine the further contents of share rights and the terms governing the issuance of shares, subject to the approval of the Supervisory Board.

Authorisation to purchase treasury shares

The General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) no. 7 of the AktG, to purchase and sell treasury shares for the purposes of securities trading, at a price not falling below or exceeding the average closing price of the Company's share in Xetra trading (or a comparable successor system) during the three trading days on the Frankfurt Stock Exchange prior to the relevant transaction by more than 10 %. This authorisation expires on 19 May 2020. The volume of shares acquired for this purpose must not exceed 5 % of the issued share capital of Aareal Bank AG at the end of any given day.

Furthermore, the General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) no. 8 of the AktG, to purchase treasury shares with a volume of up to 10 % of the issued share capital for purposes other than securities trading. This authorisation expires on 19 May 2020. Such purchases may be effected via stock exchanges or public purchase offers made to all shareholders, taking into account the prices as specified in the respective Annual General Meeting's resolution, which are in turn based on the Company's stock exchange share price. The authorisation may be exercised on one or more occasions, covering partial amounts or the total amount.

Subject to the approval of the Supervisory Board, the shares acquired under this or an earlier authorisation may be sold outside stock exchanges and without an offer to all shareholders, thereby excluding shareholders' pre-emptive rights, provided that the shares sold do not exceed the threshold value of 10 % of the Company's share capital and that the issue price is not significantly lower than the stock exchange price, or if the sale of such shares is made against contribution in kind, or if the shares are given to the holders of conversion or option rights, even if they had been issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without such a withdrawal or its implementation requiring a further resolution by the General Meeting.

The Management Board was also authorised to effect the acquisition of treasury shares by using put or call options. However, any and all share purchases involving the use of derivatives shall be limited to a maximum threshold value of 5 % of the Company's share capital. In addition, any acquisition of shares shall count towards the 10 % threshold for the authorisation to acquire treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

Material agreements which are subject to change of control clauses triggered in the event of a takeover offer

There are no material agreements which are subject to change of control clauses triggered in the event of a takeover offer. Any public offers to acquire the Company's shares are governed exclusively by the law (including the provisions of the German Securities Acquisition and Takeover Act), and the Memorandum and Articles of Association.

Compensation agreements entered into with members of the Management Board or employees in the event of a takeover offer

For details regarding compensation agreements entered into with members of the Management Board or employees in the event of a takeover bid, please refer to the Remuneration Report.

Consolidated Non-Financial Report

The Combined Separate Non-Financial Report pursuant to sections 289b (3) and 315b (3) of the HGB has been published on the Company's website, on www.aareal-bank.com/en/responsibility/reporting-on-our-progress/.

Corporate Governance Statement

Since Aareal Bank AG is the only listed Group entity, and also the Group's parent undertaking, only one Corporate Governance Statement will be issued.

The full Corporate Governance Statement pursuant to sections 289f and 315d of the HGB is publicly available on the Company's website (www.aareal-bank.com/en/about-us/corporate-governance/), and in the "Transparency" section of the Group Annual Report.

Aareal Bank is a public limited company incorporated under German law, with its registered office in Wiesbaden, Germany. It is the parent company of an international property finance and services group. Exchange-listed Aareal Bank AG prepares its financial statements in accordance with IFRSs.

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Income Statement

	Note	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
€ mn			
Interest income from financial instruments (ac and fvoci)		889	847
Interest income from financial instruments (fvpl)		44	38
Market-driven modification gains		0	2
Interest expenses for financial instruments (ac)		111	113
Interest expenses for financial instruments (fvpl)		289	236
Market-driven modification losses		0	3
Net interest income	31	**533**	**535**
Loss allowance excluding credit-driven net modification gain or loss		85	72
Credit-driven net modification gain or loss		5	0
Loss allowance	32	**90**	**72**
Commission income		279	259
Commission expenses		50	44
Net commission income	33	**229**	**215**
Net gain or loss on the derecognition of financial assets (ac)		31	24
Net gain or loss on the derecognition of financial liabilities (ac)		3	0
Net gain or loss on the derecognition of financial assets (fvoci)		30	–
Net derecognition gain or loss	34	**64**	**24**
Net gain or loss from financial instruments (fvpl)	35	1	-2
Net gain or loss from hedge accounting	36	-4	-2
Net gain or loss from investments accounted for using the equity method	37	1	0
Administrative expenses	38	488	462
Net other operating income/expenses	39	2	25
Negative goodwill from acquisitions		–	55
Operating profit		**248**	**316**
Income taxes	40	85	90
Consolidated net income		**163**	**226**
Consolidated net income attributable to non-controlling interests		2	2
Consolidated net income attributable to shareholders of Aareal Bank AG		161	224
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG[1]		161	224
of which: allocated to ordinary shareholders		145	208
of which: allocated to AT1 investors		16	16
Earnings per ordinary share (€)[2]		2.42	3.48
Earnings per AT1 unit (€)[3]		0.16	0.16

[1] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.

[2] Earnings per ordinary share are determined by dividing the earnings allocated to ordinary shareholders of Aareal Bank AG by the weighted average of ordinary shares outstanding during the financial year (59,857,221 shares). Basic earnings per ordinary share correspond to diluted earnings per ordinary share.

[3] Earnings per AT1 unit (based on 100,000,000 AT1 units with a notional amount of € 3 each) are determined by dividing the earnings attributable to AT1 investors by the weighted average of AT1 units outstanding during the financial year. Earnings per AT1 unit (basic) correspond to (diluted) earnings per AT1 unit.

Statement of Comprehensive Income

Reconciliation from Consolidated Net Income to Total Comprehensive Income

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Consolidated net income	**163**	**226**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**-43**	**-7**
Remeasurements	-62	-10
Taxes	19	3
Changes in the reserve from the measurement of equity instruments (fvoci)	**-4**	**0**
Gains and losses from equity instruments (fvoci)	-4	0
Transfers to retained earnings	–	–
Taxes	0	0
Items that are reclassified subsequently to profit or loss		
Changes in the reserve from the measurement of debt instruments (fvoci)	**-32**	**-14**
Gains and losses from debt instruments (fvoci)	-16	-20
Reclassifications to the income statement	-30	–
Taxes	14	6
Changes in the reserve from foreign currency basis spreads	**-6**	**-12**
Gains and losses from foreign currency basis spreads	-9	-17
Reclassifications to the income statement	–	–
Taxes	3	5
Changes in currency translation reserves	**3**	**5**
Gains and losses from translating foreign operations' financial statements	2	1
Reclassifications to the income statement	–	–
Taxes	1	4
Other comprehensive income	**-82**	**-28**
Total comprehensive income	**81**	**198**
Total comprehensive income attributable to non-controlling interests	2	2
Total comprehensive income attributable to shareholders of Aareal Bank AG	79	196

Statement of Financial Position

€ mn	Note	31 Dec 2019	31 Dec 2018
Assets			
Financial assets (ac)	41	**33,972**	**34,702**
Cash funds	10	1,494	1,265
Loan receivables	11	25,783	26,795
Money market and capital market receivables	12	6,618	6,578
Receivables from other transactions	14	77	64
Loss allowance (ac)	42	-386	-577
Financial assets (fvoci)	43	**3,420**	**4,450**
Money market and capital market receivables	12	3,415	4,443
Equity instruments	13	5	7
Financial assets (fvpl)	44	**2,979**	**3,183**
Loan receivables	11	1,050	711
Money market and capital market receivables	12	135	538
Positive market value of designated hedging derivatives	15	1,380	1,277
Positive market value of other derivatives	16	414	657
Investments accounted for using the equity method	17, 45	8	7
Intangible assets	18, 46	175	158
Property and equipment	19, 47	311	260
Income tax assets	20, 48	30	30
Deferred tax assets	21, 49	168	141
Other assets	22, 50	460	333
Total		**41,137**	**42,687**
Equity and liabilities			
Financial liabilities (ac)	51	**35,332**	**37,215**
Money market and capital market liabilities	23	24,526	26,371
Deposits from the housing industry	24	9,744	9,679
Liabilities from other transactions	25	94	121
Subordinated liabilities	26	968	1,044
Financial liabilities (fvpl)	52	**2,165**	**1,934**
Negative market value of designated hedging derivatives	15	1,341	1,461
Negative market value of other derivatives	16	824	473
Provisions	27, 53	581	519
Income tax liabilities	54	44	40
Deferred tax liabilities	21, 55	19	18
Other liabilities	28, 56	135	33
Equity	29, 57	**2,861**	**2,928**
Subscribed capital		180	180
Capital reserves		721	721
Retained earnings		1,812	1,797
AT1 bond		300	300
Other reserves		-154	-72
Non-controlling interests		2	2
Total		**41,137**	**42,687**

Statement of Changes in Equity

€ mn	Equity as at 1 Jan 2019	Adjustment due to first-time application of IFRS 16	Adjusted equity as at 1 Jan 2019	Total compre-hensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 31 Dec 2019
Subscribed capital	**180**		**180**						**180**
Capital reserves	**721**		**721**						**721**
Retained earnings	**1,797**	-4	**1,793**	161		-126	-16		**1,812**
AT1 bond	**300**		**300**						**300**
Other reserves	**-72**		**-72**	**-82**					**-154**
Reserve from remeasurements of defined benefit plans	-98		-98	-43					-141
Reserve from the measurement of equity instruments (fvoci)	0		0	-4					-4
Reserve from the measurement of debt instruments (fvoci)	39		39	-32					7
Reserve from changes in the value of foreign currency basis spreads	-9		-9	-6					-15
Currency translation reserves	-4		-4	3					-1
Total	**2,926**	**-4**	**2,922**	**79**		**-126**	**-16**		**2,859**
Non-controlling interests	**2**		**2**	2	-2				**2**
Equity	**2,928**	**-4**	**2,924**	**81**	**-2**	**-126**	**-16**	**–**	**2,861**

€ mn	Equity as at 1 Jan 2018	Total compre-hensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 31 Dec 2018
Subscribed capital	**180**						**180**
Capital reserves	**721**						**721**
Retained earnings	**1,738**	224		-150	-16	1	**1,797**
AT1 bond	**300**						**300**
Other reserves	**-44**	**-28**					**-72**
Reserve from remeasurements of defined benefit plans	-91	-7					-98
Reserve from the measurement of equity instruments (fvoci)	0						0
Reserve from the measurement of debt instruments (fvoci)	53	-14					39
Hedging reserves							
Reserve from changes in the value of foreign currency basis spreads	3	-12					-9
Currency translation reserves	-9	5					-4
Total	**2,895**	**196**		**-150**	**-16**	**1**	**2,926**
Non-controlling interests	**2**	2	-2				**2**
Equity	**2,897**	**198**	**-2**	**-150**	**-16**	**1**	**2,928**

Statement of Cash Flows

€ mn	Cash flow 1 Jan - 31 Dec 2019	Cash flow 1 Jan - 31 Dec 2018
Consolidated net income	**163**	**226**
Additions to and reversals of loss allowances	94	76
Amortisation, depreciation, impairment and write-ups of non-current assets	46	16
Other non-cash changes	170	164
Gains/losses on the disposal of non-current assets	-3	-55
Other adjustments	-530	-548
Subtotal	**-60**	**-121**
Changes in financial assets (ac) (excluding cash funds)	1,119	42
Changes in financial assets (fvoci)	927	245
Changes in financial assets (fvpl)	36	259
Changes in other assets	-142	-50
Changes in financial assets (ac) (excluding subordinated capital)	-1,795	-1,060
Changes in financial liabilities (fvpl)	34	-90
Changes in provisions	-74	-58
Changes in other liabilities	2	10
Income taxes paid	-72	-22
Interest received	778	868
Interest paid	-268	-317
Cash flow from operating activities	**485**	**-294**
Proceeds from the disposal of equity instruments and investments accounted for using the equity method	0	0
Payments for the acquisition of equity instruments and investments accounted for using the equity method	1	-6
Proceeds from the disposal of property and equipment and intangible assets	21	2
Payments for the acquisition of property and equipment and intangible assets	-33	-31
Effect of changes in reporting entity structure	0	-44
Cash flow from investing activities	**-11**	**-79**
Dividends paid and AT1 coupon payments	-141	-165
Changes in subordinated liabilities[1)]	-102	-276
Changes due to other funding activities	-2	-2
Cash flow from financing activities	**-245**	**-443**
Cash and cash equivalents as at 1 January	**1,265**	**2,081**
Cash flow from operating activities	485	-294
Cash flow from investing activities	-11	-79
Cash flow from financing activities	-245	-443
Cash and cash equivalents as at 31 December	**1,494**	**1,265**

[1)] The changes in subordinated liabilities in the amount of € -76 million (2018: € -221 million) consist of € -77 million (2018: € -215 million) related to cash flow relevant payments of principal and interest as well as an amount of € 1 million (2018: € -6 million) non-cash changes in fair value and changes of accrued interest.

Notes
Basis of Accounting

Aareal Bank AG is a public limited company incorporated under German law, with its registered office in Wiesbaden, Germany. It is the parent company of an international property finance and services group, and registered under no. HRB 13 184 in the Commercial Register at the Wiesbaden local court (Amtsgericht Wiesbaden).

As a listed public limited company, Aareal Bank AG has prepared its consolidated financial statements for the financial year ended on 31 December 2019 in accordance with International Financial Reporting Standards (IFRSs) applicable within the European Union (EU) as at the reporting date, in connection with the provisions pursuant to section 315e of the German Commercial Code (Handelsgesetzbuch – "HGB"). The reporting currency is the euro (€).

The Management Board approved the consolidated financial statements for publication on 2 March 2020; they will be published in the German Federal Gazette.

Accounting Policies

(1) Accounting standards

Recognition and measurement within Aareal Bank Group are based on accounting policies applied consistently throughout the Group. The consolidated financial statements are prepared on a going concern basis.

We apply accounting policies – and the presentation of financial statements – consistently, in order to ensure the comparability of financial statements over time.

Information is presented in accordance with the principle of materiality. Minor differences may occur regarding the figures stated, due to rounding.

The Bank observes the general prohibition of setting off assets against liabilities. To the extent that the criteria of IAS 12.74 are met, deferred tax assets and deferred tax liabilities are offset. If the requirements set out in IAS 32.42 are met, financial assets and liabilities are reported on a net basis.

Income and expenses are recognised on an accrual basis and recorded in the income statement in the period to which they relate.

Interest income and expenses are recognised using the effective interest method. In the case of impaired receivables, interest income and expenses are recognised only on the basis of the net carrying amount. Interest from derivatives designated for hedge accounting and economic hedging relationships is included in net interest income. Interest from derivative hedging instruments is shown under interest from financial instruments (ac and fvoci), while interest from economic hedging relationships are reported under interest from financial instruments (fvpl). We provide specific information on negative interest from financial assets or positive interest from financial liabilities in the Notes, under net interest income. These assets and liabilities are deposits as well as money market and securities repurchase transactions.

Dividend income is recognised when there is a corresponding legal title.

Commission income and expenses include revenue from the provision of goods or services in the ordinary course of business. This mainly refers to IT consulting projects, trainings, licence and maintenance agreements and hosting or outsourcing services.

The presentation of the financial position and the financial performance in the consolidated financial statements depends on the recognition and measurement methods underlying the preparation of the financial statements, as well as on estimates and assumptions made by the management in relation to uncertain future events. Any assessments required for recognition and measurement are prepared in line with the relevant accounting standards. Estimates and assumptions are based on historical experience and other factors, such as planning and current expectations and forecasts with respect to the occurrence of future events. The estimates and assessments themselves as well as the underlying assessment factors and estimation techniques are reviewed regularly and compared with actual outcome. In our view, the parameters used are relevant and reasonable.

The most significant estimates and assumptions of the management primarily refer to the calculation of provisions, allowances for credit losses and provisions in the lending business, the measurement of goodwill, property, tax assets and tax liabilities as well as options to extend or terminate leases. We refer to the item-specific disclosures in this section for information related to the estimates and assumptions actually made within the context of recognition and measurement.

An asset is recognised in the statement of financial position when it is probable that an associated future economic benefit will flow to the Company and the asset can be measured reliably.

A liability is recognised if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when the settlement amount of the liability can be measured with sufficient reliability.

(2) Changes in accounting policies

The following financial reporting standards (IASs/IFRSs) were required to be applied for the first time in the reporting period:

- **IFRS 16: Leases**
  The new financial reporting standard IFRS 16, regarding lease accounting, replaced IAS 17 as well as the related interpretations IFRIC 4, SIC 15 and SIC 7. IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise (in the statement of financial position) any leases and the related contractual rights and obligations with a term of more than twelve months, unless the underlying asset is of low value. The lessee recognises a right-of-use asset (representing its right to use the underlying leased asset) and also a lease liability (representing its obligation to make lease payments). Similar to the rules set out in IAS 17, the lessor continues to classify its leases as finance or operating leases. The criteria for classification under IFRS 16 equal those of IAS 17. In addition, IFRS 16 sets out a number of further rules for presentation, disclosures in the Notes and sale-and-lease-back transactions. The transition to the new standard was made on the basis of the modified retrospective approach. After the recognition of € 70 million in right-of-use assets and the corresponding lease liabilities of € 76 million, the transition effect, which was reported directly in equity in retained earnings, amounted to € -6 million before taxes. The practical relief provided for by the IFRS 16 as regards short-term lease agreements and low-value leased assets are made use of. Within the context of first-time application, the lease agreements were not reassessed in accordance with the standard, and right-of-use assets from leases representing onerous contracts were reduced by the amount that has already been recorded as a liability.

  Based on the operating lease obligations as at 31 December 2018, the reconciliation to the opening balance of lease liabilities as at 1 January 2019 is as follows:

€ mn	1 Jan 2019
Unrecognised lease obligations as at 31 December 2018	**65**
Recognition exemption for short-term leases and leases for low-value assets	-1
Other	2
Gross lease liability as at 1 January 2019	**66**
Adjustments due to different evaluation of extension and termination options	28
Discounting	-18
Lease liabilities as at 1 January 2019	**76**

  The weighted average of the incremental borrowing rate applied by Aareal Bank Group as at 1 January 2019 for the initial discounting of the lease liabilities was 2.0 %.

- **IFRIC 23: Uncertainty over Income Tax Treatments**
  This interpretation clarified the accounting for uncertainty in relation to income taxes.

- **IAS 19 Plan Amendment Curtailment or Settlement**
  As a result of the amendments, entities are required to re-determine the current service cost and the net interest for the remainder of the financial year in case of an amendment, curtailment or settlement of a defined benefit plan using current actuarial assumptions used to remeasure the net defined benefit liability (asset).

- **Amendments to IAS 28: Long-term Interests in Associates and Joint Ventures**
  The amendments clarify that a company is obliged to apply IFRS 9 Financial Instruments, including its impairment rules, to long-term interest in associates or joint ventures that, in substance, form part of the company's net investment in the associate or joint venture, rather than using the equity method. Accordingly, the application of IFRS 9 has priority over the application of IAS 28.

- **Amendments to IFRS 9: Prepayment Features with Negative Compensation**
  Minor changes to IFRS 9 Financial Instruments for financial assets with so-called symmetrical termination rights to facilitate their measurement at amortised cost or at fair value through other comprehensive income. In addition, the accounting for a modification of a financial liability that does not result in derecognition was clarified.

- **Annual Improvements Cycle 2015-2017**
  Within the scope of the Annual Improvements Cycle, clarifications made by the IASB and minor changes to the existing standards IFRS 3, IFRS 11, IAS 12 and IAS 23 were introduced.

Except for IFRS 16, new or revised standards or interpretations did not have any material consequences for the consolidated financial statements of Aareal Bank Group.

Until 31 December 2019, the following financial reporting standards (IASs/IFRSs) and interpretations (IFRICs) had been published by the International Accounting Standards Board (IASB) and endorsed by the EU Commission:

New International Financial Reporting Standards / Interpretations		Issued	Endorsed	Effective date
IFRS 17	Insurance Contracts	May 2017		Financial years beginning on or after 1 January 2022
ED/2019/7	General Presentation and Disclosures	December 2019		Pending

Revidsed International Financial Reporting Standards		Issued	Endorsed	Effective date
IAS 1	Definition of Material	October 2018	December 2019	Financial years beginning on or after 1 January 2020
IFRS 3	Definition of a Business	October 2018		Financial years beginning on or after 1 January 2020
IFRS 9 / IFRS 7	Interest Rate Benchmark Reform	September 2019	January 2020	Financial years beginning on or after 1 January 2020

- **IAS 1 Definition of Material**
  The amendments were issued to refine the definition of the term ”material” and to harmonise the various definitions in the Conceptual Framework and in the standards.

- **IFRS 3 Definition of a Business**
  The objective of the amendments is to resolve cases of doubt that arise when a company determines whether it has acquired a business or a group of assets. The problems result from the fact that the accounting policies for goodwill, the acquisition costs and deferred taxes in case of the acquisition of a business differ from those applicable to the purchase of a group of assets.

- **IFRS 9/IFRS 7 Interest Rate Benchmark Reform**
  The standard amendments are the first part of the effects of the interest rate benchmark reform (IBOR reform). The amendments deal with hedge accounting requirements and related notes which arise due to the uncertainties of alternative interest rates by themselves and their introduction.

  In the 2019 financial year, Aareal Bank Group decided to opt for an early application of these standards. As the Group currently has not designated any cash flow hedges, the uncertainties refer to the hedging of changes in fair value from interest rate risk. This applies to variable reference rates with terms of one to six months for the currencies AUD, CAD, DKK, EUR, GBP, SEK and USD. For the scope of hedging relationships and the nominal amounts of the hedging derivatives, please refer to Note 68 ”Disclosures on hedging derivatives”. Aareal Bank Group does not expect the changes from the IBOR reform to require the discontinuation of hedging relationships. As long as no information on the new reference rates is available, the existing reference rates will continue to be used for measurement. The effects of the IBOR reform and additional standard amendments are analysed and monitored within a single project to identify any potential need for action in due time.

With the exception of the standard amendments required under the Interest Rate Benchmark Reform, Aareal Bank Group did not opt for early application of these standards in 2019, which are required to be applied in future financial years.

Aareal Bank Group is currently reviewing the effects of the application of the new and amended financial reporting standards on the consolidated financial statements.

(3) Consolidation

Consolidation principles

The consolidated financial statements of Aareal Bank Group include all subsidiaries which are controlled directly or indirectly by Aareal Bank AG. Aareal Bank controls an investee when it has the power to direct the investee’s relevant activities, has an exposure or rights to variable returns from its involvement with the investee and has the ability to use its power over the investee to affect the amount of such returns. If control is exercised via voting rights, Aareal Bank assumes that a parent-subsidiary relationship exists if more than half of the voting rights are held directly or indirectly. In cases where voting rights are not conclusive in determining control relationships, other factors are used to assess whether Aareal Bank Group has the power over the company. For this purpose, an assessment is made of the following: purpose and design of an investee, what are the relevant activities of the company, what is the decision-making process in relation to these relevant activities and whether Aareal Bank, by virtue of its rights, currently has the ability to direct these relevant activities. In addition, we assess whether Aareal Bank Group exercises control as principal or as agent or whether a third party acts as agent for the Group. If the assessment shows that Aareal Bank has the sole power over an investee and additionally has the ability to use its power over the investee to affect the amount of the investor's returns, the investee is included in the consolidated financial statements.

Consolidation of a subsidiary begins from the date the Group obtains significant influence (full consolidation). Subsidiaries are deconsolidated when there is no longer the ability to exercise significant influence.

Any non-controlling interests resulting from full consolidation are shown in the statement of financial position, as a separate item of equity.

Initial consolidation of an entity in the event of an acquisition is based on the purchase method, in accordance with IFRS 3, whereby remeasured amounts must be used when recognising assets and liabilities (including any hidden reserves and hidden encumbrances) of an entity to be consolidated. This may lead to the recognition of new assets and liabilities (including contingent liabilities) that were previously not reported in the statement of financial position of the company to be consolidated. Any excess of acquisition cost over the Group's interest in the fair value of net assets is recognised as (positive) goodwill. Any negative goodwill determined during this comparison is charged against income.

Intragroup transactions, balances and results of transactions between Group entities are eliminated. Accounting policies applied by subsidiaries were amended for the purpose of preparing consolidated financial statements to the extent required to ensure consistent accounting throughout the Group.

Joint arrangements are defined as contractual arrangements where two or more parties carry out business activities that are subject to joint control. Joint control only exists when the decisions about the relevant activities require unanimous consent of the parties sharing control. In general, a distinction is made between joint operations and joint ventures. The parties to a joint operation that have joint control have the rights to the assets, and the obligations for the liabilities, relating to the arrangement. Assets and obligations, as well as revenue and expenses are carried on a pro-rata basis. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Interests in joint ventures are measured using the equity method.

Associates are companies in which the Group has an equity interest and may exercise significant influence, without having control. Significant influence is deemed to exist when an investor holds 20 % – 50 % of the voting rights of a company. Associates are also measured using the equity method.

In accordance with the equity method, the Group's share in the profit or loss of associates and joint ventures is recognised in the consolidated income statement from the date of acquisition and is included in the carrying amount of the equity investment, taking into account interim distributions. Further information on investments accounted for using the equity method is included in Note (45).

Associates and joint ventures are no longer accounted for using the equity method from the date when Aareal Bank loses significant influence over the company or when joint control ends.

As at the reporting date, Aareal Bank was not exposed to material limitations as regards the access to, or use of, assets of the Group and as regards the liabilities of the Group.

Reporting entity structure

As at 31 December 2019, the reporting entity structure comprised 65 companies (2018: 67), including Aareal Bank AG as well as 59 (2018: 59) subsidiaries, one joint arrangement (2018: two) as well as four associates (2018: five).

In the year under review, there were no material changes to the basis of consolidation, except for the addition of plusForta GmbH, a broker of tenant deposit guarantees in Germany, and of Cave Nuove S.p.A. and Pisana S.p.A., which originated from a former Italian lending exposure. plusForta was taken over on 1 February 2019 through the acquisition of all shares, thus extending the range of digital solutions for the housing industry and the housing industry's customers.

Aareon acquired the business operations of CalCon Holding GmbH and its subsidiaries within the scope of an asset deal, effective 1 January 2020. In Germany and Austria the takeover encompassed 100 % of the capital, and a 83.33 % stake in Romania. CalCon is a provider of digital solutions for structural condition assessment, requirements assessment, and maintenance planning in Germany and Austria. The purchase price consists of a fixed price paid of € 20 million, plus a contingent purchase price to be determined by comparing realised to planned EBIT for the years 2020 and 2021. The fair value of the contingent purchase price amounted to € 4 million at the time of acquisition and was measured on the assumption of 100 % target achievement. The maximum contingent purchase price is € 6 million, with the preliminary fair value of the assets and liabilities measured at € 11 million. The acquisition resulted in goodwill of € 13 million, including potential market value effects and synergies. The acquisition complements our Aareon Smart World product portfolio and provides potential for business with public-sector entities and the commercial property sector in Germany and Austria.

Note (87) "List of Shareholdings" includes an overview of the Group companies.

(4) Currency translation

Individual line items in the financial statements of each Group entity are measured on the basis of the currency of the primary economic environment the respective entity operates in ("functional currency"). The consolidated financial statements are prepared in euro, being both the functional and the reporting currency.

Monetary assets and liabilities denominated in a foreign currency, unsettled cash market/spot transactions and non-monetary items measured at fair value are all translated to the functional currency on the basis of the ECB reference rate prevailing on the balance sheet date. Non-monetary items measured at amortised cost are translated using historical rates. Foreign exchange forward transactions are measured at the forward exchange rate prevailing on the balance sheet date.

Currency translation adjustments on monetary assets and liabilities must be recognised in income. Depending on the relevant measurement category, currency translation adjustments on non-monetary items are either recognised directly in equity (in the currency translation reserves), or recognised in the income statement (in net gain or loss from transactions measured at fair value).

Financial statements of consolidated subsidiaries, which are presented in a currency other than the euro, are translated at the ECB reference rate prevailing at the reporting date (statement of financial position) and at average rates (income statement). Translation differences are recognised in equity, in the currency translation reserves.

(5) Revenue recognition

Aareal Bank Group recognises revenue in the banking business as well as in the area of Consulting/Services. Revenue recognition in the banking business mainly refers to the provision of loans, the administration of syndicated loans or the provision of payment systems for the property and energy industries. Aareal Bank Group recognises revenue in the same period in which the services are provided. When contracts comprise various performance obligations, each of the performance obligations are priced separately. Mostly, fixed fees are agreed. Commissions from the lending and other banking business mainly arise over time. The customer obtains control over the service while Aareal Bank is providing the service. The agreed transaction price is invoiced to the customer on a pro-rata basis as at the end of an agreed period (normally monthly or quarterly). The Bank recognises the invoiced amount as revenue when it is entitled to a consideration in an amount that directly corresponds to the value of the services already provided. Invoiced amounts are payable immediately in the agreed amounts. Since the service has already been provided at the time the invoice is issued, an unconditional right to consideration arises, and a receivable due from the customer is recorded.

In the Consulting/Services unit, Aareal Bank Group earns revenue mainly from the country-specific ERP business in the property industry, from the marketing of digital solutions and other additional products and services such as insurance management, IT outsourcing, solutions for the energy industry and integrated payment systems. In this context, services are provided within the framework of licence agreements, maintenance agreements, consulting and training projects as well as hosting from the exclusive Aareon Cloud.

Licence revenue is deemed to be realised when there is an agreement signed by both parties without a right of rescission, the product has been delivered in its entirety (e.g. via licence keys), the licence fee is fixed, and payment is probable. Thus, the customer obtains control over the right-of-use asset transferred. The payment is made primarily after the licence agreement has been concluded or after successful implementation of the software with a credit term of several days. Revenue is accrued as a contract asset until the implementation is completed. After that, the amount is recognised as a trade receivable.

The recognition of maintenance as well as hosting and outsourcing services is made on a pro-rata basis over the contractual service period. Hosting solutions are billed monthly and recorded as sales revenue. A large portion of the customers pays its maintenance and hosting fees in advance for a specified period (not more than one year). The advance payments that refer to performance conditions that have not yet been satisfied are accrued as contract liabilities and released on a pro-rata basis as the services are provided in future. The customer obtains the benefits from the service and uses the service at the same time as it is provided.

Consulting and training services are recognised in income when the service has been provided. In addition, the Group provides implementation services as part of projects. This involves the generation or enhancement of assets for the customers over which they obtain control. Revenue recognition as well as the recognition of the contract asset are based on the progress towards complete satisfaction which is normally measured using input methods. The progress of the projects is determined by comparing the contract costs incurred with the expected contract costs for the project. Customers make advance payments in relation to the long-term services provided by Aareon. These are offset against the related contract assets, or reported under contract liabilities if the advance payment received exceeds the contract asset. Provisions are recognised for anticipated losses from such services in the period in which they are caused, to the extent that there is no assets item.

Standardised contracts are concluded within Aareal Bank Group for the vast majority of contracts with customers. This does not involve costs of obtaining a contract. In addition, there are no material amounts of variable consideration for the various services. The customers are not granted significant financing components.

(6) Leases

A lease is a contract or a part of a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

In accordance with IFRS 16, a lessee has to recognise a liability for lease payments as well as an asset for the right to use the underlying asset during the lease term. The practical relief provided for by the IFRS 16 as regards short-term lease agreements and low-value leased assets is made use of. The lease liabilities include the present value of the lease payments to be made over the lease term. Lease payments may comprise:

- fixed payments less any lease incentives receivable,
- variable lease payments that depend on an index or interest rate,
- amounts expected to be payable under residual value guarantees,
- the exercise price of a purchase option if the exercise of the option is reasonably certain, and
- payments of penalties for terminating the lease if terminating the lease is reasonably certain.

To determine the present value, the lease payments are discounted using the interest rate implicit in the lease. If such rate cannot be determined, discounting is based on Aareal Bank Group's incremental borrowing rate for the corresponding maturity band and the corresponding currency. The lease term is determined as the non-cancellable period of a lease, taking into account both extension options and termination options if it is reasonably certain that such options are exercised.

The right-of-use asset is measured upon initial measurement at cost which comprises the following amounts:

- the amount of the lease liability,
- any lease payments made to the lessor at or before the commencement date, less any lease incentives received,
- any initial direct costs, and
- asset retirement obligations.

These items are re-measured at amortised cost. The right-of-use assets are depreciated on a straight-line basis over the lease term.

Aareal Bank Group does not apply the IFRS 16 rules to leases involving intangible assets. If contracts include both lease components and non-lease components, the practical expedient as provided for by the standard not to separate these components is made use of.

Aareal Bank Group also acts as lessor, in which case a distinction has to be made between operating and finance leases. The basis for this classification is the extent to which the risks and rewards incidental to ownership of an underlying asset are attributable to either the lessor or the lessee. If a substantial portion of the risks and rewards remain with the lessor, the lease is classified as an operating lease. Where substantially all risks and rewards are transferred to the lessee, the lease is classified as a finance lease.

The major rental contracts of Aareal Bank Group as lessor are operating leases and mainly refer to let property. They are reported in the statement of financial position under other assets. Lease contracts are entered into individually and include various terms and conditions.

In the case of operating leases, the leased asset continues to be recognised as an asset at amortised cost. The lease payments received are reported in the income statement in net other operating income/expenses.

In the case of finance leases, Aareal Bank Group derecognises the carrying amount of the leased asset as at the commencement date and recognises a receivable at an amount equal to the net investment in the lease. Any gains or losses on disposal are recognised in the income statement.

For subsequent measurement, interest income from the lease receivable is recognised and the net investment in the lease is reduced by the lease payments received. Any impairment resulting from these lease receivables are included in the loss allowance in accordance with IFRS 9.

(7) Consolidated statement of cash flows

Aareal Bank Group's statement of cash flows records cash flows pertaining to the areas of operating activities, investing activities and financing activities for the period under review. The starting point of the consolidated statement of cash flows is the amount of cash and cash equivalents, consisting of cash on hand, balances with central banks as well as public-sector debt instruments and bills of exchange eligible for refinancing at central banks.

The definition of the term "operating activities" is consistent with the composition of the operating profit in the statement of comprehensive income. Cash flows from investing activities include proceeds from and payments for property and equipment, intangible assets, equity instruments and investments. Cash flows from financing activities include cash flows from transactions with providers of equity and subordinated capital.

(8) Determination of fair value

The determination of fair value is governed by IFRS 13 and applies to both financial instruments and non-financial assets or liabilities. In accordance with IFRS 13.9, the fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction under current market conditions at the measurement date. The determination of the fair value is based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. Another factor to be taken into account is whether Aareal Bank can enter into a transaction for the relevant asset or liability at the price in that market at the measurement date. The principal market is the market with the greatest volume and the highest level of activity for the asset or liability to which Aareal Bank has access. The most advantageous market is the market that maximises the amount that would be received to sell the asset, or minimises the amount that would be paid to transfer the liability.

Fair value hierarchy

In accordance with IFRS 13.72 et seqq., the fair value determination is based on the fair value hierarchy pursuant to which the inputs used are classified into various hierarchy levels on the basis of their respective market proximity and objectivity. The fair value of assets and liabilities is allocated to Level 1 of the fair value hierarchy if it is determined on the basis of unadjusted qualifying prices in active markets for identical assets or liabilities. Fair values determined using inputs other than qualifying prices included within Level 1 that are observable for the financial instrument, either directly or indirectly, are included in Level 2 of the fair value hierarchy. Fair values determined using valuation techniques where one or more material inputs are not based on observable market data are assigned to Level 3 of the fair value hierarchy. The estimation uncertainties as regards fair value measurement increase the higher the level is.

Measurement methods

The property and public-sector loans included in loan receivables are measured using the discounted cash flow method for the purpose of the determination of fair value. Discounting of future cash flows of a transaction is based on transaction-specific risk-adjusted interest rates. These are derived on the basis of a virtually risk-free market interest rate for each currency depending on the relevant term, taking into account add-ons for risks specific to the counterparty as well as credit costs. In the case of loans subject to fixed interest rates, the contractually agreed payments are used as future cash flows. The future cash flows for floating-rate loans are derived using the future forward interest rates, taking into account the relevant spread for customer-specific terms and conditions. In the case of defaulted loans, future cash flows are reduced by the expected losses.

Debt securities and promissory note loans for which no current market price is available in an active market are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data to the extent possible. These approaches include the discounted cash flow (DCF) method which is used to determine the present value of contractual cash flows until the expected end of the term. The present value is determined based on the benchmark curve applicable for the relevant market, taking into account mark-ups based on credit quality and liquidity. The valuation model used for options included in the transaction is the commonly used Black-Scholes model or numerical procedures.

In the case of unquoted financial investments in equity instruments, the costs of acquisition may also be the best estimate of fair value.

The fair value of OTC derivatives is determined on the basis of sector-specific standardised measurement models, such as the present value method or option pricing models. These techniques are based on inputs of active markets, such as interest rates, yield curves and credit spreads. The fair value of foreign exchange forwards is generally based on current forward exchange rates quoted on active markets. Since the derivatives are part of highly effective collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives Transactions) which are each subject to a master collateralisation agreement, measurement adjustments to reflect any potential counterparty credit risk or own credit risk (CVA and DVA) are not required for reasons of materiality. The Bank uses the overnight interest rate swap curve (OIS curve) for the measurement of derivatives secured by cash collateral.

Amortised cost is an adequate estimate of fair value for cash funds, other loan receivables as well as short-term money market receivables and liabilities.

(9) Recognition and measurement of financial instruments

Pursuant to IAS 32, a financial instrument is any contract that gives rise to a financial asset at one contracting party and a financial liability or equity instrument at another contracting party.

Recognition

Financial instruments (including derivative financial instruments) must be recognised if the reporting entity has become a party to the contractual provisions of such financial instruments. Trade date and settlement date are not the same for regular way purchases and sales of financial assets. Such regular way purchases and sales may be accounted for either at trade date or at settlement date. At Aareal Bank Group, financial instruments (fvpl) are recognised at the trade date, while all other financial instruments are recognised at the settlement date.

Financial instruments have to be derecognised when the contractual rights to the cash flows from the financial asset expire or an entity transfers the financial asset, including substantially all its risks and rewards. The modification of the contractual terms may also result in the derecognition of a financial instrument and the recognition of a new financial instrument.

If only a portion of risks and rewards is transferred and a portion of control is retained, the financial asset is recognised only to the extent of its continuing involvement. The extent of the continuing involvement corresponds to the extent to which the Company is exposed to changes in the value of the financial asset. A financial liability is derecognised when it is extinguished, i.e. when the obligation specified in the contract is discharged.

Modification

As a matter of principle, a modification is defined as any change made to existing terms of a loan agreement or a contractual adjustment during the loan or contract term. This applies regardless of the reasons for the modification (credit-driven or market-driven). Contractual adjustments may either lead to the derecognition of the ”old” and the recognition of a ”new” asset when such adjustments are substantial to the extent that they, in essence, constitute a new asset (hereinafter referred to as ”substantial modification”) or to the recalculation of the carrying amount and the recognition of a net modification gain or loss, when such adjustments constitute an adjustment of an existing asset (hereinafter referred to as ”non-substantial modification”).

The contractual adjustments subject to modifications may generally be caused by the borrower's credit quality and solvency (credit-driven modifications) or the granting of more favourable terms and conditions in an existing contract or the adjustment of the framework for financings as a result of changes in the customer's financing needs (market-driven modifications).

Both substantial and non-substantial modifications have an impact on profit or loss.

The amount of net modification gains or losses arising from non-substantial modifications is determined by the difference of the gross carrying amounts before and after the modification. Net modification gains or losses arising from market-driven modifications are recognised in net interest income, while credit-driven modifications are reported in the loss allowance. Subsequently, the changes in the carrying amount of the receivable is amortised over the remaining term of the receivable and recorded in net interest income.

In the case of a substantial modification, the old asset has to be derecognised, and a new asset has to be recognised. The difference of the gross carrying amounts before and after the modification is reported as net derecognition gain or loss after utilisation of the existing loss allowance in the case of market-driven modifications. In the case of credit-driven modifications, a loss allowance is recorded prior to derecognition in an amount that covers the entire difference between the old carrying amount and the fair value determined at the time of initial recognition.

Measurement

Upon initial recognition, financial instruments are measured at fair value, for subsequent measurement at ac or fvoci (cf. section Classification), in each case plus any transaction costs.

Subsequent measurement of financial assets is based on the classification of the financial instrument. Depending on the classification, financial assets are measured at amortised cost, at fair value through other comprehensive income or at fair value through profit or loss. Investments in equity instruments are measured at fair value through profit or loss, unless an irrevocable election is made at initial recognition to present subsequent changes in fair value in other comprehensive income. Within Aareal Bank Group, this election is exercised as a rule due to the investment characteristics of the equity instruments.

Financial liabilities are measured at amortised cost.

In addition, financial assets and liabilities may be designated as at fair value through profit or loss if certain prerequisites are met. Aareal Bank Group does not make use of this option.

Classification

The classification, i.e. the determination of the measurement category of a financial asset is to be assessed on the basis of two criteria. The objective criterion refers to the contractual design as to whether the payments solely represent payments of interest and principal on the principal amount outstanding (SPPI = solely payments of principal and interest). Relevant criteria were defined that are reviewed at initial recognition. For example, this may be financings with a primary investment risk or contractually agreed payments that depend on the borrower's economic performance. The subjective classification criterion refers to the business model, i. e. the aim that a company pursues for a group of assets.

Subsequent measurement has to be based on amortised cost (ac) when the financial instrument is held in order to collect contractual cash flows (business model "Hold") and additionally the contractual cash flows represent solely payments of principal and interest, i. e. are SPPI compliant. This classification category is used for a large portion of the lending and securities business.

Subsequent measurement at fair value, with changes in fair value being recognised initially directly in equity and subsequently reclassified to profit or loss (so-called recycling) (fair value through other comprehensive income (fvoci)) has to be made when financial instruments are SPPI compliant and are held either to collect contractual cash flows or to be sold (business model "Hold & Sell").

Subsequent measurement at fair value, with changes in fair value being recognised through profit or loss (fvpl), has to be made if the financial instrument is not SPPI compliant or cannot be allocated to one of the two business models mentioned above. The latter is the case for example when there is the purpose of selling such financial instruments in the near term due to syndication covenants.

Loss allowance

Loss allowances are based on the internal staging and expected credit loss (ECL/EL) model of Aareal Bank. For this purpose, financial instruments measured at amortised cost and at fair value through other comprehensive income as well as loan commitments and financial guarantees are allocated to various stages at both initial recognition and subsequent measurement. The related loss allowances are recognised in the amount of the twelve-month or the lifetime expected credit loss.

Stage 1: All financial instruments without impairment trigger are allocated to this stage at initial recognition. If the credit risk is not significantly increased, the financial instrument has to remain in Stage I for subsequent measurement. Loss allowances are recognised in the amount of the losses expected for the following twelve months and interest income is calculated on the basis of the gross carrying amount, applying the effective interest method. Loss allowances have to be recognised on a present value basis.

Stage 2: All financial instruments where credit risk has increased significantly since initial recognition are allocated to this stage. Loss allowances are recognised in the amount of the losses expected for the entire remaining term of the instrument and interest income is calculated on the basis of the gross carrying amount, applying the effective interest method. Loss allowances have to be recognised on a present value basis. The significant increase in credit risk for the allocation to Stage 2 is determined using the so-called expected downgrade bank-internal staging model and taking into consideration quantitative and qualitative criteria such as the credit rating of the customer, the intensity of customer handling and payment defaults. If the significant increase in credit risk no longer applies, the financial instrument is re-transferred to Stage I. A description of the credit risk methods and systems in place at Aareal Bank AG is presented in the Risk Report as part of the Group Management Report.

Stage 3: This stage includes all financial instruments where there is objective evidence of impairment (impairment trigger or credit impaired). Loss allowances are recognised in the amount of the losses of the lifetime expected credit loss, and interest income is calculated on the basis of the net carrying amount (i. e. gross carrying amount less loss allowance) using the effective interest method. The lifetime expected credit loss in Stage 3 is determined as the difference between the gross carrying amount and the present value of expected future cash flows (discounted using the original effective interest). If the impairment triggers no longer apply, the financial instrument is re-transferred to Stage 1 or 2.

POCI (purchased or originated credit impaired): This category includes all financial instruments that were subject to an impairment trigger at initial recognition. The loss allowance is recorded in the amount of the lifetime expected credit loss.

The expected credit loss is generally determined by Aareal Bank using a model-based procedure where, depending on the stage, one- or multi-year parameters are used. The calculation of the expected loss in Stage 1 and of lifetime expected credit loss in Stage 2 is based on the one-year or lifetime probability of default (PD), respectively, the loss given default (LGD), the expected exposure at default (EAD), a discount factor (DF) and the expected contractual term. Current and expected country-specific economic conditions such as the GDP, long-term interest rates and unemployment rate are included in the LGD by means of a scenario-weighted market value forecast. A period of not more than twelve months is assessed for Stage I, while the expected contractual term of the financial instrument has to be taken into account for Stages 2 and 3 (and, in addition, the expected term for loan repayment in Stage 3). In the year under review, the macroeconomic scenarios for model-based determination of expected credit losses were refined. The impact of this change in estimates, which was applied prospectively, on income was immaterial.

The expected loss in Stage 3 is usually determined on the basis of individually estimated cash flows (ECF procedure) in several probability-weighted scenarios. The amount of the loss allowance is determined as being the difference between the carrying amount of the asset and the present value of the expected future cash flows, discounted using the original effective interest rate applicable at initial recognition (taking into account cash flows from realisation of collateral provided). Collateral is largely provided in the form of land charges or mortgages; these are measured at fair value which is generally based on either the income capitalisation approach or the discounted cash flow method. Impairment triggers are strong indications for a decline of the borrower's credit quality, arrears as well as further indications that not all interest and principal payments can be made as contractually agreed.

The loss allowance for debt instruments measured at amortised cost is reported in the item "Loss allowance (ac)", for debt instruments measured at fair value through other comprehensive income in the item "Reserve from the measurement of debt instruments (fvoci)" and for loan commitments and financial guarantees under provisions. Debt instruments reported under POCI are accounted for on a net basis, i. e. without any loss allowance. Changes in loss allowance are reflected by increasing or decreasing the carrying amount through other loss allowance.

If the receivables are not recoverable, the corresponding loss allowance is utilised and the receivable is derecognised. Direct write-offs are not made.

The loss allowance for receivables from other transactions is determined using a simplified procedure in the amount of the lifetime expected credit losses.

Hedging relationships

The risk management strategy set out in the Risk Report of the Group Management Report is the basis for the recognition of hedging relationships. At Aareal Bank Group, risks from value fluctuations are hedged in the case of transactions not measured at fair value through profit or loss. In this context, the risks from hedged items are intended to be offset by entering into hedging derivatives where the fair value changes have the opposite direction compared to those of the hedged item. Average prices of the hedges are not relevant for risk management. Hedging relationships are not recorded for transactions that are measured at fair value through profit or loss. The results from economic hedging relationships are offset in net gain or loss from transactions measured at fair value.

Hedge accounting in accordance with IFRS 9 distinguishes various forms of hedging relationships.

Fair value hedges are used to hedge hedged items against fair value changes resulting from changes in interest rates or from changes in interest and exchange rates that are determined accordingly as hedged risk. At Aareal Bank Group, property loans, securities and promissory note loans are typically hedged using interest rate swaps and cross-currency swaps. The derivatives used for hedging are accounted for at fair value through profit or loss. The offsetting fair value changes of the hedged item resulting from the hedged risk are also recognised through profit or loss. The proportion of the fair value changes of the hedged item not attributable to the hedged risk is accounted for in line with the classification of the hedged item. A fully effective hedging relationship results in offsetting measurement results. The hedging relationship may result in adjustments in the carrying amount of the underlying transaction. Such adjustments will only be recognised in income at the end of the transaction term.

Hedges of a net investment in a foreign operation are used to hedge currency risks arising on the translation of the net assets of foreign Group companies. The effective portion of measurement gains or losses from derivative hedging instruments is recognised directly in equity in the currency translation reserve. The ineffective portion of the hedging derivative's fair value changes have to be recognised in the income statement. The gain or loss on the hedging derivative relating to the effective portion of the hedge that has been recognised directly in equity shall be recognised in profit or loss on disposal of the foreign operation. Any translation differences resulting from the translation of an entity with a different functional currency into the Group currency also have to be recognised directly in equity in the currency translation reserve; they will be reclassified to the income statement upon disposal of the foreign operation.

The effectiveness of hedging relationships is reviewed by way of a forward-looking sensitivity analysis regarding the hedged risks. Factors which may lead to ineffectiveness include the term of transactions or payment dates, or diverging market conventions for underlying transactions and related hedges which affect the relevant measurement parameters (e.g. discounting using an OIS rate). Currency basis spreads are accounted for as hedging costs, with fair value changes of this element recognised in other comprehensive income. In the event of any changes to hedging relationships occurring in the course of risk management, the hedge ratio of existing hedges and/or hedged items is adjusted accordingly.

(10) Cash funds

Cash funds include cash on hand and balances with central banks. Cash funds are exclusively allocated to the measurement category "ac".

(11) Loan receivables

The item "Loan receivables" comprises property loans, public-sector loans and other loan receivables, including deferred interest. Loan receivables can be allocated to all measurement categories. At present, they are allocated to the ac and fvpl measurement categories. The portion of loan commitments not disbursed is reported as contingent liabilities.

(12) Money market and capital market receivables

The item ”Money market and capital market receivables” comprises money market receivables, promissory note loans and debt securities, including deferred interest. Money market and capital market receivables may generally be allocated to all measurement categories.

(13) Equity instruments

This item includes unconsolidated equity instruments. They are allocated to the measurement category ”fvoci”.

(14) Receivables from other transactions

The item ”Receivables from other transactions” comprises trade receivables and other financial receivables. Receivables from other transactions are exclusively allocated to the measurement category ”ac”.

(15) Positive market value of designated hedging derivatives / Negative market value of designated hedging derivatives

The items ”Positive market value of designated hedging derivatives” and ”Negative market value of designated hedging derivatives” include derivatives with positive or negative market values from fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation, including deferred interest. Derivatives are exclusively allocated to the measurement category ”fvpl”. The basis for the recognition of hedging relationships is described in the chapter ”Recognition and measurement of financial instruments” in this section. Effects from the measurement of these derivatives are reported in the item ”Net gain or loss from hedge accounting”, together with the effects from the measurement of the transactions.

(16) Positive market values of other derivatives / Negative market value of other derivatives

Derivative financial instruments that are not part of recognised hedging relationships are reported in Aareal Bank Group under positive or negative market values of other derivatives. They are mainly used to hedge economic market price risks. Derivatives are exclusively allocated to the measurement category ”fvpl”. Results from the measurement and the termination of the derivatives are reported in the item ”Net gain or loss from financial instruments (fvpl)”. Interest received or paid in connection with these derivatives is also recorded generally in the item ”Net gain or loss from financial instruments (fvpl)”. Interest received or paid for derivatives entered into for hedging purposes which, however, do not meet the hedge accounting criteria, is reported in net interest income. Effects from the measurement of these derivatives are reported in the item ”Net gain or loss from financial instruments (fvpl)”, together with the effects from the measurement of the transactions.

(17) Investments accounted for using the equity method

The item "Investments accounted for using the equity method" includes shares in companies where Aareal Bank Group can exercise significant influence (associates) as well as shares in joint ventures.

Investments in associates included in this item are recognised at cost when the significant influence arises, and subsequently carried at amortised cost whereby, in particular, the share of results of operations of any financial year is recognised in income.

The equity method applied to the major associates was based on the most recent available financial statements.

(18) Intangible assets

The item "Intangible assets" consists of proprietary software, goodwill and other intangible assets such as purchased software and licences.

Intangible assets (except goodwill) are carried at cost, less accumulated amortisation and any impairment losses.

Research costs incurred in connection with software development are expensed as they are incurred. Development costs are capitalised from the time when the software development can be regarded as completed from a technical perspective, and several other conditions are fulfilled. Borrowing costs directly attributable to software development are also part of the cost. They are amortised on a straight-line basis, using an estimated economic life of between three and ten years. Purchased software is also deemed to have a limited useful life. Amortisation is recognised in administrative expenses.

Goodwill is defined as the excess of the cost of acquisition over the fair value of the Group's interest in the net assets of an acquired entity, at the time of acquisition (positive difference). Goodwill is carried at historical cost less accumulated impairments. Any negative goodwill arising upon acquisition is immediately recognised in income.

In case the annual impairment test shows that there are indications of impairment of intangible assets (as set out in IAS 36) and that the recoverable amount is lower than the carrying amount of the asset concerned, the asset is written down through profit or loss, to the estimated recoverable amount.

If it is impossible to estimate the recoverable amount for a specific asset, the recoverable amount of the cash-generating unit that the asset belongs to must be determined. A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Aareal Bank Group defines cash-generating units either on the basis of a single subsidiary or on product level. The recoverable amount of an asset or a cash-generating unit is the higher of fair value less costs to sell and value in use. (Value in use is the present value of future cash flows expected to arise from the continuing use of an asset or cash-generating unit.) Future cash flows are determined based on medium-term projections. The present value of the future cash flows is determined using discount factors which are in line with the risks involved. Accordingly, the recognition of intangible assets and the impairment test is also subject to estimation uncertainties.

(19) Property and equipment

The item ”Property and equipment” includes owner-occupied land and buildings, office furniture and equipment as well as a hotel which is operated by Aareal Bank. Property and equipment is measured at cost, less accumulated depreciation and impairment losses. Depreciation and impairment losses are reported under administrative expenses, while those of the owner-operated hotel are shown in net other operating income/expenses.

Owner-occupied buildings reported under property and equipment are depreciated on a straight-line basis, over a period of 25 to 50 years. Owner-occupied land is not depreciated. Please refer to the explanations in the Notes on other assets for the accounting method to be applied for land and buildings which are not owner-occupied. Office furniture and equipment items are depreciated using the straight-line method, applying the following periods:

	Depreciation period
Other property and equipment	
IT equipment	3-7 years
Other office furniture and equipment	5-13 years

Tenant improvements are depreciated based on the principles applicable for the relevant building.

For details on recognising impairments as defined in IAS 36, please refer to the explanations in the Note on intangible assets in this section.

Gains and losses upon disposal of property and equipment are recognised in income (in net other operating income/expenses).

The costs to purchase property and equipment in the amount of up to € 250.00 (low-value assets) are expensed as they are incurred.

Any items of property and equipment with a cost of more than € 250.00 net, but not exceeding € 1,000.00, can be combined in a collective account for the year, which is then depreciated on a straight-line basis over a period of five years.

(20) Income tax assets/income tax liabilities

The measurement of uncertain tax positions is made using the best estimate of the expenditure required to settle the obligation (most likely amount). In the context of acquisitions in accordance with IFRS 3, contingent liabilities were also recognised at their expected value. These are released when the reasons for their recognition cease to exist.

(21) Deferred tax assets / deferred tax liabilities

Deferred tax assets are recognised when they are deemed recoverable. The recoverability is assessed using tax planning (internal assessment) on the basis of medium-term Group planning. Accordingly, deferred tax assets are only recognised to the extent that we deem it probable that future taxable profits will be available against which the temporary differences and tax loss carryforwards can be utilised. Deferred taxes are calculated on the basis of country- and company-specific tax rates expected to apply at the time of the realisation of temporary differences and set-off against loss carryforwards.

Deferred tax assets and deferred tax liabilities are offset in accordance with IAS 12.74 when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or tax group.

We generally assume that the deferred tax items are of a long-term nature. The remaining maturity or the time of the expected realisation is long-term when there is one year or more between the reporting date and the maturity date.

(22) Other assets

The item "Other assets" includes, amongst other things, properties and contract assets. Properties reported under other assets are intended for short-term disposal. They are measured at the lower of cost or net realisable value, in accordance with IAS 2, and therefore are subject to estimation uncertainties.

(23) Money market and capital market liabilities

The item "Money market and capital market liabilities" comprises money market liabilities, mortgage Pfandbriefe, registered public-sector Pfandbriefe, promissory note loans and other debt securities, including deferred interest. Money market and capital market activities are allocated to the measurement category "c".

(24) Deposits from the housing industry

The item "Deposits from the housing industry" includes deposits payable on demand and term deposits, including deferred interest. Deposits from the housing industry are allocated to the measurement category "ac".

(25) Liabilities from other transactions

The item "Liabilities from other transactions" comprises trade payables and other financial liabilities. Liabilities from other transactions are exclusively allocated to the measurement category "ac".

(26) Subordinated liabilities

Subordinated funds raised do not provide for any early repayment obligation. In the event of liquidation or insolvency, claims on interest and principal from these liabilities are subordinated to the claims of all other creditors, which are not subordinated themselves. Subordinated liabilities are allocated to the measurement category ”ac”.

(27) Provisions

The item ”Provisions” comprises provisions for pensions and similar obligations, provisions for staff expenses and non-staff operating costs, provisions for risks related to unrecognised items in the lending business, provisions for legal or tax risks, as well as other provisions. Provisions are recognised when there is a present legal or constructive obligation towards third parties arising from a past event, the outflow of resources to meet this obligation is probable and the amount of the obligation can be reliably estimated. The measurement of provisions is made using the best estimate of the expenditure required to settle the obligation (most likely amount). In the context of acquisitions in accordance with IFRS 3, contingent liabilities were also recognised at their fair value (expected value). These are released when the reasons for their recognition cease to exist.

Measurement is subject to several uncertainties and often requires significant estimates made by the management in relation to various factors that may not apply subsequently. The final amount of the liabilities may deviate significantly from the measurement previously made in accounting. For example, the outcome of individual legal proceedings may not be predicted with certainty.

If utilisation in the short term, i. e. within twelve months, from the obligation is not expected, the provision will be recognised at present value.

Provisions for pensions and similar obligations

Aareal Bank Group maintains various pension plans as defined in IAS 19. For the purpose of reporting pension obligations, IAS 19 makes a distinction between defined contribution plans and defined benefit plans.

Under defined contribution plans, an enterprise pays fixed contributions into a separate entity or a fund and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Contributions paid to the statutory pension insurance scheme are also classified as defined contribution plans. The contributions paid to a defined contribution plan are recorded as staff expenses.

Defined benefit obligations are all pension obligations that do not meet the criteria of a defined contribution obligation. The amount of obligations usually depends on one or several factors, including age, length of service, and salary.

The Group’s obligations under defined benefit plans are recognised as a provision in the consolidated statement of financial position. These are based on general works agreements on an employee pension scheme, individual agreements with executive staff as well as individual agreements concluded with the members of the Company’s senior management. Projected economic and demographic developments as well as salary trends must be applied to the calculation of the provisions. Calculating the amount of provisions in the Group is based on actuarial opinions which are prepared by external actuaries on the basis of Aareal Bank-specific and Group-wide standardised parameters.

Provisions for pensions and similar obligations under defined benefit plans are determined in accordance with IAS 19 on the basis of the projected unit credit method; the various defined benefit plans are measured separately. The fair value of the plan assets is deducted from the present value of the pension obligation, taking into account, if applicable, the rules for the asset ceiling in relation to a surplus of plan assets over the benefit obligation. The resulting amount represents the net defined benefit liability (provision) or the net defined benefit asset. The net interest expense in the financial year is determined by applying the discount factor calculated at the beginning of the financial year to the net liability calculated as at that date. The discount rate used to determine the present value of the obligation is based on the capital market rate of high quality corporate bonds at the reporting date. Determination is based on the GlobalRate:Link method by Willis Towers Watson. The data basis consists of corporate bonds recorded by Bloomberg which have a rating of at least "AA" and are denominated in the same currency as the underlying pension obligation. Actuarial gains and losses (remeasurements), which – in connection with the amount of obligations – arise on changes in expectations regarding life expectancy, pension increases, salary development and discount rate compared to the estimation made at the beginning of the period or compared to the actual trend during the period, are recorded in other comprehensive income in the item "Changes in the reserve from remeasurements of defined benefit plans". Actuarial gains and losses (remeasurements) recorded in other comprehensive income may not be reclassified subsequently to profit or loss (recycling). Differences between the expected return on plan assets, determined at the beginning of the period using the then applicable discount rate, and the actual return on plan assets (remeasurement) at the end of the period are also recognised in other comprehensive income. Actuarial gains and losses as well as the difference between expected and actual return on plan assets are included in other reserves. They are reported separately in the statement of changes in equity. Thus, the recognition of pension obligations is based on estimates which are subject to uncertainty.

Share-based payment

Aareal Bank Group maintains share-based payment plans subject to cash settlement in accordance with IFRS 2. We refer to our comments in Note (78) to the consolidated financial statements, which include a detailed description of the plans and their scope as well as information on the valuation model applied and the effects of share-based payments on the Group's financial position and performance.

Provisions for obligations arising from share-based remuneration plans are recognised under administrative expenses, in the amount of the fair value of the relevant obligation as at the reporting date.

(28) Other liabilities

The item "Other liabilities" includes, among other things, contract liabilities, deferred income and liabilities from other taxes.

(29) Equity

The item "Equity" comprises subscribed capital, capital reserves, retained earnings and other reserves. Other reserves include the reserve from remeasurements of defined benefit plans, the reserves from the measurement of equity and debt instrument at fair value through other comprehensive income, the reserve from changes in the value of foreign currency basis spreads and currency translation reserve. In addition, the item "Equity" includes non-controlling interests as well as the so-called Additional Tier I bond (AT1 bond). The AT1 bond is classified as equity since there is neither an obligation to repay the bond nor is there an obligation for ongoing debt service (payment of a dividend). The transaction costs directly attributable to the issue of the AT1 bond as well as dividends paid are deducted directly from equity, net of taxes.

(30) Financial guarantee contracts

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss that it incurs because a specified debtor fails to make payment when due. A guarantor recognises a financial guarantee contract as a liability at the date of addition, using the fair value of the guarantee obligation. The obligation is subsequently measured at the greater of a provision recorded in accordance with IAS 37 and the original amount, less any accumulated amortisation. Within Aareal Bank Group, financial guarantee contracts are presented based on the present value of the claim resulting from the future premium payments of the holder, and offset with the obligation for the guarantee (net basis).

Notes to the Statement of Comprehensive Income

(31) Net interest income

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Interest income from financial assets (ac and fvoci)	875	838
Loan receivables	865	820
Money market and capital market receivables	10	18
Interest income from financial liabilities (ac)	14	9
Money market and capital market liabilities	6	5
Deposits from the housing industry	8	4
Interest income from financial instruments (fvpl)	44	38
Loan receivables	26	22
Money market and capital market receivables	6	7
Other derivatives	12	9
Market-driven modification gains	0	2
Total interest and similar income	**933**	**887**
Interest expenses from financial liabilities (ac)	99	104
Money market and capital market liabilities	73	77
Deposits from the housing industry	1	2
Liabilities from other transactions	2	0
Subordinated liabilities	23	25
Interest expenses from financial assets (ac)	12	9
Cash funds	9	8
Money market and capital market receivables	3	1
Interest expenses for financial instruments (fvpl)	289	236
Other derivatives	289	236
Market-driven modification losses	0	3
Total interest and similar expenses	**400**	**352**
Total	**533**	**535**

Net interest income amounted to € 533 million (2018: € 535 million) and was thus stable.

(32) Loss allowance

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Additions	206	137
Reversals	118	61
Recoveries on loans and advances previously written off	3	4
Loss allowance – other items	0	0
Credit-driven net modification gain or loss	5	0
Total	**90**	**72**

The loss allowance of € 90 million (2018: € 72 million) corresponded with the forecast that was increased to take account of the higher burden from accelerated risk reduction. Please also refer to our explanations in Note (61).

(33) Net commission income

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Commission income from		
ERP products (incl. additional products)	183	178
Digital solutions	51	42
Banking business and other activities	45	39
Total commission income	**279**	**259**
Commission expenses for		
Purchased services	44	40
Banking business and other activities	6	4
Total commission expenses	**50**	**44**
Total	**229**	**215**

Net commission income of € 229 million developed positively as planned, in particular due to the increase in Aareon's net commission income (2018: € 215 million). Commission income from ERP products and digital solutions includes € 22 million of licence revenue (2018: € 26 million) recognised at a point in time. In the reporting period, revenue of € 1 million (2018: € 2 million) was recorded attributable to performance obligations of earlier periods.

The net amount of commission income and commission expenses from financial assets and financial liabilities not measured at fair value amounts to € 13 million (2018: € 11 million).

(34) Net derecognition gain or loss

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Net gain or loss on the derecognition of financial assets (ac)		
Loan receivables	32	24
Money market and capital market receivables	-1	–
Net gain or loss on the derecognition of financial liabilities (ac)		
Money market and capital market liabilities	3	0
Net gain or loss on the derecognition of financial assets (fvoci)		
Money market and capital market receivables	30	–
Total	**64**	**24**

The net derecognition gain amounted to € 64 million (2018: € 24 million), exceeding our increased forecast especially as a result of structural adjustments to our securities portfolio following the acquisition of former Düsselhyp.

(35) Net gain or loss from financial instruments (fvpl)

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Net gain or loss from loan receivables	-14	-6
Net gain or loss from money market and capital market receivables	4	-2
Net gain or loss from other derivatives	13	8
Currency translation	-2	-2
Total	**1**	**-2**

(36) Net gain or loss from hedge accounting

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Ineffective portion of fair value hedges	-4	-2
Ineffective portion of net investment hedges	0	0
Total	**-4**	**-2**

(37) Net gain or loss from investments accounted for using the equity method

In the past financial year, there was a net gain from investments accounted for using the equity method of € 1 million (2018: € 0 million); this was also in line with the pro-rata results from joint ventures and associates.

(38) Administrative expenses

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Staff expenses	295	261
Wages and salaries	237	206
Social security contributions	35	33
Pensions	23	22
Other administrative expenses	152	177
Depreciation, amortisation and impairment of property and equipment and intangible assets	41	24
Total	**488**	**462**

Administrative expenses increased as expected, to € 488 million (2018: € 462 million), in particular due to running costs and integration expenses incurred in conjunction with the integration of former Düsselhyp, and Aareon's business expansion and strategic investments.

Staff expenses include contributions to defined contribution plans in the amount of € 15 million (2018: € 14 million).

Other administrative expenses include administrative costs for research and development in relation to existing and new functions and products not eligible for capitalisation in the amount of € 29 million (2018: € 27 million).

This item also includes the total fees charged by the auditor of the consolidated financial statements in the financial year 2019, which consists of the following sub-items:

€ 000's	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Auditing fees	3,987	4,616
Other assurance services	144	218
Tax advisory services	3	7
Other services	356	308
Total	**4,490**	**5,149**

Other assurance services include the review in accordance with the German Securities Trading Act (WpHG), the bank levy, software confirmations, comfort letters and the separate non-financial statement. Tax advisory services refer to general tax advice. Other services include, in particular, due diligence services and regulatory advice.

(39) Net other operating income/expenses

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Income from properties	43	57
Income from the reversal of provisions	2	5
Income from goods and services	0	1
Other operating income	23	31
Total other operating income	**68**	**94**
Expenses for properties	40	57
Expenses for other taxes	4	4
Other operating expenses	22	8
Total other operating expenses	**66**	**69**
Total	**2**	**25**

(40) Income taxes

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Current income taxes	76	55
Deferred taxes	9	35
Total	**85**	**90**

The differences between calculated and reported income taxes are presented in the following reconciliation:

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Operating profit (before income taxes)	248	316
Expected tax rate	31.7 %	31.7 %
Calculated income taxes	**79**	**100**
Reconciliation to reported income taxes		
Different foreign tax burden	-2	10
Tax attributable to tax-exempt income	–	-25
Tax attributable to non-deductible expenses	24	5
Taxes for previous years	-16	–
Reported income taxes	**85**	**90**
Effective tax rate	34 %	29 %

The expected tax rate of 31.7 % (2018: 31.7 %), including a trade tax rate of assessment of 453 %, comprises trade taxes (15.9 %), corporation taxes (15 %) and the solidarity surcharge (0.825 %; 5.5 % of corporation tax).

Notes to the Statement of Financial Position

(41) Financial assets (ac)

€ mn	31 Dec 2019	31 Dec 2018
Cash funds (ac)	**1,494**	**1,265**
Cash on hand	0	0
Balances with central banks	1,494	1,265
Loan receivables (ac)	**25,783**	**26,795**
Property loans	25,333	26,309
Public-sector loans	398	448
Other loan receivables	52	38
Money market and capital market receivables (ac)	**6,618**	**6,578**
Money market receivables	1,363	1,000
Promissory note loans	1,823	1,751
Bonds	3,432	3,827
Receivables from other transactions (ac)	**77**	**64**
Trade receivables	37	35
Other financial receivables	40	29
Total	**33,972**	**34,702**

(42) Loss allowance (ac)

31 December 2019

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance (ac)
Balance as at 1 January	**34**	**22**	**519**	**2**	**577**
Additions	13	7	184	2	**206**
Utilisation	–	–	237	1	**238**
Reversals	25	15	74	0	**114**
Transfer to Stage 1	1	-1	–	–	**–**
Transfer to Stage 2	-2	7	-5	–	**–**
Transfer to Stage 3	0	-4	4	–	**–**
Interest rate effect	–	–	21	–	**21**
Currency adjustments	1	0	3	0	**4**
Changes in the basis of consolidation	–	–	-70	–	**-70**
Transfers	–	–	–	–	**–**
Balance as at 31 December	**22**	**16**	**345**	**3**	**386**

The loss allowance for financial assets measured at amortised cost refers to loan receivables, money and capital market receivables as well as receivables from other transactions (largely trade receivables) that are measured at amortised cost.

A detailed breakdown of loss allowance by classes of financial assets is disclosed in Note (61) in the chapter ”Notes related to financial instruments”.

31 December 2018

€ mn	Stage 1	Stage 2	Stage 3	Receivables from other transactions (ac)	Total loss allowance (ac)
Balance as at 1 January	**32**	**42**	**517**	**2**	**593**
Additions	18	6	110	0	**134**
Utilisation	–	–	100	1	**101**
Reversals	16	14	26	1	**57**
Transfer to Stage 1	1	-1	–	–	**–**
Transfer to Stage 2	-1	1	–	–	**–**
Transfer to Stage 3	0	-12	12	–	**–**
Interest rate effect	–	–	5	–	**5**
Currency adjustments	0	0	1	0	**1**
Transfers	–	–	–	2	**2**
Balance as at 31 December	**34**	**22**	**519**	**2**	**577**

(43) Financial assets (fvoci)

€ mn	31 Dec 2019	31 Dec 2018
Money market and capital market receivables (fvoci)	**3,415**	**4,443**
Bonds	3,415	4,443
Equity instruments (fvoci)	**5**	**7**
Equities and other non-fixed income securities	0	0
Other investments	5	7
Total	**3,420**	**4,450**

(44) Financial assets (fvpl)

€ mn	31 Dec 2019	31 Dec 2018
Loan receivables (fvpl)	**1,050**	**711**
Property loans	1,050	711
Money market and capital market receivables (fvpl)	**135**	**538**
Promissory note loans	94	90
Bonds	38	448
Fund units	3	–

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€ mn	31 Dec 2019	31 Dec 2018
Positive market value of designated hedging derivatives (fvpl)	**1,380**	**1,277**
Positive market value of fair value hedges	1,374	1,277
Positive market value of net investment hedges	6	–
Positive market value of other derivatives (fvpl)	**414**	**657**
Positive market value of economic hedging derivatives	238	466
Positive market value of miscellaneous other derivatives	176	191
Total	**2,979**	**3,183**

(45) Investments accounted for using the equity method

Aareal Bank holds interests in four associates (2018: five, plus one joint venture) that are accounted for using the equity method. The sum total of the carrying amounts of the equity investments amounted to € 8 million (2018: € 7 million).

(46) Intangible assets

€ mn	31 Dec 2019	31 Dec 2018
Goodwill	89	85
Proprietary software	37	32
Other intangible assets	49	41
Total	**175**	**158**

Goodwill is entirely attributable to the Consulting/Services segment and can be allocated to the following business divisions:

€ mn	31 Dec 2019 Goodwill	31 Dec 2018 Goodwill
Bank division Housing Industry		
Germany	4	–
Aareon sub-group		
DACH	35	35
International Business	50	50
Total	**89**	**85**

Goodwill is generally tested for impairment in the fourth quarter of each year. The basis for the valuation is the present value of future cash flows (value in use), which are determined using medium-term projections. In this context, the projected pre-tax cash flows determined on the basis of the three-year plan are used. Accordingly, there is an individual planning of revenue and expense items within the first three years. The parameters underlying the major assumptions are based on internal and external factors as well as on past experience. The major basis is the previous year's planning. Revenue projections are largely subject to assumptions in relation to migration plans, new business, as well as renewals of contracts and follow-up business with existing customers. At the same time, these represent the key sources for estimation uncertainty. Regular sales revenues, such as maintenance and fees from transactions with existing customers, are normally not subject to estimation uncertainty. The projections for cost of materials are derived from revenue projections. The projections for staff expenses predominantly take into account the number of employees, as well as wage and salary trends. Other costs are projected based on the previous year's figures, taking into account known one-off effects. Estimation uncertainties in relation to costs arise as a result of unplanned price increases or unforeseeable one-off effects. In principle, estimation uncertainty increases if assumptions are made further into the future. Cash flows beyond the four-year horizon are determined by way of a perpetual annuity.

The present values of future cash flows were determined on the basis of a risk-adequate discount factor of 6.67 % for the Aareon sub-group and of 4.91 % after taxes for the Bank's Housing Industry division. The discount factor is calculated based on a risk-free basic interest rate of 0.07 % plus a company-specific risk premium of 7.5 %, multiplied with a beta factor of 0.88 for the Aareon sub-group and of 0.65 for the Bank's Housing Industry division. Due to the uncertainty surrounding the planning beyond the three-year horizon and our cautious view of the market environment, we assume a 2 % growth rate, which reflects expected inflation developments. The recoverable amounts show an excess compared to the carrying amounts: even if the above-mentioned material assumptions were to change (such as a 1.0 % increase in the risk-adequate discount factor, a 5.0 % decline in the EBIT included in the cash-flow projections, or a decrease in the growth rate to 1 %), this would not result in a specific impairment loss. There was no need to recognise impairment losses in the year under review.

Intangible assets developed as follows:

€ mn	2019 Goodwill	2019 Proprietary software	2019 Other intangible assets	2019 Total	2018 Goodwill	2018 Proprietary software	2018 Other intangible assets	2018 Total
Cost								
Balance as at 1 January	138	106	103	347	138	93	124	355
Additions	–	11	13	24	0	13	5	18
Transfers	–	–	–	–	–	0	1	1
Disposals	0	6	2	8	–	–	26	26
Changes in the basis of consolidation	4	–	5	9	–	–	0	0
Currency translation differences	0	0	0	0	0	0	-1	-1
Balance as at 31 December	142	111	119	372	138	106	103	347
Amortisation and impairment losses								
Balance as at 1 January	53	74	62	189	53	69	80	202
Amortisation and impairment losses	–	6	9	15	–	4	8	12
of which: impairment losses	–	–	–	–	–	–	–	–
Write-ups	–	–	–	–	–	–	–	–
Transfers	–	–	–	–	–	–	–	–
Disposals	–	6	1	7	–	–	26	26
Changes in the basis of consolidation	–	–	–	–	–	–	–	–
Currency translation differences	–	0	0	0	–	1	0	1
Balance as at 31 December	53	74	70	197	53	74	62	189
Carrying amount as at 1 January	85	32	41	158	85	24	44	153
Carrying amount as at 31 December	89	37	49	175	85	32	41	158

(47) Property and equipment

€ mn	31 Dec 2019	31 Dec 2018
Land and buildings and construction in progress	277	230
Office furniture and equipment	34	30
Total	311	260

The increase in property and equipment was mainly due to the first-time recognition of rights of use from leases (due to first-time application of IFRS 16).

Property and equipment developed as follows:

€ mn	2019 Land and buildings and construction in progress	2019 Office furniture and equipment	2019 Total	2018 Land and buildings and construction in progress	2018 Office furniture and equipment	2018 Total
Cost						
Balance as at 1 January	303	74	377	299	86	385
Adjustment due to first-time application of IFRS 16	86	8	94	–	–	–
Balance as at 1 January (adjusted)	389	82	471	299	86	385
Additions	20	11	31	6	7	13
Transfers	-1	–	-1	–	0	0
Disposals	37	6	43	2	19	21
Changes in the basis of consolidation	–	0	0	–	0	0
Currency translation differences	0	0	0	0	0	0
Balance as at 31 December	371	87	458	303	74	377
Amortisation and impairment losses						
Balance as at 1 January	73	44	117	78	54	132
Adjustment due to first-time application of IFRS 16	22	2	24	–	–	–
Balance as at 1 January (adjusted)	95	46	141	78	54	132
Amortisation and impairment losses	19	12	31	9	8	17
of which: impairment losses	–	–	–	–	–	–
Write-ups	–	–	–	13	–	13
Transfers	1	–	1	–	–	–
Disposals	21	5	26	1	18	19
Changes in the basis of consolidation	–	0	0	–	–	–
Currency translation differences	0	0	0	0	0	0
Balance as at 31 December	94	53	147	73	44	117
Carrying amount as at 1 January	230	30	260	221	32	253
Carrying amount as at 31 December	277	34	311	230	30	260

(48) Income tax assets

Income tax assets in a total amount of € 30 million as at 31 December 2019 (2018: € 30 million) include € 17 million (2018: € 1 million) expected to be realised after a period of more than twelve months.

(49) Deferred tax assets

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority, which may be netted and paid in one amount, were offset in the amount of € 495 million (2018: € 572 million).

Deferred tax assets were recognised in relation to the following items of the statement of financial position:

€ mn	31 Dec 2019	31 Dec 2018
Financial assets (ac)	53	34
Financial assets (fvpl)	1	1
Property and equipment	2	0
Other assets	0	0
Financial liabilities (ac)	466	455
Financial liabilities (fvpl)	27	123
Provisions	105	90
Other liabilities	0	0
Tax loss carryforwards	9	10
Deferred tax assets	**663**	**713**

Of the deferred taxes on loss carryforwards, an amount of € 2 million (2018: € 3 million) is attributable to foreign permanent establishments. The existing loss carryforwards may be carried forward for an unlimited period. Deferred taxes on losses carried forward were recognised to the extent that they are expected to be realised within the next five years.

The deferred tax assets not recognised or not subject to valuation adjustments amount to € 82 million (2018: € 62 million).

Deferred tax assets in the amount of € 70 million (2018: € 32 million) were reported under other reserves.

(50) Other assets

€ mn	31 Dec 2019	31 Dec 2018
Properties	337	209
Contract assets	25	24
Miscellaneous	98	100
Total	**460**	**333**

Property holdings increased as a result of the acquisition of property SPVs from former credit exposures to Italy.

The portion of the unsatisfied performance obligation from IT consulting projects in the amount of € 9 million (2018: € 10 million) is expected to be realised in the amount of € 9 million (2018: € 9 million) in the subsequent year, and in the amount of € 0 million (2018: € 1 million) thereafter. We do not disclose the portion of unsatisfied performance obligations from other contracts since the consideration from the customer equals the services provided.

(51) Financial liabilities (ac)

€ mn	31 Dec 2019	31 Dec 2018
Money market and capital market liabilities (ac)	**24,526**	**26,371**
Money market liabilities	3,566	4,600
Promissory note loans	4,797	5,200
Mortgage Pfandbriefe	10,820	10,934
Public-sector Pfandbriefe	2,585	2,989
Other debt securities	2,758	2,648
Other financial liabilities	0	0
Deposits from the housing industry (ac)	**9,744**	**9,679**
Payable on demand	7,694	7,719
Term deposits	2,050	1,960
Liabilities from other transactions (ac)	**94**	**121**
Trade payables	20	24
Other liabilities	74	97
Subordinated liabilities (ac)	**968**	**1,044**
Total	**35,332**	**37,215**

(52) Financial liabilities (fvpl)

€ mn	31 Dec 2019	31 Dec 2018
Negative market value of designated hedging derivatives (fvpl)	**1,341**	**1,461**
Negative market value of fair value hedges	1,327	1,443
Negative market value of net investment hedges	14	18
Negative market value of other derivatives (fvpl)	**824**	**473**
Negative market value of economic hedging derivatives	422	322
Negative market value of miscellaneous other derivatives	402	151
Total	**2,165**	**1,934**

(53) Provisions

€ mn	31 Dec 2019	31 Dec 2018
Provisions for pensions and similar obligations	428	362
Provisions for unrecognised lending business	2	5
Other provisions and contingent liabilities	151	152
Total	**581**	**519**

A detailed breakdown of the provisions for unrecognised lending business by classes of financial assets is disclosed in Note (61) in the chapter "Notes related to financial instruments".

Provisions for pensions and similar obligations

The pension obligations result mainly from retirement benefit plans maintained at Aareal Bank, Aareon, BauGrund and Westdeutsche Immobilien Servicing (former WestImmo), which are classified as defined contribution plans or defined benefit plans in accordance with IAS 19.

Aareal Bank contributed assets held to cover existing pension obligations into a Contractual Trust Arrangement (CTA). This is to ensure improved insolvency protection of the pension claims as a result of the limited protection provided by the German Pension Guarantee Association (Pensionssicherungsverein; PSVaG). For this purpose, a bilateral trust was agreed between Aareal Bank AG (trustor) and Aareal Pensionsverein e.V. as legally independent third party (trustee). The trustee is registered in the Register of Associations at the Wiesbaden District Court.

The trustee holds in trust the special fund for the trustor (administrative trust). Simultaneously, but senior to the administrative trust, the trustee holds the special fund for all beneficiaries on trust to secure the recorded entitlements (security trust).

The security trust is established in the interest of the beneficiaries by way of a genuine agreement for the benefit of third parties (section 328 (1) of the German Civil Code (Bürgerliches Gesetzbuch – "BGB")). On the basis of this security trust, the beneficiaries may request from the trustee that the trustee holds and manages this special fund pursuant to the regulations of this trust agreement for the purpose of securing the recorded entitlements. Upon the occurrence of an insured event, the beneficiaries may, based on the security trust, request from the trustee that the trustee satisfies their recorded entitlements pursuant to the regulations of this trust agreement out of the special fund.

The Bank is the economic beneficiary of the assets. The assets are managed by HSBC INKA in a special fund under German investment law ("Spezialfonds"). Based on an investment guideline, HSBC INKA takes investment decisions for staff pensions. A joint investment committee was established, comprising staff from HSBC INKA and Aareal Bank. The Bank transfers new assets to be invested to Aareal Pensionsverein e.V. on an annual basis, which in turn acquires additional units in the special fund. The fund manager invests interest income during the course of the year.

The Bank has taken out reinsurance policies for a portion of the benefit entitlements of active members of the Management Board and former Management Board members. These policies were also transferred to Aareal Pensionsverein e.V. on a trust basis. The Bank provides corresponding funds for contribution paid to these policies.

Transferring assets to Aareal Pensionsverein e.V. on the one hand secures benefit entitlements and claims under occupational pension schemes, and on the other hand creates plan assets within the meaning of IAS 19 which may be offset with benefit obligations of the trustor.

Brief description of the material pension plans

DePfa Bank Betriebsvereinbarung dated 14 December 1999 (BV 97)

BV 97 applies for new joiners since 1 January 1997. The following benefits are granted after a waiting period of five pensionable service years: old-age pension after completing the 65th year of age (also after any previous disability), early old-age pension, disability pension until completing the 65th year of age, as well as widow(er)'s pension.

The Bank shall grant its employees a basic pension from own contributions and additional benefits in the form of corresponding individual agreements on deferred compensation. The basic pension for the pensionable service period is calculated based on an annual benefit expense of 3.5 % for portions of the pensionable income below the contribution ceiling and 10 % for portions of pensionable income above the contribution ceiling. The employer contributions thus calculated as well as the contributions from deferred compensation are contributed into a CTA at the end of each financial year. The benefit assets, including any allocated surpluses, bear interest at a rate of at least 4 %. The annual benefit payments are calculated based on an annuitisation of the benefit assets upon occurrence of the insured event, using a fixed annuitisation table.

The pensionable service period is deemed to be the period from completing the 20th year of age to completing the 65th year of age. Pensionable income is the gross remuneration within one year.

Any actuarial deductions upon claiming old-age pensions before completing the 65th year of age are taken into account through an annuitisation of the benefit assets. The widow(er)'s pension amounts to 60 % of the employee pension. The Bank increases the current benefit payments annually by 1 %; there is no obligation to provide for an inflation adjustment.

Management Board

The six Management Board members receive their benefits based on individual commitments (a total of eight individual benefit commitments).

Two individual benefit commitments are aligned to fixed annual employer contributions, which are paid to the relevant benefit account and bear interest at a rate of 4 %. In the event of payment of early retirement, disability or death benefits, non-recurring contribution and interest payments are made directly; leading to the level of benefits that would be achieved if the employment relationship would continue until the retirement age on which the awards are based. The benefit assets are translated into a lifelong old-age or disability pension upon the occurrence of an insured event, using actuarial principles. The annuitisation factor was fixed for the time of the retirement age underlying the awards. Annuitisation is based on biometric principles and a notional interest rate of 4 % p. a. and takes into account a pension increase of 2 % p. a. The widow pension amounts to 60 % of the beneficiary's pension entitlement. The current benefit payments are adjusted based on the development of standard wages within the private banking sector.

Six individual benefit commitments are aligned to the fixed annual employer contributions and the amounts from deferred compensation, which are paid to the relevant benefit account and bear interest at a rate of 4%. In the case of disability or death, the existing benefit assets are increased by the sum total of the amounts that would have been credited in future (up to a maximum contribution period of ten years) for each full calendar year prior to turning 62 or 63. The benefit assets and the assets from deferred compensation are translated into a lifelong old-age or disability pension upon the occurrence of an insured event, using actuarial principles. Annuitisation is based on biometric principles and a notional interest rate of 4% p.a. and takes into account a guaranteed pension increase of 1% p.a. The widow pension amounts to 60% of the beneficiary's pension entitlement. The current benefit payments are increased annually by 1%; there is no obligation to provide for an inflation adjustment. The old-age pension benefits based on two of these individual commitments were secured through reinsurance policies. These reinsurance policies include benefits in the case of disability or death.

DePfa Bank Dienstvereinbarung dated 30 December 1955 (DePfa 55)
DePfa 55 is a pay-related benefit commitment for new entrants before 31 December 1988. It provides for benefit payments after completing the 65th year of age after a waiting period of five service years and benefits paid in case of occupational incapacity (disability) as well as benefits for surviving dependants, each in form of a monthly annuity.

The amount of the entitlement is based on the following increases: 5% of the last annual salary for the first five service years each, 2% of the last annual salary for the next 20 service years each, and 1% of the last annual salary for any following service year, up to a maximum percentage of 75% of the last annual salary after 35 service years. The widow(er)'s pension amounts to 60% of the old-age or disability pension. Benefits paid by social security insurance and VBL/Gerling are charged to the benefit entitlements. DePfa 55 does not include any provision allowing for an early payout of old-age pensions or for an adjustment of current benefit payments.

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

BauBoden agreement dated 1 July 1968 (BauBoden 68)
This agreement applies to employees after completing their 18th year of age who were employed by the Bank on 1 January 1967 or joined the Bank not later than on 31 December 1983. The following benefits are granted after a waiting period of ten service years: old-age pension after completing the 65th year of age, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

Benefits consist of an overall pension, comprising the statutory pension insurance scheme, the additional pension insurance scheme at VBL or BVV (which is taken into account), or the group insurance contracts and the bank subsidy. The overall pension amounts to 55% of the pensionable salary after ten years of service. The overall pension is increased by 1 % of the pensionable salary for any further service year, up to the maximum rate of 75 %. The pensionable salary is the last monthly gross salary received during service.

No actuarial deductions are made upon claiming old-age pensions before completing the 65th year of age. The widow(er)'s pension amounts to 60 % of the bank subsidy. The current pension payments are adjusted pursuant to section 16 of the German Company Pensions Act (Betriebsrentengesetz).

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

BauBoden agreement dated 12 December 1984 (BauBoden 84) and DePfa Bank Versorgungsordnung dated 28 November 1990 (DePfa 90)

BauBoden 84 applies to employees who joined the Company after 31 December 1983 and have completed their 20th year of age. DePfa 90 applies to employees who joined the Company after 31 December 1988. The following benefits are granted after a waiting period of ten service years: old-age pension and early old-age pension, (total) occupational incapacity pension as well as widow(er)'s pension.

The benefit entitlements of the employees vest after completing their 65th year of age. The amount of the monthly pension entitlement is calculated for each pensionable service year (up to a maximum of 40 service years) as follows: 0.6 % of pensionable salary up to the contribution ceiling, 2 % of the portion of pensionable salary exceeding the contribution ceiling, with pensionable salary and contribution ceiling being calculated using the average for the last twelve months. Benefits paid by BVV are charged to the benefit entitlements under BauBoden 84.

The Bank does not make any actuarial deductions upon claiming early old-age pensions. The widow(er)'s pension amounts to 60 % of the entitlements to benefit payments. The current pension payments are adjusted pursuant to section 16 of the German Company Pensions Act (Betriebsrentengesetz).

These commitments are based on final salary. The obligation resulting from the respective benefit commitment is therefore very sensitive to unexpected salary changes.

Current benefits are not subject to a fixed adjustment rate; therefore, the adjustment is made pursuant to section 16 of the German Occupational Pensions Act (Betriebsrentengesetz, BetrAVG). Accordingly, an inflation adjustment has to be made every three years given an appropriate economic situation of the Bank. Changes in inflation and, hence, pension increases have an impact on the benefit volume as regards these commitments.

AHB – General works agreement on additional pension benefits (company pension scheme) of former Corealcredit

The pension benefits to former employees of Allgemeine Hypothekenbank AG, whose employment relationship began prior to 1 January 1994, are governed by the additional benefit arrangement dated 29 August 1995 on the basis of the complementing general works agreement dated 7 March 1995.

This benefit commitment is based on aggregate benefits derived from pension benefits for civil servants. After a waiting period of five years of service, the aggregate benefit rate is 50 % of pensionable income. For each year after completing the 37th year of age, the aggregate benefit rate increases by 1 % of pensionable income, up to a maximum 75 % of pensionable income. The entitlement amounts to at least 65 % of pensionable income in the case of (total) occupational incapacity and 75 % of pensionable income in the case of workplace accidents. Pensionable income is the annual income (calculated on the basis of 14 monthly salaries), divided by 12.

The pension benefits of the statutory pension insurance and the BVV Versicherungsverein des Bankgewerbes a. G., which are based on mandatory contributions, are taken into account in the pension determined as described. To that extent, the benefit obligation directly depends on the development of the level of pensions from the statutory pension insurance on the one hand and from the BVV on the other. As a result of the German Pension Reform Act of 1992 and the associated cuts in statutory pension insurance, the pension scheme was restructured in 1995. The main pillar of the new structure is the limitation of the Bank's deficiency guarantee for the declining level of statutory pensions due to deduction factors applied at early retirement (Rentenzugangsfaktor) and the lower adjustment of the pension value. Accordingly, the Bank continues to assume the deficiency guarantee on a pro-rata basis for the periods of service until the restructuring on 31 December 1995 in relation to the deduction factors applied at early retirement and for the reduced level of the current pension value (net adjustment factor). The reduction in the level of statutory pensions that occurred during the service periods from the restructuring date until retirement is taken into account at the expense of the beneficiary.

From the start of retirement, the AHB pension is decoupled from the development of the statutory pension and the BVV pension already prior to the restructuring since only the AHB pension is adjusted for inflation on an annual basis.

Accordingly, the obligation for the pension commitment during the qualification period is, on the one hand, directly dependent upon the development of the statutory pension and the BVV pension. On the other hand, it is fully dependent upon salary development for all years of service, even including past service. The volume of the obligation also depends upon the fluctuation of inflation and hence pension increases.

Rheinboden Hypothekenbank AG – pension scheme in the version dated 1 December 1991 of former Corealcredit

The former employees of Rheinboden Hypothekenbank AG are entitled to old-age and disability pensions as well as surviving dependant's benefits in accordance with the pension schemes in the version dated 1 December 1991.

The monthly benefits for employees who commenced service prior to 1 October 1978 amount to 5 % of pensionable remuneration (most recent monthly salary based on collective or individual agreements) after ten service years and increase by 0.5 % of pensionable remuneration for each service year, up to 14 % of pensionable remuneration after 15 service years. The monthly benefit entitlement increases by 0.3 % of pensionable remuneration for any additional service years, up to a maximum of 20 %. The BVV benefits are taken into account in such entitlement to the extent that these are based on employer contributions.

The benefits for employees who commenced service after 30 September 1978 amount to 0.15 % of pensionable remuneration up to the contribution ceiling as well as 1.5 % of pensionable remuneration above the contribution ceiling for each year of service between the 25th and 65th year of age. The maximum number of recognisable service years is 35.

The old-age pension under the Rheinboden pension schemes is paid after completing the 65th year of age or upon commencement of old-age pension under the statutory pension insurance scheme (full pension). In case of early retirement, the benefits are subject to deductions of 0.3 % per month of early retirement prior to the age of 65 as a partial compensation for the additional costs associated with early retirement. The surviving dependant's benefits amount to 60 % of the employee's pension entitlement for widow(er)s as well as 15 % for half-orphans and 20 % for orphans, however, in aggregate not exceeding the amount of the employee's pension entitlement.

Supplementary individual contractual arrangements were agreed with individual pensioners and leavers with vested benefits for the purpose of the transition from the old to the new Rheinboden pension scheme and the application of the BVV benefits.

In addition, individual contractual commitments apply to former management board members and general managers – currently pensioners and one leaver with vested benefits.

The adjustment of current pensions on the basis of the Rheinboden commitments is performed on the basis of the inflation allowance set out in section 16 of the German Occupational Pensions Act (BetrAVG), with the exception of a small group of approximately ten pensioners where adjustment is made pursuant to the collective agreement for banks.

WestImmo – Pension fund rules dated 1 October 1995

The pension fund rules dated 1 October 1995 represent a defined contribution scheme. The following benefits are paid after a waiting period of five year of service: old-age pension, early old-age pension, (total) occupational incapacity pension as well as widow(er)'s and orphan's pension.

The amount of the old-age pension, the early old-age pension and the (total) occupational incapacity pension is calculated based on the sum of the pension components earned during the pensionable service period. If the pensionable service period exceeds 40 years, the monthly pension is calculated based on the sum of the highest 40 pension components earned during the pensionable service period. The amount of one pension component is derived from multiplying the reference contribution (since 2014: € 260), the personal earnings relation (relation between pensionable income and contribution ceiling of the German statutory pension insurance; earnings components above the contribution ceiling are weighted with a factor of 3.75) and the annuitisation factor in the relevant age pursuant to the annuitisation table. The amount of the early old-age pension is reduced by 0.5 % for each month in which annuity is paid prior to completing the 65th year of age. The widow(er)'s pension entitlement amounts to 60 %.

If necessary, the determination of the amount of pension obligations is based on the following actuarial assumptions applied consistently throughout the Group:

	31 Dec 2019	31 Dec 2018
Calculation method	Projected unit credit method	Projected unit credit method
Calculation basis	Actuarial tables issued by K. Heubeck in 2018	Actuarial tables issued by K. Heubeck in 2018
Actuarial assumptions (in %)		
Interest rate used for valuation	1.09	1.80
Development of salaries	2.00	2.00
Pension increase	1.53	1.57
Rate of inflation	1.75	1.75
Staff turnover rate	3.00	3.00

Development of net pension liabilities:

€ mn	Present value of pension obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2019	**448**	**-86**	**362**
Pension expense	**20**	**-1**	**19**
Current service cost	12	–	12
Net interest cost	8	-1	7
Payments	**-8**	**-7**	**-15**
Pension benefits paid	-12	1	-11
Employer's contributions	–	-4	-4
Contributions made by beneficiaries of defined benefit plans	4	-4	0
Remeasurements	**66**	**-4**	**62**
due to experience adjustments	0	–	0
due to changes in financial assumptions	66	–	66
due to changes in demographic assumptions	0	–	0
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	-4	-4
Balance as at 31 December 2019	**526**	**-98**	**428**

€ mn	Present value of pension obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2018	**431**	**-80**	**351**
Pension expense	**18**	**-2**	**16**
Current service cost	10	–	10
Net interest cost	8	-2	6
Payments	**-8**	**-7**	**-15**
Pension benefits paid	-12	1	-11
Employer's contributions	–	-4	-4
Contributions made by beneficiaries of defined benefit plans	4	-4	–
Remeasurements	**7**	**3**	**10**
due to experience adjustments	-1	–	-1
due to changes in financial assumptions	2	–	2
due to changes in demographic assumptions	6	–	6
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	3	3
Balance as at 31 December 2018	**448**	**-86**	**362**

The weighted duration of pension liabilities is 19.8 years as at 31 December 2019 (2018: 18.1 years).

Expected maturities of the defined benefit obligation (DBO):

€ mn	31 Dec 2019	31 Dec 2018
Up to 1 year	13	13
Between 1 year and 5 years	58	57
More than 5 years and up to 10 years	83	80
Total	**154**	**150**

Contributions in the amount of € 14 million (2019: € 11 million) are expected to be paid in the financial year 2020.

Sensitivity of the defined benefit obligation (DBO) compared to the central actuarial assumptions

Based on the qualitative plan description, the valuation parameters significant for calculating the amount of the obligation were derived and corresponding calculations were made as regards sensitivity:

		Defined benefit obligation 2019	Change	Defined benefit obligation 2018	Change
		€ mn	%	€ mn	%
Present value of obligations		**526**		**448**	
Interest rate used for valuation	Increase by 1.0 percentage points	436	-17	375	-16
	Decrease by 1.0 percentage points	644	23	542	21
Development of salaries	Increase by 0.5 percentage points	536	2	457	2
	Decrease by 0.5 percentage points	515	-2	439	-2
Pension increase	Increase by 0.25 percentage points	533	2	456	2
	Decrease by 0.25 percentage points	517	2	440	-2
Life expectancy	Increase by 1 year	553	5	470	5
	Decrease by 1 year	497	-5	425	-5

The sensitivity analysis takes into account, in each case, the change of an assumption, while the other assumptions remain unchanged compared to the original calculation, i.e. any potential correlation effects between the individual assumptions are not taken into consideration.

Plan assets can be broken down as follows:

€ mn	31 Dec 2019	31 Dec 2018
Cash	0	0
Investment funds	68	58
Reinsurance	30	28
Total	**98**	**86**

Apart from the usual actuarial risks, the risks associated with defined benefit obligations primarily relate to financial risks in connection with plan assets. Amongst others, these may include counterparty credit risks and market price risks. These risks are taken into account in the risk management of Aareal Bank Group. The measurement of investment funds has to be allocated to Level 2 of the fair value hierarchy.

Other provisions

Other provisions developed as follows:

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions for legal and tax risks	Other provisions	Total
Carrying amount as at 1 Jan 2019	**128**	**10**	**14**	**152**
Additions	54	1	14	**69**
Utilisation	52	1	6	**59**
Reversals	8	1	5	**14**
Interest	0	0	0	**0**
Reclassifications	-4	–	0	**-4**
Changes in the basis of consolidation	0	0	7	**7**
Exchange rate fluctuations	0	–	0	**0**
Carrying amount as at 31 Dec 2019	**118**	**9**	**24**	**151**

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions for legal and tax risks	Other provisions	Total
Carrying amount as at 1 Jan 2018	**187**	**13**	**15**	**215**
Additions	55	0	3	**58**
Utilisation	61	1	1	**63**
Reversals	35	2	6	**43**
Interest	0	0	0	**0**
Reclassifications	-31	0	-1	**-32**
Changes in the basis of consolidation	12	0	4	**16**
Exchange rate fluctuations	1	0	0	**1**
Carrying amount as at 31 Dec 2018	**128**	**10**	**14**	**152**

Other provisions of € 118 million include € 27 million expected to be realised after a period exceeding twelve months.

Provisions for staff expenses and non-staff operating costs refer to personnel provisions in the amount of € 94 million (2018: € 105 million) and provisions for non-staff operating costs in the amount of € 24 million (2018: € 23 million). Personnel provisions consist of, among other things, provisions for bonuses, partial retirement, severance pay and existing working hours accounts; Provisions for staff expenses include € 20 million in provisions for severance pay and for partial retirement. Provisions for non-staff operating expenses mainly include provisions for professional and legal advice.

(54) Income tax liabilities

Income tax liabilities in a total amount of € 44 million as at 31 December 2019 (2018: € 40 million) include € 12 million (2018: € 6 million) expected to be realised after a period of more than twelve months.

(55) Deferred tax liabilities

When recognising deferred taxes, claims and liabilities arising vis-à-vis the same tax authority, which may be netted and paid in one amount, were offset in the amount of € 495 million (2018: € 572 million).

Deferred tax liabilities were recognised in relation to the following items of the statement of financial position:

€ mn	31 Dec 2019	31 Dec 2018
Financial assets (ac)	429	383
Financial assets (fvoci)	54	130
Financial assets (fvpl)	9	52
Intangible assets	12	11
Property and equipment	6	6
Other assets	4	8
Provisions	0	0
Other liabilities	0	–
Deferred tax liabilities	**514**	**590**

(56) Other liabilities

€ mn	31 Dec 2019	31 Dec 2018
Lease liabilities	84	–
Deferred income	1	1
Liabilities from other taxes	35	17
Contract liabilities	15	14
Miscellaneous	0	1
Total	**135**	**33**

An amount of € 10 million (2018: € 14 million) of the contract liabilities was recorded in profit or loss in the current reporting period.

Lease liabilities represent the corresponding item to the right-of-use assets from leases recognised (first-time application of IFRS 16).

(57) Equity

€ mn	31 Dec 2019	31 Dec 2018
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	1,812	1,797
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-141	-98
Reserve from the measurement of equity instruments (fvoci)	-4	0
Reserve from the measurement of debt instruments (fvoci)	7	39
Reserve from foreign currency basis spreads	-15	-9
Currency translation reserves	-1	-4
Non-controlling interests	2	2
Total	**2,861**	**2,928**

The item "Reserve from the measurement of debt instruments (fvoci)" includes loss allowance of € 0 million (2018: € 0 million).

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 180 million as at the reporting date (2018: € 180 million). It is divided into 59,857,221 notional fully-paid no-par value shares ("unit shares") with a notional value of € 3 per share. The shares are bearer shares. Each share carries one vote. There are no pre-emptive rights or constraints with respect to dividend payouts.

Treasury shares

The General Meeting held on 20 May 2015 authorised the Management Board, pursuant to section 71 (1) No. 7 of the AktG, to purchase and sell treasury shares for the purposes of securities trading, at a price not falling below or exceeding the average closing price of the Company's share in Xetra trading (or a comparable successor system) during the three trading days on the Frankfurt Stock Exchange prior to the relevant transaction by more than 10 %. This authorisation expires on 19 May 2020. The volume of shares acquired for this purpose must not exceed 5 % of the issued share capital of Aareal Bank AG at the end of any given day.

Furthermore, the Management Board was authorised by means of a resolution of the General Meeting held on 20 May 2015, pursuant to section 71 (1) no. 8 of the AktG, to purchase own shares up to a volume of 10 % of the share capital for purposes other than trading in treasury shares. This authorisation expires on 19 May 2020. Shares may be acquired via the stock exchange or by means of a public offer to buy directed at all shareholders, and at purchase prices stipulated in the authorisation and based on the prevailing market price of the Company's shares. This authorisation may be exercised, in full or in part, on one or more occasions.

The shares acquired in accordance with this or an earlier authorisation may be sold, subject to Supervisory Board approval, outside the stock exchange and without an offer directed at all shareholders, subject to the exclusion of shareholders' pre-emptive rights, when the shares sold do not exceed 10 %

of the share capital and the issue price is not significantly below the prevailing stock exchange price or in the event of a sale against contributions in kind, or when the shares sold are used to service rights from convertible bonds or bonds with warrants. This also applies to shares issued by subsidiaries. The treasury shares may also be given to the holders of conversion or option rights in lieu of new shares from a contingent capital increase. The shares can also be withdrawn, without such a withdrawal or its implementation requiring a further resolution by the General Meeting.

The Management Board was also authorised to effect the acquisition of treasury shares by using put or call options. Any acquisition of shares using derivatives is limited to 5 % of share capital. In addition, any acquisition of shares shall count towards the 10 % threshold for the authorisation for the acquisition of treasury shares. Where treasury shares are acquired using equity derivatives, the shareholders' right to enter into any option transactions with the Company is excluded in analogous application of section 186 (3) sentence 4 of the AktG.

Authorised capital

Aareal Bank has authorised capital pursuant to the resolution by the Annual General Meeting held on 31 May 2017. The Annual General Meeting authorised the Management Board to increase, on one or more occasions, the Company's share capital by up to a maximum total amount of € 89,785,830 (Authorised Capital 2017) by issuance of new bearer shares for contribution in cash or in kind, subject to the approval of the Supervisory Board; this authority will expire on 30 May 2022. In the event of a capital increase against cash contributions, the shareholders shall be granted a subscription right, unless the Management Board exercises its authority to exclude shareholder's pre-emptive subscription rights. The Management Board may exclude shareholders' subscription rights, subject to approval by the Supervisory Board and the conditions set out below:

a) In the event of a capital increase against cash contributions, provided that the issue price of the new shares is not significantly below the prevailing stock exchange price of the Company's listed shares at the time of the final determination of the issue price. However, this authorisation shall be subject to the proviso that the aggregate value of shares sold to the exclusion of shareholders' subscription rights, in accordance with section 203 (1) or (2) and section 186 (3) sentence 4 of the AktG, shall not exceed 10 % of the issued share capital at the time said authorisation comes into effect or – if lower – at the time it is exercised. Any shares that were issued or sold during the term and prior to the exercising of said authorisation, in direct or analogous application of section 186 (3) sentence 4 of the AktG, shall count towards the above threshold of 10 % of the issued share capital. Said ten-per-cent threshold shall also include shares the issuance of which is required under the terms of debt securities with embedded conversion or option rights on shares issued pursuant to section 186 (3) sentence 4 of the AktG (excluding shareholders' subscription rights), which were (or may be) issued during the validity of this authorisation;

b) for fractional amounts arising from the determination of the applicable subscription ratio;

c) where this is necessary to grant subscription rights to the holders of bonds with warrants or convertible bonds issued (or to be issued) by the Company or its affiliated companies, which subscription rights are required to entitle these holders to the same extent as they would have been entitled to upon exercising their conversion or option rights or upon performance of a conversion obligation, if any, thus protecting such holders against dilution;

d) for an amount of up to € 4,000,000 to offer employees (of the Company or its affiliated companies) shares for subscription.

e) in the event of a capital increase against contributions in kind for the purpose of acquiring companies, divisions of companies or interests in companies or other assets.

The above authorisation for the exclusion of shareholders' subscription rights in the case of capital increases against contributions in cash or in kind is limited to a total of 20% of the share capital; this limit may be exceeded neither at the time said authorisation comes into effect, nor at the time it is exercised. The above-mentioned 20% threshold shall furthermore include treasury shares which are sold to the exclusion of shareholders' subscription rights during the validity of this authorisation as well as such shares which are issued to service debt securities, provided that the debt securities were issued to the exclusion of shareholders' subscription rights during the validity of this authorisation due to the authorisation under agenda item 6 of the Annual General Meeting on 21 May 2014. When a new authorisation for the exclusion of shareholders' subscription rights is resolved after the reduction and said new authorisation comes into effect, the upper limit, reduced in accordance with the above-mentioned requirements, shall be increased again to the amount permitted by the new authorisation, with a maximum total of 20% of the share capital in accordance with the above-mentioned requirements.

The authorised capital has not been utilised.

Conditional capital

Based on a resolution passed by the Annual General Meeting on 22 May 2019, the Management Board was authorised to issue, on one or more occasions until 21 May 2024, profit-participation certificates with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of € 900,000,000. The profit-participation certificates must be constructed in such a way that the funds paid for them after issuance can be recognised as banking regulatory capital pursuant to the legal regulations applicable as at the time of issuance. Profit-participation certificates and other hybrid promissory note loans to be issued according to this authorisation shall be connected with conversion rights, entitling or compelling, in accordance with their respective conditions, the holder to purchase Company shares. Conversion rights or obligations may only be issued or created for no-par value bearer shares of the Company with a proportionate amount of the Company's share capital of up to € 71,828,664.00. The sum of shares to be issued so as to service conversion or option rights or conversion obligations from profit-participation certificates or hybrid promissory note loans issued pursuant to this authorisation, including shares issued during validity of this authorisation as a result of another authorisation (especially from the Authorised Capital 2017), may not exceed an amount of € 71,828,664.00 (which equals approx. 40% of the current share capital). Subject to the approval of the Supervisory Board, the Management Board may exclude shareholders' pre-emptive rights in relation to the profit-participation rights in certain cases.

Accordingly, the Company's share capital is subject to a conditional capital increase not exceeding € 71,828,664.00 by issuance of up to 23,942,888 new no-par value bearer shares ("Conditional Capital 2019"). The purpose of the conditional capital increase is to grant shares to holders or creditors of convertible bonds issued in accordance with the aforementioned authorisation. The new no-par value bearer shares may only be issued at a conversion price in line with the resolution passed by the General Meeting on 22 May 2019. The conditional capital increase shall only be carried out insofar as conversion rights are exercised or as conversion obligations from such convertible bonds are fulfilled or as the Company makes use of alternative performance and insofar as no cash compensation is granted or treasury shares are used to service the rights. The new shares shall be entitled to a share in the profits from the beginning of the financial year in which they come into existence through the exercise of conversion rights or the fulfilment of conversion obligations The Management Board is authorised to determine the details of the conditional capital increase. The Management Board is also authorised to determine the further contents of share rights and the terms governing the issuance of shares, subject to the approval of the Supervisory Board.

To date, the Conditional Capital has not yet been utilised.

Capital reserves

The capital reserves contain premiums received upon the issuance of shares. Costs incurred within the framework of a capital increase reduce capital reserves.

Retained earnings

Retained earnings are comprised of statutory reserves (pursuant to section 150 of the AktG) of € 5 million (2018: € 5 million) and of other retained earnings of € 1,807 million (2018: € 1,792 million).

Additional Tier 1 bond (AT1 bond)

On 13 November 2014, the Management Board issued notes in an aggregate nominal amount of € 300 million with a denomination of € 200,000 and an initial interest rate of 7.625 %, based on the authorisation granted by the Annual General Meeting on 21 May 2014.

The notes bear interest of 7.625 % p.a. from the interest commencement date to 30 April 2020. The rate of interest for any interest period commencing on or after 30 April 2020 shall be equal to the reference rate (one-year EUR swap rate) determined on the relevant interest determination date plus a margin of 7.18 % p.a.

The notes constitute unsecured and subordinated obligations of the issuer.

Upon the occurrence of a trigger event, the redemption amount and the principal amount of each note shall be reduced by the amount of the relevant write-down. The write-down shall be effected pro rata with all other Additional Tier 1 instruments within the meaning of the CRR, the terms of which provide for a write-down upon the occurrence of the trigger event. A trigger event occurs if the Common Equity Tier 1 capital ratio, pursuant to Article 92 (1) (a) CRR or a successor provision, and determined on a consolidated basis, falls below 7.0 %. After a write-down has been effected, the principal amount and the redemption amount of each note, unless previously redeemed or repurchased and cancelled, may be written up in each of the financial years of the issuer subsequent to such write-down until the full initial principal amount has been reached.

The notes may be redeemed, in whole but not in part, at any time at the option of the issuer, subject to the prior consent of the competent supervisory authority, upon not less than 30 and not more than 60 days' prior notice of redemption at their redemption amount (taking into account a potential write-down) together with interest accrued until the redemption date (to the extent that interest payment is not cancelled or ruled out in accordance with the terms and conditions of the notes), when the tax or regulatory reasons set out in the terms and conditions of the notes apply. The issuer may also redeem the notes, in whole but not in part, at any time, subject to the prior consent of the competent supervisory authority, upon not less than 30 days' notice of redemption with effect as at 30 April 2020 for the first time and, thereafter, with effect as at each interest payment date at their redemption amount together with interest (if any) accrued to the redemption date.

Distributions

The Management Board of Aareal Bank AG proposes to the Annual General Meeting that the net retained profit of € 119,714,442.00 for the financial year 2019, as reported under the German Commercial Code (HGB), be used to distribute dividends. With 59,857,221 notional no-par value shares outstanding, this translates into a dividend of € 2.00 per share. The dividend paid in 2019 amounted to € 2.10 per notional no-par value share.

In addition, on 30 April 2020, the Management Board will resolve on a distribution in relation to the AT1 instruments, pursuant to the terms and conditions of the notes.

Notes to Financial Instruments

A detailed description of the system in place at Aareal Bank Group to measure, limit, and manage risks throughout Aareal Bank Group is presented in the Risk Report as part of the Group Management Report. The disclosures on the description and the extent of the risks arising from financial instruments in accordance with IFRS 7 are included (in part) in the Risk Report.

(58) Net gains/losses of financial instruments by category

The following overview shows the net gains or net losses from financial instruments in accordance with the classification and measurement categories of financial assets and liabilities (from which the results are generated):

€ mn	1 Jan – 31 Dec 2019	1 Jan – 31 Dec 2018
Net gain or loss from financial assets (ac)	-63	-49
Net gain or loss from financial liabilities (ac)	4	0
Net gain or loss from financial assets (fvoci) recognised in other comprehensive income	-16	-20
Net gain or loss from financial assets (fvoci) transferred to the income statement	30	–
Net gain or loss from equity instruments (fvoci)	-4	0
Net gain or loss from financial instruments (fvpl)	1	-2
Net gain or loss from financial guarantee contracts and loan commitments	3	1

The net results include measurement gains and losses, realised gains/losses on disposal, subsequent recoveries on loans and advances previously written off in relation to all financial instruments of the respective measurement category. The net gain or loss from financial instruments (fvpl) also comprises the net gain or loss from currency translation.

The hedge result from hedged items is aggregated with the hedge result from derivative hedging instruments in one line item and amounted to € -4 million (2018: € -2 million) in the year under review. Moreover, the change in the reserve from foreign-currency basis spreads amounted to € -9 million (2018: € -17 million).

(59) Fair value hierarchy in accordance with IFRS 13

The carrying amounts of financial instruments held by Aareal Bank Group which are reported at fair value in the statement of financial position are presented in the following table (p. 180) according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument.

31 December 2019

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**3,420**	**3,415**	**3**	**2**
Money market and capital market receivables	3,415	3,415	–	–
Equity instruments	5	–	3	2
Financial assets (fvpl)	**2,979**	**0**	**1,926**	**1,053**
Loan receivables	1,050	–	–	1,050
Money market and capital market receivables	135	0	132	3
Positive market value of designated hedging derivatives	1,380	–	1,380	–
Positive market value of other derivatives	414	–	414	–
Financial liabilities (fvpl)	**2,165**	**0**	**2,165**	**–**
Negative market value of designated hedging derivatives	1,341	–	1,341	–
Negative market value of other derivatives	824	0	824	–

31 December 2018

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**4,450**	**4,443**	**1**	**6**
Money market and capital market receivables	4,443	4,443	–	–
Equity instruments	7	–	1	6
Financial assets (fvpl)	**3,183**	**308**	**2,164**	**711**
Loan receivables	711	–	–	711
Money market and capital market receivables	538	308	230	–
Positive market value of designated hedging derivatives	1,277	–	1,277	–
Positive market value of other derivatives	657	–	657	–
Financial liabilities (fvpl)	**1,934**	**–**	**1,934**	**–**
Negative market value of designated hedging derivatives	1,461	–	1,461	–
Negative market value of other derivatives	473	–	473	–

Amounts of € 69 million were reassigned from Level 2 to Level 1 during the financial year.

The fair values of loan receivables recognised at fair value in the statement of financial position that are assigned to Level 3 of the fair value hierarchy developed as follows during the period under review:

Loan receivables (fvpl)

€ mn	2019	2018
Fair value as at 1 January	**711**	**604**
Change in measurement	**-18**	**-2**
Portfolio changes		
Additions	924	690
Derecognition	567	582
Deferred interest	0	1
Fair value as at 31 December	**1,050**	**711**

Financial instruments held in the Bank's portfolio contributed € -18 million to the net gain or loss from financial assets (fvpl) (2018: € -1 million).

Regarding loan receivables (fvpl), the add-ons for risks specific to the counterparty represent the material input parameter not observable in the market. Regarding the non-defaulted loans, an increase/decrease by 1 % would lead to a decrease/increase of the fair value by approximately € 31 million (2018: approximately € 12 million).

The carrying amounts of financial instruments held by Aareal Bank Group which are reported at amortised cost in the statement of financial position are presented in the following table according to the three-tier fair value hierarchy pursuant to IFRS 13.72 et seq. The presentation is made for each class of financial instrument:

31 December 2019

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (ac)	**33,899**	**3,059**	**4,951**	**25,889**
Cash funds	1,494	–	1,494	–
Loan receivables	25,850	–	2	25,848
Money market and capital market receivables	6,481	3,059	3,422	–
Receivables from other transactions	74	–	33	41
Financial liabilities (ac)	**35,477**	**1,854**	**33,486**	**137**
Money market and capital market liabilities	24,610	1,533	23,034	43
Deposits from the housing industry	9,744	–	9,744	–
Liabilities from other transactions	94	–	0	94
Subordinated liabilities	1,029	321	708	–

31 December 2018

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (ac)	**34,556**	**3,165**	**4,495**	**26,896**
Cash funds	1,265	–	1,265	–
Loan receivables	26,858	–	3	26,855
Money market and capital market receivables	6,372	3,165	3,207	–
Receivables from other transactions	61	–	20	41
Financial liabilities (ac)	**37,168**	**2,327**	**25,003**	**9,838**
Money market and capital market liabilities	26,278	2,006	24,234	38
Deposits from the housing industry	9,679	–	–	9,679
Liabilities from other transactions	121	–	0	121
Subordinated liabilities	1,090	321	769	–

(60) Comparison of carrying amounts and fair values of the financial instruments

The fair values of financial instruments are compared with their carrying amounts (including loss allowance) in the following table. The presentation is made for each class of financial instrument:

€ mn	31 Dec 2019 Carrying amount	31 Dec 2019 Fair value	31 Dec 2018 Carrying amount	31 Dec 2018 Fair value
Financial assets (ac)	**33,586**	**33,899**	**34,125**	**34,556**
Cash funds	1,494	1,494	1,265	1,265
Loan receivables	25,403	25,850	26,232	26,858
Money market and capital market receivables	6,615	6,481	6,567	6,372
Receivables from other transactions	74	74	61	61
Financial assets (fvoci)	**3,420**	**3,420**	**4,450**	**4,450**
Money market and capital market receivables	3,415	3,415	4,443	4,443
Equity instruments	5	5	7	7
Financial assets (fvpl)	**2,979**	**2,979**	**3,183**	**3,183**
Loan receivables	1,050	1,050	711	711
Money market and capital market receivables	135	135	538	538
Positive market value of designated hedging derivatives	1,380	1,380	1,277	1,277
Positive market value of other derivatives	414	414	657	657

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€ mn	31 Dec 2019 Carrying amount	31 Dec 2019 Fair value	31 Dec 2018 Carrying amount	31 Dec 2018 Fair value
Financial liabilities (ac)	**35,332**	**35,477**	**37,215**	**37,168**
Money market and capital market liabilities	24,526	24,610	26,371	26,278
Deposits from the housing industry	9,744	9,744	9,679	9,679
Liabilities from other transactions	94	94	121	121
Subordinated liabilities	968	1,029	1,044	1,090
Financial liabilities (fvpl)	**2,165**	**2,165**	**1,934**	**1,934**
Negative market value of designated hedging derivatives	1,341	1,341	1,461	1,461
Negative market value of other derivatives	824	824	473	473

(61) Disclosures on credit risk

For information on risk management practice and input factors, please refer to the chapter "Credit default risk" in the Risk Report.

The following overviews present the loss allowance and the provisions for credit risks per stage and separately by product groups.

Loss allowance (ac)

2019

€ mn	Balance as at 1 January	Additions	Utilisation	Reversals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Interest effect	Currency adjustment	Changes in the basis of consolidation	Balance as at 31 December
Stage 1	**34**	**13**	**–**	**25**	**1**	**-2**	**0**	**–**	**1**	**–**	**22**
Loan receivables (ac)	33	12	–	24	1	-2	0	–	1	–	21
Money market and capital market receivables (ac)	1	1	–	1	0	–	–	–	0	–	1
Stage 2	**22**	**7**	**–**	**15**	**-1**	**7**	**-4**	**–**	**0**	**–**	**16**
Loan receivables (ac)	12	7	–	7	-1	7	-4	–	0	–	14
Money market and capital market receivables (ac)	10	–	–	8	0	–	–	–	–	–	2
Stage 3	**519**	**184**	**237**	**74**	**0**	**-5**	**4**	**21**	**3**	**-70**	**345**
Loan receivables (ac)	519	184	237	74	–	-5	4	21	3	-70	345
Receivables from other transactions	**2**	**2**	**1**	**0**	**–**	**–**	**–**	**–**	**0**	**–**	**3**
Total	577	206	238	114	–	–	–	21	4	-70	386

2018

€ mn	Balance as at 1 January	Addi-tions	Utili-sation	Rever-sals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Interest effect	Currency adjustment	Trans-fers	Balance as at 31 De-cember
Stage 1	**32**	**18**	**–**	**16**	**1**	**-1**	**0**	**–**	**0**	**–**	**34**
Loan receivables (ac)	31	18	–	16	1	-1	0	–	0	–	33
Money market and capital market receivables (ac)	1	0	–	0	0	–	–	–	0	–	1
Stage 2	**42**	**6**	**–**	**14**	**-1**	**1**	**-12**	**–**	**0**	**–**	**22**
Loan receivables (ac)	23	6	–	5	-1	1	-12	–	0	–	12
Money market and capital market receivables (ac)	19	–	–	9	0	–	–	–	–	–	10
Stage 3	**517**	**110**	**100**	**26**	**0**	**0**	**12**	**5**	**1**	**–**	**519**
Loan receivables (ac)	517	110	100	26	0	0	12	5	1	–	519
Receivables from other transactions	**2**	**0**	**1**	**1**	**–**	**–**	**–**	**–**	**0**	**2**	**2**
Total	593	134	101	57	–	–	–	5	1	2	577

The loss allowance for financial assets (ac) is reported in the item "Loss allowance (ac)" on the assets side of the statement of financial position.

Loss allowance in the reserve from the measurement of debt instruments (fvoci)

The loss allowance for debt instrument (fvoci) amounts to € 0 million (2018: € 0 million) and is reported on the equity and liabilities side of the statement of financial position under other reserves.

Provisions for unrecognised lending business

2019

€ mn	Provisions as at 1 January	Addi-tions	Utili-sation	Reversals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Interest effect	Currency adjustment	Provisions as at 31 December
Stage 1	2	1	–	1	0	–	–	–	0	2
Stage 2	0	0	–	0	0	–	–	–	0	0
Stage 3	3	–	–	3	–	–	–	–	0	0
Total	5	1	–	4	–	–	–	–	0	2

2018

€ mn	Provisions as at 1 January	Additions	Utilisation	Reversals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Interest effect	Currency adjustment	Provisions as at 31 December
Stage 1	4	1	–	3	0	0	–	–	0	2
Stage 2	0	0	–	0	0	0	–	–	0	0
Stage 3	2	2	0	1	–	–	–	–	0	3
Total	**6**	**3**	**0**	**4**	**–**	**–**	**–**	**–**	**0**	**5**

The provisions for unrecognised lending business refer to loan commitments and contingent liabilities and are reported on the equity and liabilities side of the statement of financial position under provisions.

No impaired financial assets were recognised for the first time during the current financial year, nor were assets acquired within the context of the realisation of collateral.

Credit quality of financial receivables from other transactions

Financial receivables from other transactions are also subject to credit risk. Of the receivables from other transactions in the amount of € 77 million (2018: € 64 million), € 66 million (2018: € 58 million) were neither overdue nor impaired, € 5 million (2018: € 4 million) were overdue but not impaired and € 6 million (2018: € 2 million) were impaired.

(62) Reconciliation of gross carrying amounts of financial assets

The following tables show the development of the gross carrying amounts of financial assets that are subject to the impairment rules and to which the loss allowance mentioned above can be attributed.

Financial assets (ac) 2019

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Impairment and reversals of impairment	Net modification gain or loss	Currency and other changes	Gross carrying amount as at 31 December
Loan receivables	**26,795**	**10,567**	**12,082**	**–**	**–**	**–**	**-229**	**-5**	**737**	**25,783**
Stage 1	24,422	10,476	10,997	86	-726	-57	–	0	719	23,923
Stage 2	786	78	287	-86	728	-307	–	-5	9	916
Stage 3	1,587	13	798	–	-2	364	-229	–	9	944
POCI	0	–	0	–	–	–	–	–	–	–
Money market and capital market receivables	**6,578**	**1,360**	**1,440**	**–**	**–**	**–**	**–**	**–**	**120**	**6,618**
Stage 1	5,773	1,359	1,302	548	–	–	–	–	115	6,493
Stage 2	805	1	138	-548	–	–	–	–	5	125
Receivables from other transactions	**64**	**58**	**44**	**–**	**–**	**–**	**–**	**–**	**-1**	**77**
Total	**33,437**	**11,985**	**13,566**	**–**	**–**	**–**	**-229**	**-5**	**856**	**32,478**

Financial assets (ac) 2018

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer in Stage 1	Transfer in Stage 2	Transfer in Stage 3	Impairment and reversals of impairment	Net modification gain or loss	Currency and other changes	Gross carrying amount as at 31 December
Loan receivables	**25,885**	**8,992**	**8,304**	**–**	**–**	**–**	**-100**	**-1**	**323**	**26,795**
Stage 1	23,151	8,879	7,701	53	-205	-1	–	-1	247	24,422
Stage 2	1,167	14	312	-36	210	-229	–	0	-28	786
Stage 3	1,567	99	291	-17	-5	230	-100	0	104	1,587
POCI	0	–	0	–	–	–	–	–	–	0
Money market and capital market receivables	**6,087**	**1,547**	**980**	**–**	**–**	**–**	**–**	**–**	**-76**	**6,578**
Stage 1	4,526	1,547	904	686	-21	–	–	–	-61	5,773
Stage 2	1,561	–	76	-686	21	–	–	–	-15	805
Receivables from other transactions	**76**	**40**	**52**	**–**	**–**	**–**	**–**	**–**	**–**	**64**
Total	32,048	10,579	9,336	–	–	–	-100	-1	247	33,437

Financial assets (fvoci) 2019

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Impairment and reversals of impairment	Net modification gain or loss	Currency and other changes	Gross carrying amount as at 31 December
Money market and capital market receivables	**4,443**	**1,028**	**1,842**	**–**	**–**	**–**	**–**	**–**	**-214**	**3,415**
Stage 1	4,443	1,028	1,842	–	–	–	–	–	-214	3,415
Total	4,443	1,028	1,842	–	–	–	–	–	-214	3,415

Financial assets (fvoci) 2018

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer in Stage 1	Transfer in Stage 2	Transfer in Stage 3	Impairment and reversals of impairment	Net modification gain or loss	Currency and other changes	Gross carrying amount as at 31 December
Money market and capital market receivables	**4,343**	**609**	**426**	**–**	**–**	**–**	**–**	**–**	**-83**	**4,443**
Stage 1	4,240	609	426	99	0	–	–	–	-79	4,443
Stage 2	103	–	–	-99	0	–	–	–	-4	–
Total	4,343	609	426	–	–	–	–	–	-83	4,443

Please refer to the presentation of the items of the statement of financial position in the section "Notes to the statement of financial position" for information on maximum credit risk exposure since the carrying amount corresponds to the maximum credit risk exposure of Aareal Bank as at the balance sheet date, for both items that are subject to the impairment rules and for financial assets that are not subject to the impairment rules. The collateral received is described in the Report on the Economic Position and in the Risk Report, part of the Group Management Report.

As at the current reporting date, no receivables from the lending business that were written off during the reporting year, were still part of foreclosure proceedings.

(63) Modification effects

If modifications are made to financial assets during the contract term leading to changes in the contractual cash flows and if these changes are not that extensive that the financial asset is derecognised and a new asset is recognised, such modifications are non-substantial modifications. Following a non-substantial modification, the carrying amount of a financial asset is remeasured and a net modification gain or loss is recorded in net interest income or in the loss allowance.

The following table shows the amortised cost before modification of financial assets that were subject to non-substantial modifications in the reporting period as well as the related modification gain or loss.

	2019			2018		
	Stage 1	Stage 2	Stage 3	Stage 1	Stage 2	Stage 3
€ mn						
Amortised cost before modification	284	82	–	248	45	484
Net gain or loss on modification	0	-5	–	-1	0	0
Amortised cost after modification	**284**	**77**	**–**	**247**	**45**	**484**

During the financial year, no receivables from the lending business were reclassified from Stage 2 or Stage 3 to Stage 1, which had been modified since they were first classified as Stage 2 or Stage 3 receivables (2018: € – million).

(64) Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is presented in the statement of financial position when currently there is a legally enforceable right to set off the recognised amounts, and when the Bank intends either to settle on a net basis – or to realise the asset and settle the liability simultaneously. The following overviews show whether and to what extent financial instruments were actually offset as at the current reporting date. The tables also include disclosures on financial instruments that are part of an enforceable master netting or similar arrangement that do not meet the criteria for offsetting in the statement of financial position.

Financial assets

31 December 2019

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	1,800	–	1,800	1,065	658	77
Reverse repos	–	–	–	–	–	–
Total	**1,800**	**–**	**1,800**	**1,065**	**658**	**77**

31 December 2018

€ mn	Gross carrying amounts of recognised financial assets	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial liabilities which were not subject to offsetting	Collateral received	Remaining net amount
Derivatives	1,843	–	1,843	1,031	731	81
Reverse repos	–	–	–	–	–	–
Total	**1,843**	**–**	**1,843**	**1,031**	**731**	**81**

Financial liabilities

31 December 2019

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	2,174	–	2,174	1,065	1,077	32
Repos	–	–	–	–	–	–
Total	**2,174**	**–**	**2,174**	**1,065**	**1,077**	**32**

31 December 2018

€ mn	Gross carrying amounts of recognised financial liabilities	Gross carrying amounts of offset amounts	Net carrying amount reported in the statement of financial position	Financial assets which were not subject to offsetting	Collateral provided	Remaining net amount
Derivatives	1,611	–	1,611	1,031	538	42
Repos	–	–	–	–	–	–
Total	**1,611**	**–**	**1,611**	**1,031**	**538**	**42**

To reduce counterparty risk, Aareal Bank Group concludes standardised master agreements for financial derivatives and securities repurchase agreements, such as the ISDA Master Agreement, the German Master Agreement on Financial Derivatives or the Master Agreement for Securities Repurchase Transactions. In addition, Aareal Bank enters into collateral agreements (Credit Support Annex to the ISDA Master Agreement and Collateral Annex to the German Master Agreement on Financial Derivatives) in which a mutual collateralisation of all claims between the contracting parties is agreed and which include netting arrangements.

The master agreements for financial derivatives used by Aareal Bank include netting arrangements at a single transaction level (so-called "payment netting"), which provide for a netting of payments when both parties need to make payments in the same currency on the same date, as set out in the contract. Aareal Bank does not offset financial derivatives according to the rules related to payment netting, as the transactions are not settled on a net basis. Aareal Bank Group has not entered into arrangements providing for netting of derivatives across several transactions.

For securities repurchase transactions (repo), depending on the counterparty, payment or delivery netting is made. In line with the rules set out in the master agreement for repo transactions, payments or deliveries of securities may be offset when both counterparties have to make payments in the same currency on the same date, or have to deliver securities of the same type. Transactions effected on the basis of the master agreement for repo transactions generally meet the offsetting requirements of IAS 32.

(65) Assets provided or accepted as collateral

Assets provided as collateral

Aareal Bank Group has provided financial assets as collateral for its liabilities or contingent liabilities. The following overview shows the carrying amount of the collateral provided and the items of the statement of financial position in which they are reported.

€ mn	31 Dec 2019	31 Dec 2018
Money market and capital market receivables (ac, fvoci and fvpl)	1,434	1,381
Receivables from other transactions (ac)	26	17
Total	**1,460**	**1,398**

The protection buyer has no right to sell or re-pledge any of financial assets pledged as collateral (2018: € – million). There is a fully cash-collateralised and irrevocable payment obligation in the amount of € 26 million (2018: € 17 million) from the bank levy and also for the deposit guarantee scheme of German banks. This obligation is reported under receivables from other transactions (ac).

Assets accepted as collateral

Aareal Bank Group accepts financial assets as collateral. These assets may be sold or pledged without the collateral owner being in default. No fixed-income securities were accepted as collateral for repo transactions as at the reporting date (2018: € – million).

Collateral is provided and accepted predominantly on the basis of standardised agreements on securities repurchase transactions and on the collateralisation of forward transactions.

(66) Transfer of financial assets without derecognition

Aareal Bank Group sells securities subject to a take-back requirement as borrower within the framework of genuine repurchase agreements. Within the scope of such agreements, securities are transferred to lenders without resulting in the securities being derecognised since Aareal Bank Group retains the substantial risks and rewards from the securities. The risks to which Aareal Bank Group is still exposed comprise the default risk, the interest rate risk and other price risks. The equivalent values received as collateral during the transfer of securities are accounted as money-market receivables or liabilities. Within the context of securities repurchase transactions, the unrestricted title and the unrestricted power of disposition is transferred to the lender upon delivery of the securities. The lender has the right to sell or pledge these securities, however, he is required to retransfer securities of the same type and in the same amount as at the repurchase date.

As in the previous year, no securities were part of repurchase agreements as at the balance sheet date.

(67) Derivative financial instruments

The following table shows positive and negative market values (including pro-rata interest) of all derivative financial instruments by hedge and risk types:

	Fair value as at 31 Dec 2019		Fair value as at 31 Dec 2018	
	positive	negative	positive	negative
€ mn				
Fair value hedge derivatives	**1,374**	**1,327**	**1,277**	**1,443**
Interest rate risk	1,374	1,294	1,277	1,422
Interest rate swaps	1,374	1,294	1,277	1,422
Interest rate and currency risk	–	33	–	21
Cross-currency swaps	–	33	–	21
Hedge of net investments	**6**	**14**	**–**	**18**
Currency risk	6	14	–	18
Cross-currency swaps	6	14	–	18
Other derivatives	**414**	**824**	**657**	**473**
Interest rate risk	182	427	190	260
Interest rate swaps	181	426	184	254
Swaptions	–	–	–	0
Caps, floors	1	1	6	6
Interest rate and currency risk	232	397	467	213
Spot and forward foreign exchange transactions	4	21	14	3
Cross-currency swaps	228	376	453	210
Total	**1,794**	**2,165**	**1,934**	**1,934**

Derivatives have been entered into with the following counterparties:

	Fair value as at 31 Dec 2019		Fair value as at 31 Dec 2018	
	positive	negative	positive	negative
€ mn				
OECD banks and central governments	1,701	2,164	1,820	1,888
Companies and private individuals	93	1	114	46
Total	**1,794**	**2,165**	**1,934**	**1,934**

The following overview shows the cash flows of derivative financial instruments by risk types, based on the contractual maturity. The amounts shown in the table represent the contractually agreed future undiscounted cash flows.

31 December 2019

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate risk					
Interest rate swaps					
Cash inflows	135	381	1,015	264	**1,795**
Cash outflows	134	264	853	277	**1,528**
Caps, floors					
Cash inflows	0	0	1	0	**1**
Cash outflows	0	0	1	0	**1**
Interest rate and currency risk					
Spot and forward foreign exchange transactions					
Cash inflows	2,210	274	–	–	**2,484**
Cash outflows	2,226	273	–	–	**2,499**
Cross-currency swaps					
Cash inflows	897	1,048	8,484	–	**10,429**
Cash outflows	949	1,211	9,041	53	**11,254**
Total cash inflows	**3,242**	**1,703**	**9,500**	**264**	14,709
Total cash outflows	**3,309**	**1,748**	**9,895**	**330**	15,282

31 December 2018

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Interest rate risk					
Interest rate swaps					
Cash inflows	155	424	1,282	380	**2,241**
Cash outflows	170	297	1,023	386	**1,876**
Swaptions					
Cash inflows	–	–	–	–	**–**
Cash outflows	–	–	0	–	**0**
Caps, floors					
Cash inflows	0	2	4	1	**7**
Cash outflows	0	2	4	1	**7**
Interest rate and currency risk					
Spot and forward foreign exchange transactions					
Cash inflows	1,575	238	–	–	**1,813**
Cash outflows	1,566	238	–	–	**1,804**
Cross-currency swaps					
Cash inflows	509	1,528	6,855	51	**8,943**
Cash outflows	549	1,637	7,198	–	**9,384**
Total cash inflows	**2,239**	**2,192**	**8,141**	**432**	13,004
Total cash outflows	**2,285**	**2,174**	**8,225**	**387**	13,071

The procedure for measuring and monitoring liquidity risk is described in the Risk Report, part of the Group Management Report.

(68) Disclosures on hedging relationships

Disclosures on hedging derivatives

The following tables show designated hedging derivatives separately for each type of hedging relationship, risk category and product type:

Positive market value of designated hedging derivatives

€ mn	Carrying amount 31 Dec 2019	Nominal amount 31 Dec 2019	Fair value change 1 Jan - 31 Dec 2019	Carrying amount 31 Dec 2018	Nominal amount 31 Dec 2018	Fair value change 1 Jan - 31 Dec 2018
Fair value hedges						
Interest rate risk						
Interest rate swaps	1,374	17,915	423	1,277	18,276	-87
Hedge of net investments						
Currency risk						
Cross-currency swaps	6	518	0	–	–	–
Total	**1,380**	**18,433**	**423**	**1,277**	**18,276**	**-87**

Negative market value of designated hedging derivatives

€ mn	Carrying amount 31 Dec 2019	Nominal amount 31 Dec 2019	Fair value change 1 Jan - 31 Dec 2019	Carrying amount 31 Dec 2018	Nominal amount 31 Dec 2018	Fair value change 1 Jan - 31 Dec 2018
Fair value hedges						
Interest rate risk						
Interest rate swaps	1,294	12,186	256	1,422	12,470	-56
Interest rate and currency risk						
Cross-currency swaps	33	118	5	21	112	-5
Hedge of net investments						
Currency risk						
Cross-currency swaps	14	597	0	18	599	17
Total	**1,341**	**12,901**	**261**	**1,461**	**13,181**	**-44**

The following overview presents the nominal amounts of the hedging derivatives by maturities.

31 December 2019

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Fair value hedges					
Interest rate risk					
Interest rate swaps	843	3,512	17,999	7,747	**30,101**
Interest rate and currency risks					
Cross-currency swaps	–	–	118	–	**118**
Hedge of net investments					
Currency risk					
Cross-currency swaps	184	218	713	–	**1,115**
Total nominal amounts	**1,027**	**3,730**	**18,830**	**7,747**	**31,334**

Of the total amount of € 31.3 billion, € 6.8 million is linked to non-euro reference interest rates.

31 December 2018

€ mn	up to 3 months	3 months to 1 year	1 year to 5 years	more than 5 years	Total
Fair value hedges					
Interest rate risk					
Interest rate swaps	2,678	3,571	17,031	7,466	**30,746**
Interest rate and currency risks					
Cross-currency swaps	–	–	112	–	**112**
Hedge of net investments					
Currency risk					
Cross-currency swaps	205	180	214	–	**599**
Total nominal amounts	**2,883**	**3,751**	**17,357**	**7,466**	**31,457**

Disclosures on hedged items

Hedged items of fair value hedges

The following tables show hedged items separately for each type of hedging relationship and risk category:

€ mn	Active hedging relationships			Discontinued hedging relationships
	Carrying amount 31 Dec 2019	Accumulated hedge adjustment 31 Dec 2019	Change in hedged fair values 1 Jan - 31 Dec 2019	Balance of hedge adjustments 31 Dec 2019
Interest rate risk				
Loan receivables (ac)	6,539	94	77	70
Money market and capital market receivables (ac)	2,538	520	44	22
Money market and capital market receivables (fvoci)	3,236	209	-121	48
Money market and capital market liabilities (ac)	18,653	1,025	176	59
Subordinated liabilities (ac)	841	51	2	4
Interest rate and currency risk				
Money market and capital market receivables (ac)	164	46	5	–

€ mn	Active hedging relationships			Discontinued hedging relationships
	Carrying amount 31 Dec 2018	Accumulated hedge adjustment 31 Dec 2018	Change in hedged fair values 1 Jan - 31 Dec 2018	Balance of hedge adjustments 31 Dec 2018
Interest rate risk				
Loan receivables (ac)	6,888	17	12	29
Money market and capital market receivables (ac)	3,940	645	-31	180
Money market and capital market receivables (fvoci)	3,898	330	-54	54
Money market and capital market liabilities (ac)	17,616	850	-89	76
Subordinated liabilities (ac)	915	49	-5	4
Interest rate and currency risk				
Money market and capital market receivables (ac)	153	41	-5	–

Hedge of net investments

The change in value of currency-hedged net investments in foreign operations amounted to € -10 million (2018: € 22 million) in the financial year under review. The balance of the hedging reserve (net) stood at € -20 million (2018: € -10 million) at year-end.

Net gain or loss from hedge accounting

Fair value hedges

The net gain or loss from hedge accounting include the following ineffective portions of fair value hedges by risk categories:

€ mn	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
Interest rate risks	-4	-2
Interest rate and currency risks	0	0
Total	**-4**	**-2**

Hedge of net investments

The ineffective portion of currency-hedged net investments in foreign operations amounted to € 0 million (2018: € 0 million), reported in net gains or losses from hedge accounting. No amounts were reclassified from the reserve for currency-hedged net investments to the income statement.

(69) Maturities of financial liabilities

The following overview shows the future undiscounted cash flows of non-derivative financial liabilities and of loan commitments.

Maturities as at 31 December 2019

€ mn	Payable on demand	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Money market and capital market liabilities (ac)	845	1,486	4,181	10,307	9,608	**26,427**
Deposits from the housing industry (ac)	7,696	2,050	–	–	–	**9,746**
Subordinated liabilities (ac)	–	17	43	454	588	**1,102**
Financial liabilities from other transactions (ac)	91	0	2	0	–	**93**
Lease liabilities	–	3	9	33	40	**85**
Financial guarantees	154	–	–	–	2	**156**
Loan commitments	1,205	–	–	–	–	**1,205**

Maturities as at 31 December 2018

€ mn	Payable on demand	Up to 3 months	3 months to 1 year	1 year to 5 years	More than 5 years	Total
Money market and capital market liabilities (ac)	896	2,692	4,864	10,090	10,374	**28,916**
Deposits from the housing industry (ac)	7,719	1,960	–	–	–	**9,679**
Subordinated liabilities (ac)	–	29	88	656	405	**1,178**
Financial liabilities from other transactions (ac)	118	0	2	0	–	**120**
Financial guarantees	156	–	–	–	2	**158**
Loan commitments	1,480	–	–	–	–	**1,480**

The Risk Report, part of the Group Management Report, includes a detailed description of the liquidity risk associated with financial liabilities.

Segment Reporting

(70) Operating segments of Aareal Bank

Aareal Bank prepares its segment reporting in accordance with IFRS 8 Operating Segments.

In accordance with the "management approach" set out in IFRS 8, the segment report discloses, on a segment-specific basis, financial information which is relevant for internal control of an entity and which is also used by such entity's management to make decisions on the allocation of resources as well as to measure the financial performance of segments.

Two operating segments were defined within Aareal Bank in line with internal management reporting, based on the organisational structure established according to the various products and services offered.

The **Structured Property Financing segment** comprises the property financing and refinancing activities. In this segment, Aareal Bank facilitates property investments for its domestic and international clients, and is active in this respect in Europe, North America and Asia/Pacific. It offers commercial property financing solutions, especially for office buildings, hotels, retail, logistics and residential properties. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. In addition to local experts, the Bank also has industry specialists at its disposal, to create financing packages for logistics and retail properties and hotels. This enables Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients. What makes Aareal Bank special are its direct client relationships, which – in very many cases – it has maintained for many years.

Aareal Bank has a broad and solid refinancing base. It has established itself as an active issuer of Pfandbriefe (German covered bonds), which account for a major share of the Bank's long-term funding. The AAA rating of the Pfandbriefe additionally confirms the quality of the cover assets pool. To cater to a broad investor base, Aareal Bank covers a wide range of other refinancing tools, including promissory notes and debt securities. Depending on market conditions, the Bank places large-sized public issues or private placements. The Bank also generates deposits from the housing industry, which represent a strategically important additional source of funding. Furthermore, it has recourse to institutional money market investor deposits. The success of our capital and money market activities, and the business with housing industry clients, are the results of a combination of a sustainable business model with a sound understanding of the capital markets, and the quality of the cover assets pool.

The **Consulting/Services segment** offers the housing and commercial property industries services and products for managing property portfolios and processing payment flows. Within this segment, our subsidiary Aareon and the Bank's Housing Industry division work together closely.

We operate our IT system consultancy and related advisory services for the housing and commercial property sector through our Aareon subsidiary. Aareon offers its customers reliable, pioneering solutions in the fields of consulting, software and services to optimise IT-supported business processes in the digital age. The ERP (Enterprise Resource Planning) systems, which are tailored to the needs of the respective market, may be supplemented by further digital solutions for purposes of process optimisation. The majority of these integrated systems forms the digital ecosystem "Aareon Smart World". It connects property companies with customers, employees and business partners as well as technical "equipment" in apartments and buildings. Aareon Smart World can be used to restructure and optimise processes. The applications help to reduce costs, enable the creation of new business models by providing links between all participants and offer more ease-of-use in the dialogue between tenants and employees of the housing industry.

Aareon offers software solutions both in Germany and abroad that may be used in various types of operating environments: in-house services, hosting and Software as a Service (SaaS) from the exclusive Aareon Cloud. Data from Aareon's Cloud Computing is held in Aareon's certified data-processing centre in Mainz, which guarantees data security and protection at the highest level. Following successful advice, implementation and training, customers usually opt for a maintenance model covering regular support services.

In its Housing Industry division, Aareal Bank offers its customers products and solutions for optimising digital payments, electronic banking and cash management processes. Aareal Bank distributes BK01, the leading procedure in the German housing and property management sector for the automated settlement of mass payments. The procedure is integrated in licensed bookkeeping systems. Therefore, customers in Germany may process their payment transactions and account management from the administration software employed. Apart from the German residential and commercial property sector, the German energy and waste disposal industry is a second important customer group of the Bank's Housing Industry division. This enables the offer of further products, facilitating the cross-sector cooperation of target groups and realising synergy effects via end-to-end digital processes. The use of the payment transaction products of Aareal Bank generates deposits that contribute significantly to Aareal Bank Group's refinancing base. Starting in the reporting year, the interest rate contribution and the negative interest are reported in the segment's net interest income (previously in net commission income).

Income and expenses within Aareal Bank are predominantly attributable to transactions with third parties, and are directly allocated to the responsible business segment. Revenue from transactions between Aareal Bank's segments was not generated in a significant amount. Therefore, we elected not to distinguish between internal and external revenue in the following disclosures. Administrative expenses not directly attributable to any of the business segments are segmented in line with the internal cost allocation, based on the principle of causation.

The results of the business segments are determined by the operating profit as well as by the return on equity (RoE) and the cost/income ratio (CIR). RoE, which indicates a segment's profitability, is calculated as the ratio of the segment's operating result (after non-controlling interests and after AT1 interest) to the portion of equity allocated to that segment on average. The cost/income ratio – determined as the ratio of input to output of resources – is used as an indicator for the cost efficiency of business segments. Equity allocated to the Structured Property Financing segment is calculated on the basis of the capital charge pursuant to Basel IV. For the Consulting/Services segment, it is calculated using equity carried in the statement of financial position.

(71) Segment results

	Structured Property Financing		Consulting/ Services		Consolidation/ Reconciliation		Aareal Bank Group	
	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
€ mn								
Net interest income[1]	549	547	-16	-12	0	0	533	535
Loss allowance	90	73	0	-1			90	72
Net commission income[1]	10	9	227	212	-8	-6	229	215
Net derecognition gain or loss	64	24					64	24
Net gain or loss from financial instruments (fvpl)	1	-2	0	0			1	-2
Net gain or loss from hedge accounting	-4	-2					-4	-2
Net gain or loss from investments accounted for using the equity method	1	0	0				1	0
Administrative expenses	254	241	242	227	-8	-6	488	462
Net other operating income/expenses	-1	21	3	4	0	0	2	25
Negative goodwill from acquisitions		55						55
Operating profit	**276**	**338**	**-28**	**-22**	**0**	**0**	**248**	**316**
Income taxes	95	99	-10	-9			85	90
Consolidated net income	**181**	**239**	**-18**	**-13**	**0**	**0**	**163**	**226**
Consolidated net income attributable to non-controlling interests	0	0	2	2			2	2
Consolidated net income attributable to shareholders of Aareal Bank AG	181	239	-20	-15	0	0	161	224
Allocated equity[2]	2,115	2,058	215	189	237	268	2,567	2,515
Cost/income ratio (%)	41.0	40.4	113.0	111.6			59.0	58.2
RoE before taxes (%) [2] [3]	12.0	15.3	-13.9	-12.7			8.7	11.6
Employees (average)	**796**	**800**	**1,995**	**1,964**			**2,791**	**2,764**
Segment assets	**30,012**	**31,989**	**11,125**	**10,698**			**41,137**	**42,687**

[1] As of this reporting year, interest from housing industry deposits is shown in net interest income of the Consulting/Services segment (previously included in net commission income). The previous year's figures were adjusted accordingly.
[2] Equity allocated to the Structured Property Financing segment for the same period of the previous year was adjusted to bring it into line with Basel IV; RoE before taxes is thus also changed accordingly.
[3] The allocation of earnings is based on the assumption that net interest payable on the AT1 bond is recognised on an accrual basis.

Commission income from contracts with customers is allocated to the segments as follows:

	Structured Property Financing		Consulting / Services		Consolidation / Reconciliation		Aareal Bank Group	
	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2019	1 Jan - 31 Dec 2018
€ mn								
ERP products (incl. add-on products)			196	191	-13	-13	183	178
Digital solutions			51	42			51	42
Banking business and other activities	13	12	32	27			45	39
Total	**13**	**12**	**279**	**260**	**-13**	**-13**	**279**	**259**

(72) Income by geographical markets

	2019	2018
€ mn		
Germany	563	522
Rest of Europe	160	172
North America	99	75
Asia/Pacific	5	3
Total	**827**	**772**

Income includes net interest income (excluding loss allowance), net commission income, net gain or loss on derecognition and net gain or loss from financial instruments (fvpl). Allocation to geographical markets is based on the registered office or domicile of the Group company or branch office.

Other Notes

(73) Assets and liabilities in foreign currency

Foreign currency assets

€ mn	31 Dec 2019	31 Dec 2018
USD	11,264	13,096
GBP	4,271	4,408
CAD	1,357	908
SEK	701	608
CHF	364	400
DKK	117	323
Other	256	94
Total	**18,330**	**19,837**

Foreign currency liabilities

€ mn	31 Dec 2019	31 Dec 2018
USD	11,230	13,084
GBP	4,262	4,340
CAD	1,349	905
SEK	701	584
CHF	365	401
DKK	119	322
Other	248	91
Total	**18,274**	**19,727**

(74) Subordinated assets

In the event of insolvency or liquidation of the issuer, subordinated assets are those subordinate to the claims of all other creditors. There were no subordinated assets in the financial year 2019 (2018: € 0 million)

(75) Leases

Leases where the Bank acts as the lessee

The following overview shows the movements in the right-of-use assets from leases where Aareal Bank Group acts as the lessee.

2019

	Right-of-use assets in		
€ mn	Land and buildings	Office furniture and equipment	Total
Cost			
Balance as at 1 January	**64**	**6**	**70**
Additions	17	5	**22**
Transfers	-1	–	**-1**
Amortisation and impairment losses	9	4	**13**
Disposals	2	0	**2**
Currency translation differences	0	–	**0**
Balance as at 31 December	**69**	**7**	**76**

Right-of-use assets are recognised under property and equipment.

Aareal Bank Group primarily rents properties which are, in some cases, subject to longer-term rental agreements with extension options of up to ten years where the exercise is reasonably certain. The leases are not subject to material residual value guarantees.

The entire cash outflows from leases where Aareal Bank Group is the lessee in the current period amount to € 16 million as at the reporting date.

Expenses and income from Aareal Bank Group include the following amounts from leases with Aareal Bank Group as the lessee in the 2019 financial year:

€ mn	31 Dec 2019
Interest expenses for lease liabilities	2
Expenses for short-term leases	2
Expenses for low-value leases	0
Income from the sublease of right-of-use assets	0

In the financial year 2019, there were no sale-and-lease-back transactions, and neither were there any material variable lease payments.

The future undiscounted cash flows from lease liabilities based on their maturities are disclosed in the Note "Maturities of financial liabilities".

Leases where the Bank acts as the lessor

Aareal Bank Group acts as lessor as regards the lease of property. All rental contracts are classified as operating leases. Properties leased by the Group are reported under the item "Other assets". Not all properties reported under the item "Other assets" are currently let. The risks of these properties are included in property risk management.

Income from operating leases amounted to € 12 million in the year under review. They are recognised in the income statement on a straight-line basis over the lease term.

The following overview shows the future undiscounted payments under operating leases based on their maturities where Aareal Bank Group acts as the lessor.

€ mn	31 Dec 2019	31 Dec 2018
Up to 1 year	8	9
Longer than 1 year, and up to 5 years	17	24
Longer than 5 years	4	7
Total minimum lease payments	**29**	**40**

(76) Contingent liabilities and loan commitments

€ mn	31 Dec 2019	31 Dec 2018
Contingent liabilities	157	158
Loan commitments	1,205	1,480
of which: irrevocable	881	1,035

Contingent liabilities include irrevocable payment obligations regarding the bank levy and the liability to the deposit guarantee scheme of German banks. These and the values reported under loan commitments given represent the maximum default risk to which Aareal Bank Group is exposed at the end of the reporting period.

Furthermore, the Bank is involved in legal disputes. Based on a legal analysis, successful outcome of these disputes is more likely than not. Essentially, these are legal disputes with borrowers (or former borrowers) who claim damages against the Bank. These are included in the table above, with a probability-weighted amount of € 99 million (2018: € 109 million), but have not been recognised as liabilities.
We estimate the maximum default risk in the low triple-digit million range. The duration of proceedings depends on the complexity of each individual litigation, and the legal remedies available in each case. Likewise, the final amount in the event of defeat may vary considerably, depending upon the duration of proceedings and the legal remedies. Refunds of litigation costs are possible. Accordingly, the recognition of contingent liabilities is also subject to estimation uncertainties.

(77) Regulatory capital and capital management

As regards meeting minimum capital ratios, Aareal Bank Group has to comply with the capital adequacy requirements set out in the Capital Requirements Regulation (CRR), the Capital Requirements Directive (CRD IV), the German Banking Act (Kreditwesengesetz, KWG) and the German Solvency Regulation (Solvabilitätsverordnung, SolvV) pursuant to Basel III. This requires the Bank to maintain own funds (including capital conservation buffer and the countercyclical buffer) of at least 10.7 % of its risk-weighted assets in 2020 (2019: 10.6 %). Risk-weighted assets must be backed by Tier 1 capital of at least 8.7 % (2019: 8.6 %). Compliance with the capital requirements has to be reported to the competent supervisory authorities on a quarterly basis. The capital requirements were complied with at all times during the reporting period.

In 2020, the SREP total capital requirement of the ECB amounts to 12.9 % (2019: 12.9 %) for Aareal Bank Group. It comprises the minimum own funds requirement pursuant to Article 92(1) of the CRR, Pillar 2 Requirement (P2R) as well as capital conservation buffer and a countercyclical buffer. In 2020, the SREP-CET 1 requirement is 9.4 % (2019: 9.4 %), including the above-mentioned buffers.

The objectives of capital management are optimising the capital base as well as an efficient capital allocation to the individual business areas in terms of risk and income. Subject to further regulatory changes, Aareal Bank considers a target CET 1 ratio (post-finalisation of Basel III – so-called "Basel IV") of around 12.5 % to be appropriate as a target capital ratio relevant for internal control. This ratio, which is significantly above the legal minimum requirement and above the ECB's requirements, is to guarantee the Bank's capacity to act. The capital ratios are managed through the generation of profits, an active dividend policy, optimisation of the capital structure, and an efficient management of risk assets.

Within the context of capital management, projections are made on a regular basis showing the changes of the individual capital components and risk-weighted assets, as well as the resulting capital ratios. This is reported regularly within the framework of management reporting. The strategic allocation of capital to the individual business segments is incorporated in the Group's annual overall planning process.

Aareal Bank Group's regulatory capital is composed of the following:

€ mn	31 Dec 2019 [1]	31 Dec 2018
Tier 1 capital (T1)		
Subscribed capital and capital reserves	900	900
Eligible retained earnings	1,653	1,590
Accumulated other comprehensive income	-133	-54
Amounts to be deducted from CET 1 capital	-229	-195
Total Common Equity Tier 1 (CET1) capital	**2,191**	**2,241**

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[1] When calculating own funds, net income for the year was taken into account, having regard to the Management Board's proposal for the appropriation of profits for the 2019 financial year and the pro-rated deferral of the net interest from the AT1 bond. The appropriation of profits is subject to approval by the Annual General Meeting. The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning the NPL stock as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account for determining regulatory capital.

€ mn	31 Dec 2019[1)]	31 Dec 2018
AT1 bond	300	300
Sum total of Additional Tier 1 (AT1) capital	**300**	**300**
Sum total of Tier 1 capital (T1)	**2,491**	**2,541**
Tier 2 (T2) capital		
Subordinated liabilities	830	830
Other	22	48
Sum total of Tier 2 capital (T2)	**852**	**878**
Total capital (TC)	**3,343**	**3,419**

[1)] When calculating own funds, net income for the year was taken into account, having regard to the Management Board's proposal for the appropriation of profits for the 2019 financial year and the pro-rated deferral of the net interest from the AT1 bond. The appropriation of profits is subject to approval by the Annual General Meeting. The expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning the NPL stock as well as the ECB's NPL guidelines for exposures newly classified as NPLs, were taken into account for determining regulatory capital.

The regulatory measurement of risk-weighted assets (RWA) in the area of credit risks is based on both the Advanced Internal Ratings Based Approach (AIRBA) and on the standardised approach (CRSA). RWA as at 31 December 2019 can be broken down as follows:

€ mn	Risk-weighted assets (RWA) 31 Dec 2019	Minimum capital requirements 31 Dec 2019	Risk-weighted assets (RWA) 31 Dec 2018	Minimum capital requirements 31 Dec 2018
Credit risk	**8,774**	**702**	**10,300**	**824**
Credit Risk Standard Approach (CRSA)[1)]	595	48	586	47
Advanced IRB (AIRB) approach[1)]	7,388	591	8,865	709
Equity under the IRB approach based on the simple risk-weighted approach	791	63	849	68
Counterparty credit risk	**486**	**39**	**582**	**47**
Mark to market	283	23	376	30
Risk exposure amount from contributions to the default fund of a central counterparty	0	0	0	0
Credit Valuation Adjustment	203	16	206	16
Market risk	**61**	**5**	**92**	**7**
Operational risk	**1,489**	**119**	**1,489**	**119**
Basic indicator approach	44	4	44	4
Standard approach	1,445	116	1,445	116
Other receivables (e.g. deferred tax assets)	**385**	**31**	**328**	**26**
Total	**11,195**	**896**	**12,791**	**1,023**

[1)] Risk exposures towards institutions are determined using the CRSA starting on 31 December 2019. Previously, the AIRBA was used.

(78) Additional disclosures to the Remuneration Report

Management Board

In the financial year 2019, the Management Board's total remuneration amounted to € 11 million (2018: € 10 million), of which € 5 million (2018: € 5 million) referred to variable components.

Payments to former Management Board members and their surviving dependants totalled € 2 million in 2019 (2018: € 3 million).

The pension obligations to former members of the Management Board and their surviving dependants amounted to a total of € 35 million as at 31 December 2019 (2018: € 33 million).

Supervisory Board

The total remuneration of members of the Supervisory Board for the financial year 2019 amounted to € 2 million (2018: € 2 million). The remuneration for any financial year shall be due and payable one month after the end of the respective financial year.

Remuneration for key executives

The definition of executives in key positions within Aareal Bank Group includes members of management or supervisory bodies of Aareal Bank AG.

Total remuneration of executives in key positions is analysed below:

€ 000's	31 Dec 2019	31 Dec 2018
Short-term benefits	8,600	7,349
Post-employment benefits	7,704	3,026
Other long-term benefits	1,548	1,441
Termination benefits	–	–
Share-based remuneration	2,580	2,402
Total	**20,432**	**14,218**

Provisions for pension obligations concerning key executives totalled € 26 million as at 31 December 2019 (2018: € 19 million).

Disclosures on share-based remuneration

Valuation model and valuation assumptions

The obligations resulting from share-based payment arrangements as at the balance sheet date correspond to the remuneration granted, discounted to the balance sheet date. The discount period corresponds to the period from the balance sheet date to the earliest exercise or payout date, per plan and per tranche. The discount is based on the Euribor swap rate applicable as at the relevant balance sheet date, depending on the term.

Amount of cash-settled share-based payment transactions

The total amount of outstanding virtual shares in relation to existing share-based payment arrangements changed as follows:

Quantity (number)	2019	2018
Balance (outstanding) at 1 January	**656,900**	**691,546**
Granted during the reporting period	276,782	211,421
Expired during the reporting period	–	–
Exercised during the reporting period	233,939	246,067
Balance (outstanding) at 31 December	**699,743**	**656,900**
of which: exercisable	–	–

The fair value of the virtual shares granted during the reporting period amounted to € 8 million (2018: € 6 million) as at the balance sheet date.

The virtual shares exercised during the reporting period were converted at a weighted average price of the Aareal Bank AG share of € 28.70 (2018: € 39.08).

Impact on financial performance

The total amount expensed for share-based payment transactions was € 10 million during the financial year 2019 (2018: € 1 million). The portion of the total amount expensed attributable to members of the Management Board amounted to € 3 million (2018: € 0 million) and can be broken down to the individual members of the Management Board as follows:

€	2019	2018
Hermann J. Merkens	820,318	-157,261
Marc Hess[1)]	395,408	100,822
Dagmar Knopek	564,712	-176,781
Christiane Kunisch-Wolff	466,764	122,941
Thomas Ortmanns	574,412	-155,427
Christof Winkelmann	435,043	159,461

[1)] Marc Hess was appointed to the Management Board on 1 October 2018.

In addition, € 0 million (2018: € 0 million) was expensed for former members of the Management Board.

The intrinsic value of the virtual shares exercisable at the reporting date amounted to € 0 million (2018: € 0 million), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2019 amounted to € 30 million (2018: € 28 million). It is reported in the statement of financial position in the line item ”Provisions”.

(79) Related party disclosures in accordance with IAS 24

The group of related parties of Aareal Bank Group comprises the members of management or supervisory bodies of Aareal Bank AG (see preceding note) and close members of these persons' families. The group of companies related to Aareal Bank Group consists of the companies set out in Note 87 "List of Shareholdings" as well as the companies attributable to the related persons within the meaning of IAS 24.9 (b)(vi). Intra-group receivables and liabilities, as well as consolidated income and expenses, are not shown here.

The following list provides an overview of the balances of existing transactions with related parties:

€ mn	31 Dec 2019	31 Dec 2018
Management Board	–	–
Supervisory Board	–	–
Other related parties	16	18
Total	**16**	**18**

The item "Other related parties" includes a loan of € 16 million which was provided to our investee Mount Street Group Limited on an arm's length basis, as well as receivables from the BauGrund/TREUREAL syndicate in the amount of € 0.2 million.

In addition, there were no further significant transactions within the meaning of IAS 24.

(80) Events after the reporting date

On 17 February 2020, the ECB authorised Aareal Bank to terminate the AT1 bond issued without having to replace it with a new issue. Since this date, the Bank has deducted the AT1 bond from regulatory capital, as required by the ECB (in accordance with Art. 28 (2) of Delegated Regulation (EU) 241/2014), due to the possibility of terminating the bond at any time. The Bank has not yet terminated the issue as at the time of preparing the financial statements.

There were no other material events after the reporting period which would have to be reported here.

(81) Contingencies

By means of a Letter of Comfort in favour of the Monetary Authority of Singapore, Aareal Bank AG has undertaken to ensure that Aareal Bank Asia Ltd. is able to fulfil its obligations at any time.

(82) Disclosures pursuant to section 160 (1) no. 8 of the AktG

Pursuant to the German Securities Trading Act (WpHG), any investor whose shareholding in a listed company reaches, exceeds or falls short of certain threshold values in terms of voting rights (whether by purchase, sale or by any other means) must notify the Company and the German Federal Financial Supervisory Authority. The lowest threshold for this notification requirement is 3 %. 100 % of Aareal Bank AG shares are held in free float.

As at 31 December 2019, we were aware of the following shareholders holding a share in the voting rights of at least 3 % pursuant to section 33 (1) of the WpHG:

	Location	Total[1]	Threshold reached on
Responsible entity			
DEKA	Frankfurt	9.60 %	22 May 2018
BlackRock	Wilmington	9.51 %	23 December 2019
VBL[2]	Karlsruhe	6.50 %	3 February 2015
Dimensional Fund	Austin	5.25 %	30 August 2019
iShares Trust[3]	Wilmington	5.22 %	3 April 2019
Igor Kuzniar	Zug	5.07 %	10 December 2019
Teleios Global Opportunities Master Fund Ltd.[4]	George Town	5.07 %	10 December 2019
Allianz Global Investors	Frankfurt	4.99 %	2 October 2019
JPMorgan Investment Management Inc.[5]	Wilmington	3.07 %	13 November 2018
JPMorgan Chase Bank[5]	Columbus	3.07 %	13 November 2018
JPMorgan Asset Management (UK)[5]	London	3.07 %	13 November 2018
Staat Norwegen (über Norges Bank)	Oslo	3.05 %	26 February 2018
DFA International Small Cap Value[6]	Baltimore	3.01 %	7 August 2018

[1] Direct and indirect holdings of voting rights
[2] Shares are managed by Deka and are therefore included in DEKA's holding of 9.60 %
[3] Shares are also attributed to BlackRock and are therefore included in BlackRock's holding of 9.51 %
[4] Shares are also attributed to Igor Kuzniar and therefore correspond to his share of voting rights
[5] The holdings are attributed to each other across these three companies. Therefore, the overall share is 3.07 %.
[6] Shares are also attributed to Dimensional Fund and are therefore included in Dimensional Fund's holding of 5.25 %

(83) Declaration of Compliance in accordance with Section 161 of the AktG

The Management Board and the Supervisory Board issued the Declaration of Compliance as stipulated in section 161 of the AktG, and made this Declaration available to shareholders. It is available to the public on the Company's website on www.aareal-bank.com/en/about-us/corporate-governance/declaration-of-compliance/.

(84) Employees

The number of Aareal Bank Group employees is shown below:

	31 Dec 2019[1]	Average 1 Jan - 31 Dec 2019[2]	31 Dec 18[1]	Average 1 Jan - 31 Dec 2018[2]
Salaried employees	2,640	2,641	2,593	2,612
Executives	148	150	155	152
Total	**2,788**	**2,791**	**2,748**	**2,764**
of which: part-time employees	556	564	569	548

[1] This number does not include 45 employees of the hotel business (31 December 2018: 47 employees).
[2] This number does not include 180 employees of the hotel business (1 January to 31 December 2018: 191 employees).

(85) Nature and extent of interests in unconsolidated structured entities

In accordance with IFRS 12.24, the nature and extent of interests in unconsolidated structured entities as well as the nature of, and changes in, the risks associated with such interests have to be disclosed in the annual report. An interest in a structured entity arises from a contractual and/or non-contractual involvement which entitles the Group to receive variable returns from the relevant activities of the structured entity. Examples for this are equity or debt instruments of structured entities or the provision of financing, collateral and guarantees to structured entities.

Structured entities are companies where voting rights or similar rights are not the dominant factor to assess control of the company. The relevant activities of structured entities are directed by means of contractual arrangements; any voting rights relate to administrative tasks only. Structured entities are characterised by features or attributes such as restricted activities, a narrow and well-defined objective and/or insufficient equity. In addition, structured entities may relate to financings in the form of multiple contractually linked instruments to investors that create concentrations of credit or other risks. Examples of structured entities are securitisation vehicles, asset-backed financings and some investment funds.

Aareal Bank Group mainly interacts with structured entities such as open-ended property funds and leased property companies. In this context, the Group provides financing to structured entities in the form of loans or guarantees. Strategic investments made by the Group are included under "Other". The leased property companies were established by third parties for the financing of particular transactions and have the legal form of a German private limited company with a limited liability company as general partner (GmbH & Co KG). In the year under review and the previous year, Aareal Bank Group did not provide any non-contractual support for unconsolidated structured entities.

To the extent that this is relevant, the following table (p. 212) shows the carrying amounts of assets and liabilities recognised by Aareal Bank Group as at the reporting date as well as the existing off-balance sheet risk exposures that relate to unconsolidated structured entities. The carrying amounts of the assets and off-balance sheet items correspond to the Group's maximum loss exposure from interests in unconsolidated structured entities (without taking into account collateral). The size of the structured entities was determined on the basis of the net fund assets for open-ended property funds and other vehicles and on the basis of total assets for leased property companies.

31 December 2019

€ mn	Open-ended property funds	Leased property companies	Other	Total
Assets				
Loan receivables	31	17	3	**51**
Off-balance sheet exposures				
Loan commitments and guarantees (nominal value)	–	–	2	**2**
Size range of structured units	**€ 167 mn – € 896 mn**	**€ 5 mn – € 47 mn**	**€ 1 mn – € 11 mn**	

31 December 2018

€ mn	Open-ended property funds	Leased property companies	Other	Total
Assets				
Loan receivables	159	30	–	**189**
Off-balance sheet exposures				
Loan commitments and guarantees (nominal value)	–	–	–	**–**
Size range of structured units	**€ 160 mn – € 734 mn**	**€ 5 mn – € 44 mn**	**–**	

(86) Country-by-Country Reporting

The disclosure requirements refer to information on registered office, revenue, profit or loss, taxes on profit or loss, received government assistance as well as wage and salary earners of Aareal Bank AG, together with its foreign branches and domestic and foreign subsidiaries included in the reporting entity-structure, prior to consolidation.

For this purpose, the Bank's entities – subsidiaries as well as Aareal Bank AG's foreign branches – are allocated to our two business segments, Structured Property Financing and Consulting/Services.

Aareal Bank defines the branch offices' operating profit, which is used as a proxy for revenue, as the sum of the following consolidated income statement items (in accordance with IFRSs):

- Net interest income before loss allowance
- Net commission income
- Net derecognition gain or loss
- Net gain or loss from financial instruments (fvpl)
- Net gain or loss from hedge accounting

- Net gain or loss from investments accounted for using the equity method
- Net other operating income/expenses
- Negative goodwill

Taxes disclosed are tax expenses in accordance with IFRSs.

The number of wage and salary earners relates to average full-time equivalent staff employed during the financial year.

The following overview shows all countries where Aareal Bank AG has offices, including foreign branches and subsidiaries. Please refer to the list of shareholdings as regards the allocation of individual subsidiaries to the relevant country of domicile. Aareal Bank AG's foreign branches are located in France, Ireland, Italy, Poland, Sweden and the UK.

2019

	Revenues	Profit/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**612**	**276**	**95**	**908**
Belgium	1	1	–	–
France	6	1	1	7
Germany	419	223	70	814
Ireland	1	2	0	1
Italy	50	-62	–	31
Poland	9	5	2	5
Singapore	4	3	0	5
Spain	0	0	–	–
Sweden	4	2	1	3
United Kingdom	8	5	0	7
USA	118	96	21	35
Consolidation	-8	–	–	–
Consulting/Services segment	**214**	**-28**	**-10**	**1,652**
Finland	–	0	–	3
France	28	7	3	193
Germany	133	-42	-13	983
Netherlands	32	6	–	266
Norway	3	3	0	5
Sweden	7	-2	0	78
United Kingdom	11	0	0	124
Consolidation	–	–	–	–
Total	**826**	**248**	**85**	**2,560**

Government assistance was not received in the financial year 2019.

Aareal Bank Group's return on assets, calculated as the ratio of net profit to total assets, was 0.39 % as at the record date.

2018

	Revenues	Profi/loss before taxes	Taxes on profit or loss	Number of wage and salary earners
	€ mn	€ mn	€ mn	Full-time equivalents
Structured Property Financing segment	**646**	**338**	**99**	**935**
Belgium	1	1	–	–
France	9	5	2	4
Germany	460	289	46	844
Ireland	3	5	0	1
Italy	75	-34	30	32
Poland	11	8	1	5
Singapore	3	1	0	5
Spain	–	–	0	–
Sweden	3	1	0	3
United Kingdom	8	5	-	7
USA	78	57	20	34
Consolidation	-5	–	–	–
Consulting/Services segment	**204**	**-22**	**-9**	**1,611**
France	25	6	2	186
Germany	130	-32	-12	961
Netherlands	30	6	1	261
Norway	7	-1	–	7
Sweden	–	-2	0	79
United Kingdom	12	1	0	117
Consolidation	–	–	–	–
Total	**850**	**316**	**90**	**2,546**

(87) List of shareholdings

The list of shareholdings is prepared pursuant to section 313 (2) of the HGB. The disclosures in relation to the companies' equity and earnings are retrieved from the financial statements based on the respective local financial reporting principles.

31 December 2019

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
1	Aareal Bank AG	Wiesbaden			
	I. Fully-consolidated subsidiaries				
2	Aareal Bank Asia Ltd.	Singapore	100.0	SGD 22.7 mn	SGD 4.2 mn [1]
3	Aareal Beteiligungen AG	Frankfurt	100.0	167.0	0.0 [3]
4	Aareal Capital Corporation	Wilmington	100.0	USD 1,018.8 mn	USD 11.7 mn [4]
5	Aareal Estate AG	Wiesbaden	100.0	2.9	0.0 [3]
6	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 [3]
7	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.7	0.1 [1]
8	Aareal Holding Realty LP	Wilmington	99.8	USD 221.4 mn	USD -0.3 mn [4]
9	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	419.7	0.0 [3]
10	Aareon AG	Mainz	100.0	165.7	26.3
11	Aareon Deutschland GmbH	Mainz	100.0	34.7	0.0 [3]
12	Aareon Finland Oy	Helsinki	100.0	0.0	-0.3 [1]
13	Aareon France S.A.S.	Meudon-la Forêt	100.0	9.5	3.6 [2]
14	Aareon Nederland B.V.	Emmen	100.0	28.2	2.0 [2]
15	Aareon Norge AS	Oslo	100.0	NOK 5.7 mn	NOK -19.9 mn [2]
16	Aaeron Planungs- und Bestandsentwicklungs GmbH	Mainz	100.0	-0.4	-0.5 [1]
17	Aareon Sverige AB	Mölndal	100.0	SEK 26.1 mn	SEK -24.9 mn [2]
18	Aareon RELion GmbH	Augsburg	100.0	-0.4	-0.5 [2]
19	Aareon RELion Nord GmbH	Hamburg	100.0	1.1	0.4 [2]
20	Aareon RELion Süd GmbH	Augsburg	100.0	0.6	0.4 [2]
21	Aareon UK Ltd.	Coventry	100.0	GBP 4.8 mn	GBP 0.4 mn [2]
22	AV Management GmbH	Mainz	100.0	0.4	0.0 [3]
23	BauContact Immobilien GmbH	Wiesbaden	100.0	8.5	0.7
24	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 [3]
25	BauGrund Solida Immobilien GmbH	Frankfurt	100.0	0.1	0.0 [1]
26	BauGrund TVG GmbH	Munich	100.0	0.1	0.0 [1]
27	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.6	3.5 [2]
28	BVG – Grundstücks- und Verwertungsgesellschaft mit beschränkter Haftung	Frankfurt	100.0	152.3	0.0 [3]
29	Cave Nuove S.p.A.	Rome	100.0	-76.9	0.0
30	DBB Inka	Dusseldorf	100.0	100.1	-0.6
31	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	0.5	0.0 [1]

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[1] Preliminary figures as at 31 December 2019; [2] Equity and results as at 31 December 2018;
[3] Profit and loss transfer agreement/control and profit transfer agreement; [4] Disclosures in accordance with IFRSs

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
32	Deutsche Structured Finance GmbH	Wiesbaden	100.0	3.0	-1.3
33	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 3)
34	DHB Verwaltungs AG	Wiesbaden	100.0	5.1	0.0 3)
35	FIRE B.V.	Utrecht	60.0	0.0	0.0 2)
36	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	3.0	0.0 3)
37	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0
38	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 3)
39	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.5	0.0 1)
40	Izalco Spain S.L.	Madrid	100.0	13.3	-0.5 1)
41	Jomo S.p.r.l.	Brussels	100.0	26.4	1.0 1)
42	Kalshoven Automation B.V.	Amsterdam	100.0	1.2	0.7 2)
43	La Sessola Holding GmbH	Wiesbaden	100.0	86.6	0.0 1)
44	La Sessola S.r.l.	Rome	100.0	100.7	-7.3 1)
45	La Sessola Service S.r.l.	Rome	100.0	4.5	-0.2 1)
46	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn 4)
47	Mercadea S.r.l.	Rome	100.0	7.3	0.0 1)
48	Mirante S.r.l.	Rome	100.0	4.6	-0.6 1)
49	Northpark Realty LP	Wilmington	100.0	USD 118.0 mn	USD 3.0 mn 4)
50	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	3.0	0.0 3)
51	Participation Elfte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
52	Participation Zehnte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 3)
53	phi-Consulting GmbH	Bochum	100.0	1.9	0.2 3)
54	Pisana S.p.A.	Rome	100.0	-17.1	0.0
55	plusForta GmbH	Dusseldorf	100.0	0.2	0.0 3)
56	Sedum Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG	Wiesbaden	94.9	-2.0	3.4 1)
57	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	100.0	23.8	0.0 3)
58	Terrain Beteiligungen GmbH	Wiesbaden	94.0	57.6	1.0 1)
59	Westdeutsche Immobilien Servicing AG	Mainz	100.0	50.1	0.0 3)
60	WP Galleria Realty LP	Wilmington	100.0	USD 124.1 mn	USD 0.8 mn 4)
	II. Joint Arrangements				
61	Konsortium BauGrund/TREUREAL[5]	Bonn	50.0	0.0	0.0 1)
	III. Associates				
62	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Bremen	48.4	0.3	0.0 2)
63	Mount Street Group Limited	London	20.0	GBP 3.1 mn	GBP 4.4 mn 1)
64	OFI Group GmbH	Frankfurt	35.8	0.4	-0.6 1)
65	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	0.0	0.0 1)
	IV. Other enterprises[6]				

1) Preliminary figures as at 31 December 2019; 2) Equity and results as at 31 December 2018;
3) Profit and loss transfer agreement/control and profit transfer agreement; 4) Disclosures in accordance with IFRSs; 5) Joint operation;
6) With a carrying amount of > € 3 million, which is why BrickVest Ltd is no longer shown as at 31 December 2019

(88) Executive Bodies of Aareal Bank AG

The members of the Management Board and the Supervisory Board disclose their offices held, in accordance with the requirements set out in section 285 of the HGB and Article 435 (2) of Regulation (EU) No 575/2013, in conjunction with the EBA Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013 (EBA/GL/2016/11) and the Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2017/12).

Supervisory Board

Marija Korsch, Chairman of the Supervisory Board
Former partner of Bankhaus Metzler seel. Sohn & Co. Holding AG

Aareal Bank AG	Chairman of the Supervisory Board	
Just Software AG	Member of the Supervisory Board	
Nomura Financial Products Europe GmbH	Member of the Supervisory Board	
(Offices held at other listed companies)		
Instone Real Estate Group N.V.	Member of the Supervisory Board	
(Non-commercial mandates)		
FAZIT – Stiftung Gemeinnützige Verlagsgesellschaft mbH	Shareholder and member of the Advisory Board	
Städelsches Kunstinstitut und Städtische Galerie	Member of the Administration	
Gesellschaft der Freunde der Alten Oper Frankfurt e.V.	Deputy Chairman of the Management Board	
Stiftung Centrale für private Fürsorge	Chairman of the Foundation’s Executive Board	

Prof. Dr Stephan Schüller, Deputy Chairman of the Supervisory Board
Businessman; former spokesman of the General Partners of Bankhaus Lampe KG

Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board	
HANSAINVEST (Hanseatische Investment-GmbH)	Member of the Supervisory Board	
Merica Holdings Plc Ltd.	Member of the Board of Directors	
(Non-commercial mandates)		
hsh portfoliomanagement AöR	Member of the Board of Directors	(since 1 January 2019)
SC Preußen Münster 06 GmbH	Member of the Board of Directors	(until 10 October 2019)

Klaus Novatius*, Deputy Chairman of the Supervisory Board
Aareal Bank AG

Aareal Bank AG	Deputy Chairman of the Supervisory Board	(since 1 January 2019)

Thomas Hawel*
Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board
Aareon Deutschland GmbH (Mandat innerhalb der Aareal Bank-Gruppe)	Deputy Chairman of the Supervisory Board

Petra Heinemann-Specht*
Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board

* Employee representative member of the Supervisory Board of Aareal Bank AG

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Richard Peters
President and Chairman of the Management Board of Versorgungsanstalt des Bundes und der Länder

Aareal Bank AG	Member of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH (Liquidation geplant)	Member of the Supervisory Board (not active)	(until 15 February 2019)

(Non-commercial mandates)

VBLV e.V.	Chairman of the Management Board

Dr Hans-Werner Rhein
German Lawyer (Rechtsanwalt)

Aareal Bank AG	Member of the Supervisory Board

(Offices held at other listed companies)

Deutsche Familienversicherung AG	Chairman of the Supervisory Board

(Non-commercial mandates)

Müller-Matthieu Stiftung	Chairman of the Management Board
ARIAS Deutschland e.V.	Chairman of the Management Board
St. Petri Stiftung, Hamburg	Member of the Board of Managing Directors

Sylvia Seignette
Former CEO for Germany and Austria, Crédit Agricole CIB (formerly Calyon)

Aareal Bank AG	Member of the Supervisory Board

Elisabeth Stheeman
External Member of the Financial Policy Committee and the Financial Market Infrastructure Board, Bank of England, Prudential Regulation Authority

Aareal Bank AG	Member of the Supervisory Board

(Offices held at other listed companies)

Edinburgh Investment Trust Plc	Member of the Board of Directors	(since 23 May 2019)
Korian SA	Member of the Supervisory Board	(until 6 June 2019)

Hans-Dietrich Voigtländer
Associate Partner at BDG Innovation + Transformation GmbH & Co. KG

Aareal Bank AG	Member of the Supervisory Board

Prof. Dr Hermann Wagner, Chairman of the Audit Committee
German Chartered Accountant, tax consultant

Aareal Bank AG	Member of the Supervisory Board
btu beraterpartner Holding AG	Member of the Supervisory Board
Squadra Immobilien GmbH & Co. KGaA	Member of the Supervisory Board

(Offices held at other listed companies)

PEH Wertpapier AG	Member of the Supervisory Board
Consus Real Estate AG (”Scale” segment of the Regulated Unofficial Market)**	Member of the Supervisory Board

Beate Wollmann*
Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board

* Employee representative member of the Supervisory Board of Aareal Bank AG
** Banking supervisory authority has approved the acceptance of this fifth Supervisory Board office in accordance with section 25d (3) of the KWG.

Composition of Supervisory Board's committees

Executive and Nomination Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Klaus Novatius	Deputy Chairman
Richard Peters	
Dr Hans-Werner Rhein	

Technology and Innovation Committee	
Hans-Dietrich Voigtländer	Chairman
Marija Korsch	Deputy Chairman
Thomas Hawel	
Richard Peters	
Elisabeth Stheeman	

Audit Committee	
Prof. Dr Hermann Wagner	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Marija Korsch	
Richard Peters	
Hans-Dietrich Voigtländer	
Beate Wollmann	

Remuneration Control Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Klaus Novatius	Deputy Chairman
Hans-Dietrich Voigtländer	

Risk Committee	
Sylvia Seignette	Chairman
Elisabeth Stheeman	Deputy Chairman
Petra Heinemann-Specht	
Marija Korsch	
Dr Hans-Werner Rhein	
Prof. Dr Hermann Wagner	

Management Board

Hermann Josef Merkens, Chairman of the Management Board
Corporate Strategy, Project & Credit Portfolio Management, Corporate Communications, Investor Relations incl. Sustainability, Board Office, Human Resources, Legal, Audit

Becker & Kries family foundation	Member of the Board of Trustees	(since 9 June 2019)
(Offices held at companies of Aareal Bank Group)		
Aareal Estate AG	Chairman of the Supervisory Board	
Aareal Capital Corporation	Chairman of the Board of Directors	
Aareon AG	Deputy Chairman of the Supervisory Board	
Aareal Beteiligungen AG (formerly Corealcredit Bank AG)	Chairman of the Supervisory Board	

Marc Hess, Member of the Management Board
Finance & Controlling, Treasury

(Offices held at companies of Aareal Bank Group)		
Aareon AG	Member of the Supervisory Board	(since 1 January 2019)
Düsseldorfer Hypothekenbank AG	Chairman of the Supervisory Board	(until 24 June 2019)

Dagmar Knopek, Member of the Management Board
Credit Management, Workout and Operations

HypZert GmbH	Chairman of the Supervisory Board	
(Offices held at companies of Aareal Bank Group)		
Düsseldorfer Hypothekenbank AG	Member of the Supervisory Board	(until 24 June 2019)
Westdeutsche Immobilien Servicing AG (formerly Westdeutsche ImmobilienBank AG)	Chairman of the Supervisory Board	(until 7 March 2019)

Christiane Kunisch-Wolff, Member of the Management Board
Risk Controlling, Regulatory Affairs and Compliance

(Offices held at companies of Aareal Bank Group)		
Westdeutsche Immobilien Servicing AG (formerly Westdeutsche ImmobilienBank AG)	Member of the Supervisory Board	(until 7 March 2019)

Thomas Ortmanns, Member of the Management Board
Housing Industry, Information Technology and Organisation

(Offices held at companies of Aareal Bank Group)		
Aareon AG	Chairman of the Supervisory Board	

Christof Winkelmann, Member of the Management Board
Sales Unit Structured Property Financing

(Offices held at companies of Aareal Bank Group)		
Aareal Bank Asia Limited	Chairman of the Board of Directors	
Aareal Capital Corporation	Member of the Board of Directors	
La Sessola Service S.r.l.	Member of the Management Board	
La Sessola S.r.l.	Member of the Management Board	

Responsibility Statement

To the best of our knowledge, and in accordance with the applicable reporting principles, the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Wiesbaden, 2 March 2020

The Management Board

Hermann J. Merkens **Marc Hess** **Dagmar Knopek**

Christiane Kunisch-Wolff **Thomas Ortmanns** **Christof Winkelmann**

Independent Auditors' Report

To Aareal Bank AG, Wiesbaden

Report on the audit of the consolidated financial statements and of the Group management report

Audit Opinions

We have audited the consolidated financial statements of Aareal Bank AG, Wiesbaden, and its subsidiaries (the Group), which comprise the statement of financial position as at 31 December 2019, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the financial year from 1 January to 31 December 2019, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report of Aareal Bank AG for the financial year from 1 January to 31 December 2019. In accordance with the German legal requirements, we have not audited the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315e Abs. (paragraph) 1 HGB (andelsgesetzbuch: German Commercial Code) and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as at 31 December 2019, and of its financial performance for the financial year from 1 January to 31 December 2019, and

- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the group management report does not cover the content of those parts of the group management report listed in the "Other Information" section of our auditor's report.

Pursuant to § 322 Abs. 3 Satz (sentence) 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the Audit Opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). We performed the audit of the consolidated financial statements in supplementary compliance with the International Standards on Auditing (ISAs). Our responsibilities under those requirements, principles and standards are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the consolidated financial statements and on the group management report.

Key Audit Matters in the Audit of the Consolidated Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January to 31 December 2019. These matters were addressed in the context of our audit of the consolidated financial statements as a whole and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

❶ Recoverability of the Italian mortgage loan portfolio
❷ Recoverability of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items
❸ Implementation of SAP S/4HANA software to handle business processes in the core banking business and accounting

Our presentation of these key audit matters has been structured in each case as follows:

① Matter and issue
② Audit approach and findings
③ Reference to further information

Hereinafter we present the key audit matters:

❶ Recoverability of the Italian mortgage loan portfolio

① In the consolidated financial statements of Aareal Bank AG, loans and advances to customers in the amount of € 2.7 billion that are secured by properties in Italy (hereinafter "Italian mortgage loan portfolio") are reported as of 31 December 2019. As of 31 December 2019, the allowances for credit losses for the Italian mortgage loan portfolio amounts to a total of € 268 million. Italy's difficult macro-economic situation has in past years, in part, led to financial difficulties and restructuring proceedings for Aareal Bank AG's borrowers. The realization of the properties on which the Italian mortgage loan portfolio is based has taken a number of years so far, depending on their size, location and type. Aareal Bank AG analyzes the financial circumstances of borrowers using, inter alia, the annual financial statements, business plans and rent rolls provided, and generally examines the market values of the associated collateral at least once a year. In the majority of cases, Aareal Bank AG obtains external valuations to determine the market values of the properties used as collateral. Property market values are calculated by the appraisers in each case as the present values of future cash flows using the discounted cash flow method, with the appraisers deriving the assumptions about future cash flows that can be generated by the property using the information and business plans provided by the borrowers, or determined on the basis of floor area-related comparative values. If it is found when assessing the borrower that there has been a default and the income from the collateral is expected to be insufficient, the Company applies a specific valuation allowance (Stage 3). When determining the specific valuation allowances for the Italian mortgage loan portfolio, the executive directors make assumptions concerning cash flow, completion and realization as well as assumptions concerning the probability of scenarios. Since even relatively small changes in these assumptions have a significant influence on the associated collateral value and the measurements of the loans and advances are subject to uncertainties in this regard, this matter was of particular significance in the context of our audit.

② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances of the lenders and the recoverability of the related collateral in a risk-focused sample of exposures. We evaluated the valuations performed by the appraisers and their review by Aareal Bank AG in terms of their suitability, up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time, we gained an understanding of the original data, value parameters and assumptions on which the valuations and their review by Aareal Bank AG were based, evaluated these critically and assessed whether they were within a justifiable range. In some cases, we carried out our own property inspections. In addition, we based our assessment of the executive directors' assumptions concerning cash flow, completion and realization on general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash inflows and outflows as well as assumptions concerning the probability of scenarios. Furthermore, we examined the relevant credit processes in the Aareal Bank AG's internal control in terms of the appropriateness of their design and tested their effectiveness. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the Italian mortgage loan portfolio and the procedures implemented are appropriate.

③ The Company's disclosures regarding the risk allowances are contained in notes 9, 32 and 42 in the notes to the consolidated financial statements, which also comprise the risk allowances for the Italian mortgage loan portfolio.

❷ Recoverability of properties acquired from previous loan exposures as reported in the property, plant and equipment and other assets balance sheet items

① In the consolidated financial statements of Aareal Bank AG, properties acquired from previous loan exposures were reported as of 31 December 2019 in the amount of € 129 million in the property and equipment balance sheet line item in accordance with IAS 16 Property, Plant and Equipment and in the amount of € 337 million under the other assets balance sheet line item in accordance with IAS 2 Inventories. The properties were acquired by Aareal Bank AG through fully consolidated real estate special purpose entities. Aareal Bank AG tests the properties acquired from former credit exposures at least once a year for impairment using external valuations. The market values of the properties are calculated in each case as the present values of future cash flows using the discounted cash flow method, with the appraisers deriving the assumptions about future cash flows using the information and projections provided by the executive directors, or determined on the basis of floor area-related comparative values. In addition, the executive directors make assumptions about completion, leasing and marketing. Since even relatively small changes in these assumptions have a significant influence on the market values of the properties and the measurements are therefore subject to uncertainties, this matter was of particular significance in the context of our audit.

② As part of our audit, we particularly evaluated the valuations performed by the external appraisers in terms of their up-to-dateness and methodology, as well as the transparency of the value calculation. At the same time we gained an understanding of the original data, value parameters and assumptions on which the valuations were based, evaluated these critically and assessed whether they were within a justifiable range. In this context we involved our own real estate experts. In addition, we based our assessment of the cash flow, completion, leasing and marketing assumptions made by the executive directors on, inter alia, a comparison with general and sector-specific market expectations as well as on documentation and explanations from the executive directors about expected cash flows. Furthermore, we evaluated the classification of the properties and, therewith, the respective accounting policies to be applied under IAS 2 and IAS 16. Taking account of the information available, we conclude that the assumptions made by the executive directors for testing the impairment of the properties acquired from former exposures and the classifications applied are appropriate.

③ We refer to the Company's disclosures on property, plant and equipment and other assets contained in notes 19, 22, 47 and 50 in the notes to the consolidated financial statements.

❸ Implementation of SAP S/4HANA software to handle business processes in the core banking business and accounting

① Aareal Bank AG processes a significant amount of its accounting-related data using IT applications based on software developed by SAP SE, Walldorf. The applications are used in particular to handle business processes in the core banking business (including to manage loans and collateral), for accounting (ongoing recording of business transactions in subledgers and in the general ledger and preparing the consolidated financial statements) and for management accounting.

As part of its strategy to modernize and harmonize its IT architecture, Aareal Bank AG resolved a changeover to the new SAP product generation, S/4HANA. In the course of defined project phases, a new SAP system with system configuration adapted to current requirements (customizing) was successively set up on the basis of the existing SAP system from the fourth quarter of 2018. Defined datasets were migrated from the old to the new SAP system at the end of November 2019.

The implementation of SAP S/4HANA was of particular significance in the context of our audit due to the key role of the SAP system for the handling of processes in the core banking business and for the financial accounting system and thus for the functioning of the control and accounting processes and the legal compliance of the consolidated financial statements.

② As part of our audit, we first obtained an understanding of the objectives, organization, scheduling and project management of the implementation project. On this basis, we assessed the appropriateness of the functional and technical concept based on what we considered to be the most important documents. In addition, during the project we assessed whether the test plan was appropriate and complete. We verified, on a sample basis, that testing was properly carried out and documented and that test results were taken into appropriate consideration within the various test phases (functional and integration tests). Furthermore, we assessed the appropriateness of the data migration concepts and the proper performance and documentation of the data migration. This involved, among other things, verifying the appropriateness of the reconciliation activities performed by the Company as of the data migration date, including tracking abnormalities. In addition, we inspected the approvals of the Company's involved departments and verified whether the approvals required for going live had been granted.

We also assessed the design and operating effectiveness of selected controls put in place to ensure proper data processing during ongoing operations. As part of our audit, we also evaluated the report prepared by Internal Audit on its audit carried out in connection with the implementation of SAP S/4HANA.

Based on our audit procedures, we were able to satisfy ourselves overall that the SAP S/4HANA software was properly implemented in a comprehensible manner.

③ The Company's disclosures relating to the implementation of SAP S/4HANA are contained in section "Accounting-related Internal Control and Risk Management System" in the group management report.

Other Information

The executive directors are responsible for the other information. The other information comprises the following non-audited parts of the group management report:

- the statement on corporate governance pursuant to § 289f HGB and § 315d HGB included in section "Corporate Governance Statement" of the group management report
- the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB

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

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

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

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Executive Directors and the Supervisory Board for the Consolidated Financial Statements and the Group Management Report

The executive directors are responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition, the executive directors are responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the executive directors are responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, the executive directors are responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation, and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) and supplementary compliance with the ISAs will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

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

- Obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems.

- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315e Abs. 1 HGB.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express audit opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinions.

- Evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.

- Perform audit procedures on the prospective information presented by the executive directors in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 22 May 2019. We were engaged by the supervisory board on 25 June 2019. We have been the group auditor of Aareal Bank AG, Wiesbaden, and its legal predecessors without interruption since the financial year 1976.

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

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Christian F. Rabeling.

Frankfurt/Main, 3 March 2020

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

sgd. Ralf Schmitz	**sgd. Christian F. Rabeling**
Wirtschaftsprüfer	**Wirtschaftsprüfer**
(German Public Auditor)	**(German Public Auditor)**

Responsible and transparent corporate governance is of great importance to Aareal Bank AG, and is considered the essence of prudent commercial conduct by both the Management Board and the Supervisory Board.

Transparency

Corporate Governance Statement pursuant to Sections 289f and 315d of the German Commercial Code (HGB) / Corporate Governance Report

Declaration of Compliance in accordance with Section 161 of the AktG

Aareal Bank AG has complied with the recommendations of the Government Commission "German Corporate Governance Code" (as amended and published in the German Federal Gazette on 24 April 2017) – except for the restriction set out below – since the last Declaration of Compliance was issued in December 2018; and will continue to do so, subject to the same restriction.

Pursuant to section 25d of the German Banking Act (Kreditwesengesetz – "KWG"), the Executive and Nomination Committee of Aareal Bank AG's Supervisory Board is required to assume additional tasks which are not supposed to be prepared by shareholder representatives on the Supervisory Board alone. Hence, the Executive and Nomination Committee also includes employee representative members, in contravention of the recommendation in section 5.3.3 of the German Corporate Governance Code (the "Code"). However, the Committee will ensure that the nomination of candidates for election by the Annual General Meeting will be determined exclusively by shareholder representatives on the Committee.

Wiesbaden, December 2019

The Management Board

Hermann J. Merkens **Marc Hess** **Dagmar Knopek**

Christiane Kunisch-Wolff **Thomas Ortmanns** **Christof Winkelmann**

For the Supervisory Board

Marija Korsch (Chairman)

Corporate Governance at Aareal Bank Group

Aareal Bank Group is managed by the parent company Aareal Bank AG. Aareal Bank is a listed bank, which by virtue of being classified as "significant", is supervised directly by the European Central Bank. Although we, the Management Board and the Supervisory Board of Aareal Bank AG, are required to observe a large number of specific corporate governance rules, our common understanding does not end with our compliance with these rules. We also discuss on a regular basis the application of voluntary standards that are recommended by the Code, the supervisory authorities, our shareholders or due to international best practice, or that arise for the Supervisory Board and the Management Board in their day-to-day work.

Our top priority is to act in the interests of the Company and hence to meet our responsibility to the employees, customers, shareholders and the public alike.

Disclosures regarding Corporate Governance standards

To discharge its responsibility, senior management aligns corporate governance with legal and regulatory rules, as well as a comprehensive set of internal rules and regulations, which provide concrete guidance on the conduct and processing of the Bank's business, in line with our ethical responsibility. All members of staff have access to these documents, via common internal communications channels such as the Bank's Intranet.

Sustainability approach

Contributing to sustainable economic development is a priority for Aareal Bank Group. As a partner to the property industry, Aareal Bank Group is thus pursuing a business strategy appropriate to the requirements of the sector and the stakeholders. The Group is aware of the responsibility associated with its sustainability mission statement and the need to focus on the needs of society, and aims to preserve the foundations on which future generations can live and shape their lives.

The sustainability mission statement, which is supported by an integrated sustainability management system, underpins our sustainable corporate strategy, providing a summary of the corporate responsibility principles of Aareal Bank Group that are aligned with our objective of doing business sustainably:

- We think with a view to the future taking ethical, societal and ecological topics into account.

- We analyse trends holistically, evaluate the resulting opportunities and risks, and align our forward-looking sustainability programme with this.

- We focus on all relevant stakeholder groups, seek to engage in active dialogue with them in a variety of ways and show how we make use of the insights we have gained.

- We make sure that business decisions take account of ecological, social and governance factors, and communicate our progress and the challenges we face transparently and credibly.

- We set priorities and implement our decisions, thereby reinforcing corporate sustainability values such as reliability, innovative ability, integrity and compliance, our appeal as an employer, and an emphasis on building and maintaining high-trust client relationships.

We orient ourselves on national and international frameworks, commit to initiatives or have joined organisations that represent generally accepted ethical standards and whose values we share. Relevant organisations here include:

- United Nations Global Compact
- International Labor Organization
- German Corporate Governance Code
- Diversity Charter
- Work-Care Balance Charter

At an organisational level, Aareal Bank Group has assigned responsibility for sustainability management to the Chairman of the Management Board. In this way, Aareal Bank Group emphasises the strategic importance of sustainability for its corporate philosophy and steers its practical implementation at the highest level. Established already in 2012, the Sustainability Committee supports the Management Board in the ongoing development of the sustainability programme and in coordinating the Group-wide sustainability activities. It includes representatives from all key divisions.

Further details can be found in the latest Sustainability Report: www.aareal-bank.com/en/responsibility/reporting-on-our-progress/sustainability-reporting/

Code of Conduct

We believe that the principles of integrity and responsible conduct must be observed by the members of the Management Board and the Supervisory Board, and by all our employees across the Company, regardless of their functions and duties. Our internal Code of Conduct therefore contains binding rules governing the legal and ethical conduct of employees vis-à-vis clients, business partners, and colleagues. Aareal Bank Group's efforts in this context are also motivated by the desire to affirm and further strengthen the confidence placed by stakeholders – our clients, investors, and staff: www.aareal-bank.com/fileadmin/DAM_Content/Konzern/dokumente/Code_of_Conduct_en.pdf.

Principles of diversity

The Management Board and the Supervisory Board are openly committed to diversity throughout the entire Aareal Bank Group.

Aareal Bank defines diversity as:

- The appreciation that every individual is unique, and the respect for this uniqueness
- Equal opportunities at all levels
- The prevention of discrimination of any kind
- The belief that diversity enriches corporate culture and also represents a success factor in reaching strategic goals.

The goals are to promote Aareal Bank Group's image as a modern employer, to strengthen employee commitment and increase employee motivation, to ensure skills and competencies are fostered individually in a way that promotes employee performance, to react to demographic change and an ageing workforce, and to take into account individual circumstances and stages of life.

In order to highlight the significance of diversity and document the fact that the concept of diversity is very important to Aareal Bank Group, the Bank signed the Charter of Diversity (an initiative launched by the German industry in 2006) in 2013.

Aareal Bank employs people from more than 30 different countries. At Aareal Bank's foreign locations, we take care to ensure that positions are primarily filled by local staff if possible. Aareal Bank Group attaches great importance to the equal treatment of women and men, whether in the context of filling vacant positions, with regard to continuous professional development, or in terms of remuneration. Specifically, any vacancies below senior executive level are generally published throughout the Company, in the form of job advertisements that all members of staff – male or female – may apply for. When setting the remuneration of employees, we do not differentiate by gender but rely exclusively on aspects such as qualification, professional experience or training.

In accordance with the German Act on Equal Participation of Men and Women in Executive Positions in the Private and Public Sector (Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern an Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst), the Management Board sets specific targets – including concrete implementation deadlines – for the share of women holding executive positions on the first two management levels below the Management

Board of Aareal Bank AG. On the first management level below the Management Board, by 30 June 2022 at least 13.5 % of executive positions are to be held by women. On 31 December 2019, the share of female managers on this level was 16.2 %. On the second management level below the Management Board, by 30 June 2022 at least 21.1 % of executive positions are to be held by women; On 31 December 2019, the share of female managers on this level was 23.7 %.

Across Aareal Bank Group, the share of women in executive positions s tood at 23.8 % (Aareal Bank AG: 21.9 %; Aareon: 24.1 %), with women accounting for 36.8 % of Aareal Bank Group's entire workforce (Aareal Bank AG: 41.9 %; Aareon GmbH: 33.1 %).

Severely disabled persons made up 4.8 % of Aareal Bank's staff base in 2019. This employee group is represented in the Group's German entities by a disability representative.

In Germany, Aareal Bank and Aareon apply the German General Equal Treatment Act (Allgemeines Gleichbehandlungsgesetz – "AGG"), with specially-appointed AGG Officers overseeing compliance. At the same time, AGG training is held for all employees. In the US, the employee manual contains rules designed to avoid harassment at the workplace ("Anti-Harassment Rules").

Working practices of the Management Board and the Supervisory Board

Management Board

The Management Board is responsible for managing the Company and for its strategic orientation, material transactions and proper organisation. This also includes the implementation of effective monitoring systems. It focuses its business activities upon the Company's long-term and sustainable development. Its decisions incorporate the long-term consequences of its actions and are guided by the ethical principles of Aareal Bank Group (see relevant corporate governance principles).

Supervisory Board

The Supervisory Board exercises its control using different instruments. On the one hand, it sets out the reporting requirements of the Management Board in its internal Rules of Procedure, to ensure comprehensive and prompt reporting. These reports include the financial reports prior to being published, the reports of Internal Audit, Risk Controlling and Compliance, as well as the external auditor's reports. It also determines the transactions of the Management Board in its internal Rules of Procedure, where its approval is required.

Furthermore, the Supervisory Board contributes to the sustainable success of Aareal Bank Group – in the interest of investors, clients, staff, and the general public – by selecting suitable Management Board members (as set out in the Guidelines for the Selection of Members of the Supervisory Board and Management Board), a Management Board remuneration system which is aligned with the Company's long-term and sustainable interests (as set out in the Remuneration Report), and the effective supervision of this remuneration system.

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Remuneration Control Committee, the Risk Committee, the Audit Committee, and the Technology and Innovation Committee. An overview of the respective committee members can be found in the Notes: www.aareal-bank.com/en/investors-portal/finance-information/financial-reports/archiv/2019/.

Executive and Nomination Committee

The Executive and Nomination Committee prepares the plenary meetings of the Supervisory Board, together with proposed resolutions. The committee's area of responsibility also includes assessing the internal condition of the Group, and issues concerning personnel planning for the Management Board (also regarding the contracts with individual Management Board members, based on the remuneration system prepared by the Remuneration Control Committee and adopted by the plenary meeting of the Supervisory Board). The Executive and Nomination Committee compiles profiles defining the requirements for members of the Management Board and the Supervisory Board and supports the Supervisory Board in selecting suitable candidates. Based on an annual evaluation, it determines the extent to which the members of the Management Board or Supervisory Board have a need for further training, or whether other adjustments are required. Furthermore, the Executive and Nomination Committee monitors, and resolves if necessary, decision proposals regarding loans to senior managers and other related party transactions.

The Executive and Nomination Committee, excluding the employee representatives, discusses the nomination of shareholder representatives for election by the Annual General Meeting.

Remuneration Control Committee

The Remuneration Control Committee monitors whether the structure of the remuneration systems for Management Board members and employees is appropriate, taking into account the impact of remuneration systems on Aareal Bank's overall risk profile. The Remuneration Control Committee prepares corresponding proposals concerning remuneration (including for members of the Management Board) for the plenary meeting of the Supervisory Board. The Remuneration Control Committee receives the information provided by Aareal Bank's Remuneration Officer, as well as the information on the remuneration system intended for disclosure. For further details, please refer to the section on remuneration governance in the Remuneration Report.

Risk Committee

The Risk Committee deals with all material types of risk Aareal Bank is exposed to in its business activities. In addition to the plenary Supervisory Board, it is also the recipient of the risk reports (please refer to the Risk Report). The committee is also responsible for reviewing the contents of the risk strategies in accordance with the MaRisk and preparing the corresponding resolutions of the Supervisory Board.

Audit Committee

The Audit Committee is concerned with all accounting issues, as well as regarding the audit of Aareal Bank AG and Aareal Bank Group. The committee is responsible for the preparation and conduct of the audit of the financial statements and the consolidated financial statements; it prepares the decisions to be taken by the Supervisory Board on the basis of the committee's analysis of the external auditors' reports. For this purpose, the committee reports to the plenary meeting of the Supervisory Board on the results of its analysis and the assessments derived. Preparing the audit of the financial statements also comprises the preparations for instructing the external auditors (by virtue of the corresponding resolution passed by the Annual General Meeting), verifying the independence of the external auditors, including the approval of permissible non-audit services, negotiating the auditors' fees, determining focal points of the audit, and regularly selecting new external auditors. The Audit Committee also discusses quarterly and half-yearly financial reports with the Management Board, and obtains the external auditors' report on their review of the half-yearly report. Furthermore, the Audit Committee is responsible for examining the projections submitted by the Management Board; the reports by Compliance and Internal Audit are addressed to the committee. The committee is also responsible for monitoring the effectiveness of the internal control and monitoring system.

Technology and Innovation Committee

The committee deals with issues concerning information technology used within the Company, and with issues related to IT products created and distributed by Aareal Bank Group entities. As part of these duties, the committee monitors the implementation of Aareal Bank Group's digitalisation strategy.

Communications

Aareal Bank assigns great importance to extensive communications with all of the Bank's stakeholders. It has set itself the target of actively, transparently and openly communicating with all stakeholders, taking into account the interests of all stakeholders.

All press releases, ad-hoc disclosures, corporate presentations, as well as annual, sustainability and quarterly reports published by Aareal Bank are available on the Bank's website to any interested person, and may be downloaded from there. In addition, the financial calendar is updated regularly, and provides information about upcoming events.

Aareal Bank publishes details on the financial position and performance five times annually. On these occasions, the Management Board gives a personal account of results, within the scope of press and analysts' conferences, as well as issuing press releases.

All information can be found on Aareal Bank's website: www.aareal-bank.com/en/investors-portal/.

Relationship to shareholders

To facilitate direct communication, Aareal Bank has set up a separate division within its organisation, which serves as a first point of contact for shareholders, other investors and analysts. The contact persons in Investor Relations can be found on the Aareal Bank website www.aareal-bank.com/en/investors-portal/equity-investors/contact/.

The Bank also holds an Annual General Meeting once a year. Shareholders are thus given the opportunity to actively participate in the development of the Company.

At the Annual General Meeting, the shareholders decide, in particular, on the formal approval for the members of the Supervisory Board and Management Board for the financial year under review, on the appropriation of any net retained profit, amendments to the Memorandum and Articles of Association, and authorisations on capital adjustments. The Annual General Meeting also elects the external auditors for the Company and decides who joins the Supervisory Board as shareholder representative.

The Company's shareholders may submit statements or proposals in writing, by fax or e-mail, to the Company. They may also request to speak at the Annual General Meeting. The shareholders may also submit counter or supplemental motions to the agenda items at the Annual General Meeting, so that they participate in structuring and influencing the meeting. The Management Board and the Supervisory Board refer to shareholders' comments made during the general debate, or to motions submitted by shareholders in advance, to respond to questions, or to comment on other contributions.

Guidelines regarding the selection of members of the Management Board and the Supervisory Board

The Supervisory Board of Aareal Bank AG is satisfied that the Management Board and the Supervisory Board are adequately staffed, if all members are in a position to perform their duties (professional qualification), commit the time necessary to perform these and possess the integrity to be guided by the ethical principles of Aareal Bank when performing their duties (with respect to personal reliability, conflicts of interest, and independence). The composition of the Supervisory Board and the Management Board, respectively, shall facilitate, in its entirety, cooperation and the widest possible diversity of opinions and knowledge (the concept of diversity). The Supervisory Board has defined concrete requirements and processes to incorporate these criteria for the evaluation of Management Board and Supervisory Board members, as well as when selecting candidates for appointment to the Management Board, or for shareholder representatives to the Supervisory Board. When establishing these processes, it has taken into account the legal requirements of the German Public Limited Companies Act (Aktiengesetz – "AktG"), the German Banking Act (Kreditwesengesetz – "KWG") and of the German Corporate Governance Code. The regulatory guidelines of the European Central Bank and the European banking supervision on adequacy and internal governance are also incorporated, as well as the corporate governance guidelines for the consultants on voting rights that are relevant for Aareal Bank and key shareholders. Besides the Supervisory Board, the European Central Bank also reviews the suitability of the respective candidates prior to taking up their duties, using the so-called "fit & proper" approach.

Personal reliability

The principles of personal reliability apply equally for all members of the Management Board and the Supervisory Board. All members of the Management Board and the Supervisory Board should demonstrate honesty, integrity and independence of mind. They should live by the ethical principles of Aareal Bank, as set out in the Code of Conduct, and commit sufficient time to perform their duties. The Supervisory Board calculates the time commitment of every member of the Management Board and the Supervisory Board, and reviews on an annual basis whether they also dedicate sufficient time to exercising the mandate. In this connection, the Supervisory Board takes care to ensure compliance with the requirements for the maximum number of additional offices, pursuant to sections 25c (2) and 25d (3) of the KWG.

Conflicts of interest & independence

Acting in the interests of the Company means being able to make significant judgements unbiased by considerations irrelevant to the matter at hand. The Supervisory Board therefore attaches particular importance to the handling and disclosure of conflicts of interest or potential conflicts of interest that could, for example, call into question the independence of the Supervisory Board.

In its Conflicts of Interest Policy, the Supervisory Board has laid down procedures on how to prevent or handle potential conflicts of interest affecting members of the Management Board or the Supervisory Board. Specifically, the Policy provides that individual Management Board and Supervisory Board members must establish transparency even where there is only a potential conflict of interest. The members of the Supervisory Board and the Management Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Code arose during the financial year under review. Any individual whose circumstances may give rise to a material conflict of interest that cannot be mitigated will be ineligible as a candidate.

The Supervisory Board also determines when the independence of one of its members is not ensured and carries out an annual review of whether the independence of individual members is no longer ensured, or may be compromised. In the event of the following circumstances, the Supervisory Board generally assumes that independence is not ensured:

- At the commencement of the fourth term of office as a member of the Supervisory Board of Aareal Bank AG. The term of office begins with the election by the Annual General Meeting, excluding any judicial appointments.
- The period between membership in Aareal Bank AG's Management Board and membership in the Supervisory Board is less than five years.
- The period between being a senior manager at the first management level below the Management Board and membership in the Supervisory Board of Aareal Bank AG is less than three years.
- The period between working as or on behalf of a material consultant, auditor, or other service provider or client of Aareal Bank and member-

ship in the Supervisory Board of Aareal Bank AG is less than three years.

- A Supervisory Board member is simultaneously associated with a major competitor, as a staff member, member of the Management or Supervisory Board; consultants to major competitors may also not be considered independent.

Furthermore, all Supervisory Board members are subject to the statutory limitations laid out in Section 100 (2) nos. 2 to 4 of the AktG. Unlike the criteria listed above, the statutory limitations are mandatory, which means that they prevent the nomination of a potential candidate, or require the resignation of the affected board member.

Effective 31 December 2019, the Supervisory Board believes, taking the above criteria into account, that all employee representatives (Marija Korsch, Richard Peters, Dr Hans Werner Rhein, Prof. Dr Stephan Schüller, Sylvia Seignette, Elisabeth Stheeman, Dietrich Voigtländer and Prof. Dr Hermann Wagner) are independent. Prof. Dr Stephan Schüller's term of office exceeds 12 years. However, Aareal Bank's independence assessment is not based on time limits alone, but also takes election periods into account. This was considered necessary because otherwise individual Supervisory Board members may not have been considered independent anymore in the course of their term of office – which could even affect committee chairs or the chairperson of the Supervisory Board.

Professional qualification

Every member of an executive body must possess the knowledge, ability and experience to properly perform their duties. This means that they must at least be able to understand and assess the Company's material business activities and the associated material risks, the control and monitoring system established in this regard, as well as the corresponding accounting and financial reporting systems. This also requires being familiar with the underlying material legal requirements. The members of the Management Board are responsible for the duties of the entire Management Board as well as those of the sections assigned to them. Each member of the Supervisory Board must be in a position to perform the duties incumbent on the Supervisory Board in its entirety.

If they chair a committee, they should have extensive expertise in the topics covered by the committee. The Chairman of the Audit Committee, for example, must be an expert on financial reporting issues and internal control and monitoring systems, while the Chairman of the Risk Committee must be an expert in monitoring risks. Both committee chairmen may not hold the position of Chairman of the Supervisory Board.

Overall, with regard to its collective composition, the Supervisory Board further decided that the following additional expertise be adequately represented:

- experience in sectors and financial markets which are material to Aareal Bank Group;
- digitalisation and transformation;
- strategic planning;
- designing and monitoring risk management systems, internal control systems, as well as corporate governance frameworks;
- accounting and auditing financial statements.

The curricula vitae of the members of the Management Board: www.aareal-bank.com/en/about-us/company-profile/the-management-board/ and the members of the Supervisory Board: www.aareal-bank.com/en/about-us/company-profile/supervisory-board/ can be found on the website.

Concept of diversity

In principle, the Management Board and the Supervisory Board pursue the objective in their bodies of ensuring maximum variety with regard to gender, age, internationality and professional diversity. Where there are several suitable candidates, further selection takes these aspects into account, to draw together the broadest possible spectrum of different perceptions in the interest of making the best possible decision for Aareal Bank. The Management Board ensures that these aspects of diversity are also taken into consideration at the management levels it controls, to facilitate succession that is oriented on this concept of diversity (please refer to relevant management duties/diversity). The Supervisory Board has set individual objectives for the aforementioned diversity aspects, for both itself and the Management Board, the implementation of which it presents annually. It understands these objectives as being minimum objectives; there is no reason why they cannot be exceeded.

Gender diversity

In accordance with the German Act on Equal Participation of Men and Women in Executive Positions in the Private and Public Sector, the Supervisory Board sets specific targets – including concrete implementation deadlines – for the share of female members on the Supervisory Board and the Management Board. Likewise, the Management Board defines such targets for the first two management levels below the Board. On the Supervisory Board, by 30 June 2022 at least 25 % of positions are to be held by women. The status quo is 41.66 %, unchanged from the previous year. On the Management Board, by 30 June 2022 at least 20 % of positions are to be held by women. The status quo is 33.33 % (unchanged from the previous year), following the expansion of the Management Board in 2018.

Age diversity

The Supervisory Board has set out targets for the age structure of the Management Board and the Supervisory Board, in order to safeguard the continuous development of both executive bodies. At the time of (re)election to the Supervisory Board, candidates should be less than 70 years old. Furthermore, the Supervisory Board should not consist exclusively of members who are older than 60 years. Members of the Management Board should not exceed the upper age limit of 65 years while serving on the Board. These objectives are currently met.

International profile

In addition, given Aareal Bank's international-business activities, the Supervisory Board has set itself and the Management Board the goal of having the broadest possible international experience, which can be proven by foreign nationality or considerable professional experience gained in another country. The status quo is 33 % for the Management Board and 25 % for the Supervisory Board, both unchanged from the previous year.

Diversity of professional skills

The Supervisory Board pursues the objective of maximum professional diversity when selecting the members of the Management Board and the Supervisory Board. However, the demanding professional requirements for members of the management board and the supervisory board of so-called "significant credit institutions" limit the opportunities for achieving this objective: for instance, regulatory rules require in principle that the members of the Management Board have extensive experience in the lending business and in risk management. In accordance with section 100 (5) of the AktG, the Management Board members in their entirety shall be familiar with the sector in which the Company operates. However, the Supervisory Board itself pursues the objective whereby not all members have gained the main part of their professional experience in a bank.

Annual evaluation of the suitability and performance

Compliance with the aforementioned guidelines is reviewed at least once a year or on an event-driven basis. The Executive and Nomination Committee is regularly supported by external experts.

The Executive and Nomination Committee assesses the suitability of the Management Board and the Supervisory Board in their entirety, as well as with regard to their individual members, and evaluates the structure, size, composition and performance of both bodies. Finally, the Committee advises on any recommendations made to the Supervisory Board in order to leverage the potential for improvement that has been identified.

In accordance with section 25d (4) of the KWG and section 5.4.5 of the Code, the Supervisory Board members regularly attend continuous professional development measures, and are supported to this effect by the Company. In its annual evaluation, the Executive and Nomination Committee evaluates, e.g., if further training will be required to meet future challenges or new provisions.

Succession planning

The Executive and Nomination Committee is responsible for the succession planning of the Management Board and the shareholder representatives on the Supervisory Board. On an annual basis, the Committee reviews the established competence profile, and whether this is compatible with Aareal Bank's business and risk strategies, proposing any necessary adjustments. Furthermore, the Committee reviews, as part of the annual evaluation, whether the current members of the Management and Supervisory Boards fulfil the presently applicable criteria, taking the latest amendments into account. If this is not the case, the committee suggests measures to the Supervisory Board to ensure that all criteria are fulfilled going forward. Such measures may include continuing education courses for individual or multiple Management or Supervisory Board members as well as changes in the composition of the Management or Supervisory Board.

Furthermore, at the beginning of every year, the Executive and Nomination Committee discusses personnel decisions due within the next two years, such as projected retirements, potential re-appointments, etc. Therefore, if the re-appointment of a Management or Supervisory Board member is not taken into consideration, the Executive and Nomination Committee concerns itself with a suitable successor more than one year in advance.

If changes in the composition of the Management or Supervisory Board have to be made, the Executive and Nomination Committee aims to fulfil the personal criteria, while at the same time promoting the fulfilment of the goals established in terms of board composition (collective competence profile and diversity). Succession planning for the Management Board is made in close cooperation with the chairman of the Management Board. The Executive and Nomination Committee considers both internal and external candidates.

Aareal Bank has taken various measures to be able to respond to short-term personnel fluctuations (for example, due to resignation for personal reasons), and to identify suitable internal successors. For instance, the Bank can provide tailor-made development measures to senior managers in order to fundamentally prepare them to become a member of the Management Board. This includes, in particular, business development, risk management and accounting know how as well as leadership skills. In addition, all Management Board members have first- and second-level responsibilities. This means that if the Management Board member with first-level responsibility is not available, his duties will be assumed by the respective Management Board member with second-level responsibility.

As a general rule, every competence required for the activities of Aareal Bank's Supervisory Board and its committees is represented by at least two Supervisory Board members. Hence, the Audit Committee comprises not only the respective chair as a financial expert, but also at least one other person holding the same qualifications. In addition, in order to make sure there is a quorum even in the event of short-term changes in the composition of the respective committee, every committee comprises more than three members.

Composition of the Management Board and Supervisory Board

The members of the Supervisory Board and its committees, the respective Chairmen and members of the Management Board and their relevant areas of responsibility are presented in the Note (88). As per the Supervisory Board's decision, the Management Board is comprised of six members. The Supervisory Board appoints one of the members to Chairman of the Management Board. In accordance with Aareal Bank AG's Memorandum and Articles of Association, the Supervisory Board consists of twelve members. Once elected by the Annual General Meeting, the members of the Supervisory Board elect a Chairman and two Deputy Chairmen from amongst them, for the duration of their term of office. Eight members are elected by shareholders at the Annual General Meeting. Four members are elected by employees, through the Group Works Council.

The committees comprise at least four members, while the Audit Committee and the Risk Committee comprise six members. The Chairman of the Supervisory Board belongs to every committee and assumes the position of risk management expert in the Remuneration Control Committee. According to the provisions of section 5.3.2 of the Code as well as Aareal Bank's Guidelines for the selection of members of the Management Board and the Supervisory Board, the position of Chairman of the Audit Committee and the Risk Committee is held by independent experts. Additionally, care is also taken to avoid any interlinking of the committee members' positions, to ensure the mutual exchange of information.

Purchase or sale of the Company's shares

In 2019, members of the Company's executive bodies did not carry out any transactions involving the Company's shares, which would have required publication in accordance with the requirements of Article 19 of the EU Market Abuse Regulation (596/2014/EU), in conjunction with section 26 of the WpHG. At the end of the financial year, aggregate shareholdings of members of executive bodies in the Company's shares were less than 1% of the issued share capital of Aareal Bank AG.

Accounting policies

Aareal Bank AG prepares the Group's accounts according to the International Financial Reporting Standards (IFRSs) as applicable in the European Union. The single-entity financial statements of Aareal Bank AG are prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB). The Management Board prepares the financial statements and management reports of Aareal Bank AG and Aareal Bank Group. The external auditors submit their report on the audit of the financial statements and the consolidated financial statements to the Supervisory Board, which monitors its independence at the same time. The fees paid to the external auditors are shown in Note (38) to the financial statements. Permissible non-audit services provided by the external auditors must be approved beforehand by the Audit Committee of the Supervisory Board.

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft (PwC), the auditors of the 2019 financial statements – as elected by the Annual General Meeting 2019 and instructed accordingly by the Supervisory Board – have exercised their audit activities under the management of Messrs Ralf Schmitz and Christian Rabeling. In line with the audit firm's internal regulations, their staff members rotate their audit mandates periodically – every five year in this case.

Mr Schmitz has audited Aareal Bank since 2018; Mr Rabeling, the responsible auditor, since 2019.

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Aareal Bank has confronted the various challenges in the financial year 2019 and can look back at another successful financial year in which the Bank not only generated good results, but also set the strategic course for the future. All targets were achieved in the past financial year, whilst further improving the foundations for a continuation of its positive performance over the past years. The Supervisory Board believes that Aareal Bank remains in very good shape today and is ideally equipped to meet the challenges that lie ahead.

During the financial year under review, the Supervisory Board continually advised, monitored, and supervised the management of the Company. The Management Board informed the Supervisory Board regularly, without delay and comprehensively about all the issues important to the Bank. The Management Board reported on the Group's situation, business development, key financial indicators and market developments. In addition, detailed reports and explanations were given to the Supervisory Board regarding the current liquidity status and liquidity management measures taken, the prevailing risk situation, and on risk control and risk management measures taken within the Group. The Supervisory Board was also informed about compliance within the Company on a regular basis, and it received the reports prepared by Internal Audit. The Supervisory Board also received comprehensive reports on the development of the business segments, and on operative and strategic planning, and was involved in all material decisions of Aareal Bank Group. All material events were discussed and examined in detail; where a Supervisory Board resolution was required, the decision proposals were submitted to the Supervisory Board in due time, and a decision taken. In cases where resolutions needed to be passed in periods between scheduled Supervisory Board meetings, such resolutions were passed by way of circulation or via conference calls.

Furthermore, between the meetings of the Supervisory Board, the Chairman of the Management Board kept the Chairman of the Supervisory Board informed, on a continuous and regular basis, on all material developments of the Company. The Chairman of the Management Board maintained close contact with the Chairman of the Supervisory Board, in order to discuss key issues and important decisions personally. The Chairman of the Supervisory Board then proceeded to inform the other Supervisory Board members of these discussions at the following Supervisory Board meetings.

Activities of the Plenary Meeting of the Supervisory Board

Nine plenary meetings of the Supervisory Board were held in the year under review. During these meetings, the members of the Supervisory Board received reports and explanations from the members of the Management Board, and discussed these in detail. Market developments, also considering the persistent geopolitical changes, the large number of regulatory adjustments that are yet required and further progress in implementing the "Aareal 2020" programme for the future as well as designing the successor programme "Aareal Next Level" were focal points of the work and reporting in all scheduled meetings.

Throughout the financial year, in the course of all meetings as well as during the periods between meetings, the Management Board informed the Supervisory Board about economic and market developments and their potential impact on Aareal Bank Group, in a timely, complete and comprehensible manner. This also included the measures the Bank had taken in response to the general market developments and the conditions prescribed by monetary policy. During the plenary meetings of the Supervisory Board, the Management Board reported to the Supervisory Board regularly and comprehensively; these reports also covered the development of the Structured Property Financing and Consulting/Services segments, focusing on current economic developments. In addition, the Supervisory Board was informed about the business development of the entire Aareal Bank Group. At regular intervals, the Supervisory Board was informed of the Bank's liquidity status and the related steps taken by the Bank's Treasury division. The Management Board also reported regularly on the quality of the property financing portfolio against the background of general market trends and expected changes on the various property markets. Within the scope of reporting, the regular reports prepared by the control functions – including Risk Controlling, Compliance, Internal Audit, Information Security & Data Protection, the Remuneration Officer, and Human Resources – were presented and discussed. At each plenary meeting of the Supervisory Board, the committee chairmen reported on the committee meetings that had taken place in the meantime.

The focal points of the individual meetings are outlined below.

During its January meeting, the Supervisory Board dealt with the Bank's dividend policy, the individual Management Board members' target achievement in the past financial year, and target setting for the new financial year. The dividend policy discussion was continued at a meeting in February, during which different scenarios of a potential dividend distribution were presented to the Supervisory Board, and were subsequently reviewed and assessed by the Supervisory Board.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2018 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. Furthermore, the Supervisory Board discussed the non-financial report 2018 and the results of the audit going hand in hand with it, to obtain limited assurance. Another issue covered during the March meeting included preparations for the Annual General Meeting in May 2019. This comprised the decision proposals regarding the agenda of the Annual General Meeting, including the proposal for the appropriation of profit and the proposal regarding the selection of external auditors. The annual report submitted by Internal Audit, and their audit planning for the upcoming financial year as well as their mid-term plans were also discussed during the meeting. In addition, the Supervisory Board resolved the revised Code of Conduct which also applies to the executive bodies, and concerned itself with the remuneration systems for the employees and the Management Board members; it came to the conclusion that the Company's remuneration systems are adequate.

The May meeting commenced with a detailed review of the Annual General Meeting of Aareal Bank AG, which preceded the meeting. Furthermore, the Management Board presented its regular detailed reporting on current and expected business developments, which the Supervisory Board discussed. This meeting also discussed the annual report submitted by the Compliance Officer. The Supervisory Board also agreed with the Audit Committee's proposal regarding the focal audit points set by the Supervisory Board for the audit of the financial statements for the 2019 financial year.

The two-day Supervisory Board meeting in June was held to comprehensively discuss Aareal Bank Group's current strategy implementation and refinements thereon, as well as to hear the Management Board's regular reporting. The Supervisory Board talked about the presented strategic initiatives and options with the Management Board in considerable depth and detail. Within this context, adjustments made to material risk documents were also presented and discussed.

During the September meeting, current questions concerning strategic initiatives were presented and discussed, in addition to the regular reports. This meeting took place at Aareon AG's headquarters in Mainz, which is why Aareon Group's further development was the main topic. On the one hand, the Supervisory Board discussed Aareon AG's new Management Board structure and its assignment of responsibilities with the Management Boards of Aareal Bank AG and Aareon AG. Strategic targets and growth areas at Aareon Group were also presented and discussed. On the other hand, the Supervisory Board of Aareal Bank AG was informed about the planned acquisition of CalCon Group, the purchase of which it agreed to after an in-depth review.

Furthermore, the company retirement provision system for Management Board members was adjusted based on a recommendation made by the Remuneration Control Committee (for details, please refer to the Remuneration Report › Remuneration of the Management Board 2019). Since this was only a harmonisation of the company retirement provisions, the Supervisory Board assessed this amendment as non-material, hence deeming a submission to the Annual General Meeting (by means of a so-called say-on-pay resolution) to be unnecessary for this purpose. The resolution on the remuneration system for the Management Board and the Supervisory Board is planned to be proposed to the Annual General Meeting in the year 2021. Until that time, various questions need to be addressed as regards the interpretation and compatibility of the new recommendations of the German Corporate Governance Code with the very strict German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – InstVergV).

At two meetings in October and November, the Supervisory Board asked the Management Board to report on the initiative of an investor regarding the disposal of the subsidiary Aareon. The further development of Aareon Group, and particularly the various opportunities to enhance its growth, was the topic of discussion at numerous Supervisory Board meetings, both within the Executive and Nomination Committee and in the plenary meeting of the Supervisory Board. The Supervisory Board supports the respective details communicated by the Management Board and its initiatives.

At the December meeting, the Management Board presented the strategies pursuant to the Minimum Requirements for Risk Management ("MaRisk") and the Group's corporate planning in detail. According to their respective responsibilities, the strategies had previously been presented to the Executive and Nomination Committee, the Risk Committee, and the Audit Committee, and finally to the Supervisory Board, to subsequently be discussed with the Management Board in depth. Another issue to be discussed was preparing the Corporate Governance Report, including the Corporate Governance Statement and the Declaration of Compliance. The latter was resolved and subsequently published on Aareal Bank AG's website. Furthermore, the annual review was carried out concerning Rules of Procedure for the Management Board and Supervisory Board, the individual and collective suitability and efficiency of the Management Board and Supervisory Board (annual evaluation), the review processes, and the Conflict of Interest Policy for members of the Company's executive bodies. The Supervisory Board discussed the results of the evaluation in detail and will incorporate the findings into its work. The Supervisory Board also concerned itself with the Management Board's preliminary target achievement 2019 and with deriving the Management Board targets for 2020 in accordance with the strategy presented. At its December meeting, the Supervisory Board also discussed the Audit Committee's proposal for new external auditors, which the Committee had submitted based on the selection procedure carried out for the change in external auditors from the 2021 financial year. After intensive discussions, the Supervisory Board followed the Audit Committee's proposal and will propose to the Annual General Meeting 2020 that either KPMG AG Wirtschaftsprüfungsgesellschaft or Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft be appointed as external auditors to review, if applicable, any additional financial information required, within the meaning of section 115 (7) of the German Securities Trading Act (Wertpapierhandelsgesetz – "WpHG"), during the 2021 financial year, until the next Annual General Meeting. Furthermore, it is also planned to propose to the Annual General Meeting that either KPMG AG Wirtschaftsprüfungsgesellschaft or Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft be appointed external auditors of the annual and consolidated financial statements for the 2021 financial year. In line with the recommendation of the Audit Committee, the Supervisory Board has a preference for KPMG AG Wirtschaftsprüfungsgesellschaft in each case.

At its December meeting, the Supervisory Board also resolved – based on the Executive and Nomination Committee's recommendation – to renew the term of office of Marc Hess as member of the

Management Board for a period of five years, after he had resigned from his position in agreement with the Supervisory Board. The Supervisory Board mainly based its decision on the fact that Mr Hess had become acquainted with his tasks extraordinarily quickly, providing valuable impetus for Aareal Bank's further strategic and financial development already in the first year of his term of office. Especially against the backdrop of the challenges lying ahead, such as the demanding market and competitive environment, it is of utmost importance for Aareal Bank to attract qualified leaders like Mr Hess, and to retain them for the long term, thus assuring continuity in the Management Board team.

The chairmen of Supervisory Board committees regularly gave account of the work in the committees to the plenary meeting, answering all related questions submitted by the members of the plenary meeting in detail.

To the extent that any Supervisory Board decisions were taken by way of circulation, the Supervisory Board received a report by the Management Board on the implementation of such decisions taken previously, at the subsequent Supervisory Board meeting.

As part of preparing Supervisory Board decisions, a routine examination is carried out as to whether there are any conflicts of interest. No potential conflicts of interest that would need to be considered in the context of decision-making processes were identified during the financial year under review.

Activities of Supervisory Board Committees

The Supervisory Board has established five committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Risk Committee, the Audit Committee, the Remuneration Control Committee, and the Technology and Innovation Committee.

Executive and Nomination Committee:

The Executive and Nomination Committee of the Supervisory Board convened for six meetings in the year under review. The Committee prepared the plenary meetings of the Supervisory Board in all its meetings and discussed Aareal Bank Group's strategic development with the Management Board at regular intervals. Regarding the agenda items within the responsibility of the Supervisory Board, the Committee convened without the Management Board. These meetings particularly included discussions regarding suitability requirements for Management Board and Supervisory Board members, the processes for reviewing these requirements, the targets for the composition of both executive bodies, and the results of the annual evaluation of Management Board and Supervisory Board.

In the January 2019 meeting, the Executive and Nomination Committee concerned itself with the Company's dividend policy.

The March meeting was held in order to prepare for the Annual General Meeting in May 2019. This comprised the decision proposals regarding the agenda of the Annual General Meeting. The Committee also concerned itself with the annual potential Management Board and Supervisory Board appointments in the next financial year, and thus with the topic of succession planning. Another meeting held in March was focused on personnel issues below the Management Board.

The June 2019 meeting was used to prepare for the Supervisory Board's strategy meeting, and an intense discussion as regards succession planning for the Management Board. Another topic handled was the resolution of the Supervisory Board's Rules of Information in the internal framework, which governs Management Board reporting to the committees and the Supervisory Board plenary. In conjunction with this matter, the Rules of Procedure of Management Board and Supervisory Board were amended.

The Executive and Nomination Committee meeting in September 2019 was held to prepare for this year's evaluation and the selection of external auditors to this end. In addition, the strategy dialogue for the second half of the year 2019 was discussed. Other issues in the meeting's focus were the current corporate governance developments, including implementation of the new German Corporate Governance Code (”GCGC”) and of the Bill to Implement the Second EU Shareholder Rights Directive (”ARUG II”). As proposed by the GCGC, the Chairman of the Supervisory Board held an appropriate number of talks with investors in the year under review, exchanging views on Aareal Bank's corporate governance and informing Board members concerning the contents of these talks in subsequent meetings (see ”Shareholder communication” below for details on the topics).

At the December 2019 meeting, the Executive and Nomination Committee carried out the annual review of the Rules of Procedure for the Management Board and Supervisory Board, the individual and collective suitability and efficiency of the Management Board and Supervisory Board (annual evaluation), the respective review processes, and the Conflict of Interest Policy for members of the Company's executive bodies. also considering the results of the written query directed at all Management Board and Supervisory Board members regarding potential conflicts of interest in the past financial year. The members of the Management Board and Supervisory Board have declared in writing that no conflicts of interest within the meaning of the German Corporate Governance Code arose during the financial year under review.

In addition, the Executive and Nomination Committee proposed to recommend to the Supervisory Board the re-appointment of Marc Hess for five years after his amicable resignation (please refer to the Activities of the Plenary Meeting of the Supervisory Board above).

Risk Committee:

The Risk Committee held six meetings during the year under review. It regularly discussed reports on the Bank's risk situation, which were submitted and explained by the Management Board. Having discussed the contents with the Management Board, these were duly noted and approved by the members of the Committee. Besides credit and country risks, the Committee concerned itself with market risks, liquidity risks, and operational risks, as well as reputational and IT risks. The Committee was also engaged with the analysis of Aareal Bank's risk-bearing capacity and its capital ratios. Also, detailed reports were provided regarding the Bank's liquidity status and management as well as its funding. Risks from existing investments, as well as all additional material risks were also presented.

The Risk Committee concerned itself with Aareal Bank's strategies and the derived sub-risk strategies, as well as with the risk management system. The Management Board also submitted detailed reports to the Risk Committee, covering all markets in which the Bank is active in the property finance business, as well as supplementary reports regarding the Bank's investments in securities portfolios. The Committee members discussed these reports and market views in detail. Within the scope of risk reporting, significant exposures were discussed in detail, and measures for the reduction of high-risk exposures presented and consulted within the Committee. The Risk Committee received a report on recovery planning and other risk management measures, which included preparations for the UK's exit from the EU and corresponding reactions to the current developments. The Management Board also informed the Risk Committee about all completed, ongoing and scheduled audits by the supervisory authorities at each Risk Committee meeting. In addition to regular reporting on the risk situation at each meeting, the following meetings had additional focal points on certain topics:

The Risk Committee meeting held in March 2019 dealt with the results of the risk management system review performed by the external auditors, with focused market reporting, and the supervisory authorities' focus in the 2019 financial year.

In May 2019, the Risk Committee mainly addressed the implementation of regulatory requirements, determining that six meetings per annum would be held in future, so as to allow enough time (especially for regulatory developments) per topic.

In June 2019, individual sub-risk strategies, amended to take account of regulatory requirements, were submitted to the Risk Committee for discussion.

At the September meeting, the Management Board informed the Risk Committee about current recovery planning.

At its December meeting, the Risk Committee discussed all of the Bank's business and risk strategies. The Committee monitored the terms in the client business, based on the business model and risk structure of the Bank, supported the Remuneration Control Committee in evaluating the effects of the remuneration systems on the Bank's risk, capital and liquidity situation, and checked whether the remuneration systems are aligned with the Bank's sustainable development and business strategy. Within this context, the Risk Committee also ensured that the derived risk strategies and the remuneration strategy are in line.

At another meeting in December, the Committee dealt with Aareal Bank AG's IT strategy and IT security strategy as well as with all aspects of the Bank's security management. The Technology and Innovation Committee had been invited to this end. The regulatory requirements for IT security were also discussed.

The Committee also concerned itself with the banking and regulatory environment, focusing on current topics such as individual risk types during individual meetings. Furthermore, the Risk Committee dealt with the audits performed by the supervisory authorities, the findings these audits had yielded, and the authorities' recommendations on risk-related topics.

Audit Committee:

The Audit Committee held six meetings during the year under review.

In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2019, the Audit Committee discussed with the Management Board the quarterly results to be published. Furthermore, the current status and planning of key management indicators in the financial year, and current reviews and projects at Aareal Bank were reported upon at the Audit Committee meetings. In its meetings, the Committee received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations, and duly noting both reports. The Committee was also informed about the work carried out by Internal Audit and of the audit planning. The Head of Internal Audit attended all meetings. The Committee dealt with the measures the Management Board had taken to address the shortcomings identified by external auditors, Internal Audit, and supervisory authorities, and had the Management Board report on the status and progress of the rectification of findings. External auditor representatives, too, attended all meetings, excluding the agenda items regarding the rotation of external auditors, the assessment of financial statements auditing, and the proposal for new external auditors. A regular update on the status of already approved and expected non-auditing services provided by the external auditors was given at all meetings. In anticipation of the 70 % limit of approved non-audit services in relation to planned audit services (applicable as of 2020), the Audit Committee had already voluntarily resolved to adhere to this threshold in 2018 and 2019. It was neither reached nor exceeded at any time.

At its February 2019 meeting, the preliminary figures for the 2018 financial year were submitted to the Audit Committee, and the dividend policy was discussed. In addition, the annual report 2018 and the audit planning of Internal Audit were presented.

In March 2019, the Committee received the external auditors' report on the audit of the financial and consolidated financial statements for the 2018 financial year, and discussed the results with the auditors in detail. The Committee members discussed the contents of the audit reports provided; they formed their own judgement of the audit results on the basis of these reports, and by way of meetings held with the external auditors. Furthermore, the Chairman of the Audit Committee informed the meeting about his discussions with the external auditors outside the meetings. Without the external auditors being present, the Audit Committee discussed the agenda items regarding the assessment of financial statements auditing and the proposal for the external auditors for the 2019 financial year. The Committee also concerned itself with Aareal Bank Group's Sustainability Report and the audit undertaken to obtain limited assurance for this report.

At its meeting in May 2019, the Audit Committee discussed the key points of the Supervisory Board's audit for the 2019 financial year.

At the August 2019 meeting, the Audit Committee concentrated on regulatory developments in sustainable finance, the results of the review of the half-yearly financial report as at 30 June 2019, and on the approach for the audit of the financial and consolidated financial statements.

At its November meeting, the Audit Committee focused on the change in external auditors provisioned by the German Audit Reform Act (Abschlussprüfungsreformgesetz – "AReG"). Furthermore, the Committee prepared the Supervisory Board's informational meeting in December and discussed the risks related to implementing the benchmark guideline. The Audit Committee also resolved that the quarterly planning and forecast calculation in conjunction with quarterly earnings management would take place in the form of plenary meetings in March, June, September and December as of the next financial year. The Management Board had proposed such a change. The meetings held in May, August and November concentrate on the quarterly figures and can be carried out via conference calls.

In addition to a report on the audit progress, the Management Board presented and explained the updated Group planning to the Committee during its December meeting. The Audit Committee was also informed by the Management Board about the structure of sustainability reporting for the 2019 financial year. Furthermore, the Committee was regularly informed about the risk management system and the review of the Internal Control System, in accordance with legal requirements; it duly acknowledged the reports, following discussion.

Rotation of external auditors:

To comply with the provisions set out in Regulation (EU) No. 537/2014 on the obligation to rotate external auditors, Aareal Bank published the procedure for the selection of new external auditors for Aareal Bank AG and Aareal Bank Group for the 2021 financial year via the German Federal Gazette at the beginning of the 2019 financial year. An internal project team at Aareal Bank AG, set up by the Audit Committee, will carry out the selection process. The Audit Committee also resolved the material process steps, selection criteria, and material decisions. It received regular progress reports concerning the procedure, discussing, and if applicable, deciding upon any further steps. The project team comprised the Chairman of the Audit Committee, the Chief Financial Officer, Chief Risk Officer, the member of the Management Board responsible for Credit Management and executives of the divisions primarily concerned. In line with EU provisions, the entire process was designed in a fair, transparent, and non-discriminatory manner. Following the announcement in the German Federal Gazette, auditors were prompted to voice their interest in participating in the selection process. In a next step, the interested parties received comprehensive documentation, enabling them to hand in a substantiated written tender. Following the expression of interest, the candidates were given the opportunity to resolve unanswered questions in the next phase. The project team and the Chairman of the Audit Committee then analysed and assessed the tenders subsequently submitted in writing, selected the four candidates fulfilling most of the criteria determined by the Audit Committee, and invited these contenders to present their tender and introduce the most important team members in person.
All members of the project team attended these

presentations. Based on assessment of the presentations, the team narrowed the selection to two candidates, KPMG AG Wirtschaftsprüfungsgesellschaft and Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, voicing a preference for KPMG AG Wirtschaftsprüfungsgesellschaft, and stating the reasons. This final report was submitted to the Audit Committee at its November 2019 meeting, which the two final applicants also attended to introduce themselves personally. Based on this comprehensive reporting, the Audit Committee recommended to the Supervisory Board to propose that KPMG AG Wirtschaftsprüfungsgesellschaft be appointed to review, if applicable, any additional financial information required, within the meaning of section 115 (7) of the WpHG, during the 2021 financial year, until the next Annual General Meeting. They will then be appointed as external auditors for the financial and consolidated financial statements 2021 by the 2021 Annual General Meeting. The Supervisory Board has resolved to follow the preferential recommendation made by the Audit Committee.

Remuneration Control Committee:

The Remuneration Control Committee held six meetings during the year under review.

Pursuant to the requirement set out in section 25d (12) of the KWG, which is reflected in the Rules of Procedure of Aareal Bank's Supervisory Board, the Management Board does not attend Remuneration Control Committee meetings which deal with Management Board remuneration. In the 2019 financial year, the Remuneration Control Committee held four meetings without the Management Board, and two with it.

During its six meetings, the Remuneration Control Committee discussed issues concerning the Bank's remuneration systems and all related matters, fulfilling its original assignment. For this purpose, and to the extent considered necessary, external legal and remuneration advisors were retained to provide support. The Committee supported the plenary meeting of the Supervisory Board in monitoring the inclusion of internal control units and of all other material divisions in designing the remuneration systems, and assessed the effects of the remuneration systems on the Bank's risk, capital and liquidity situation. Moreover, the Remuneration Control Committee supported the Supervisory Board with all issues related to the remuneration of the Management Board. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommendations.

At the beginning of the year under review, the Committee dealt with the Management Board's target achievement for the 2018 financial year and with determining the Management Board targets for 2019.

In March 2019, the Committee finalised the assessment of the appropriate structure of the remuneration systems for the Management Board and employees. The results of the penalty review for employees and the Management Board were also presented, as was the review of the overall amount of variable remuneration as to legal permissibility, pursuant, inter alia, to section 7 of the InstitutsVergV.

The Remuneration Control Committee meeting in June 2019 focused on the completed implementation of the comments which the supervisory authorities had made regarding the remuneration system.

At the two September meetings, the Committee concerned itself with adjusting the remuneration systems for employees after the bonus model for all employees had been harmonised, and with the succession process for the Remuneration Officer. In addition, current corporate governance developments were discussed – including implementation of the new German Corporate Governance Code and ARUG II, as well as the corresponding scheduled adjustments to remuneration reporting with the aim of increasing transparency. In September, the Remuneration Control Committee also dealt with the Management Board members' company retirement provisions, recommending to the Supervisory Board to standardise the employment contracts regarding this issue – in agreement with the individual Management Board members (please also refer to Reporting on remuneration for the Management Board › Measures in the 2019 financial year).

In the meeting at the end of the year, the Remuneration Control Committee dealt with the Management Board's preliminary target achievement for 2019 and determined the Management Board targets for 2020.

Technology and Innovation Committee:

The Technology and Innovation Committee convened for four scheduled meetings in the year under review, during which the Committee discussed the implementation and further development of the digitalisation strategy, market trends, technological developments and innovation trends in detail, especially with a view to clients of the Consulting/Services segment. Potential business opportunities arising from the growing digitalisation of business processes – and how these can be put to use by Aareal Bank Group, and especially for its clients – were explained by the employees of the Bank and respective subsidiaries responsible for the development, among others.

Further key aspects of regular discussions were issues related to the security and flexibility of IT systems provided and used within the Bank, as well as the general realignment of banking systems and related adjustments to the new requirements in the areas of accounting, regulation, and cybersecurity. The IT strategy, budget planning and monitoring of important IT projects were also discussed.

The Committee invited external experts to discuss current developments concerning selected topics.

Attendance of Supervisory Board members at plenary and committee meetings:

Where members of the Supervisory Board were unable to attend a meeting, they announced their absence in advance, giving reasons. Attendance of Supervisory Board members at meetings is shown in the table above.

Member of the Supervisory Board	Plenary meetings attended	Quote	Committee meetings attended	Quote	Number of meetings attended / number of meetings*
Marija Korsch	9 / 9	100 %	28 / 28	100 %	37 / 37
Prof. Dr Stephan Schüller	9 / 9	100 %	14 / 18	85 %	23 / 27
Klaus Novatius (since 1 January 2019)**	9 / 9	100 %	12 / 12	100 %	21 / 21
Thomas Hawel**	9 / 9	100 %	4 / 4	100 %	13 / 13
Petra Heinemann-Specht**	9 / 9	100 %	6 / 6	100 %	15 / 15
Richard Peters	9 / 9	100 %	16 / 16	100 %	25 / 25
Dr Hans-Werner Rhein	9 / 9	100 %	12 / 12	100 %	21 / 21
Sylvia Seignette	9 / 9	100 %	6 / 6	100 %	15 / 15
Elisabeth Stheeman	9 / 9	100 %	10 / 10	100 %	19 / 19
Hans-Dietrich Voigtländer	9 / 9	100 %	16 / 16	100 %	25 / 25
Prof. Dr Hermann Wagner	9 / 9	100 %	12 / 12	100 %	21 / 21
Beate Wollmann**	9 / 9	100 %	6 / 6	100 %	15 / 15

* Plenary and committee meetings; ** Employee representative

Financial Statements and Consolidated Financial Statements

The Supervisory Board instructed PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, who were elected as auditors by the Annual General Meeting 2019, with the audit of the financial statements and the consolidated financial statements. The external auditors appointed submitted a statement regarding their independence to the Supervisory Board, who duly noted it. The Supervisory Board has no reason to doubt the accuracy of this statement of independence. Fulfilling their duties as commissioned by the Supervisory Board, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft audited the financial statements prepared in accordance with the German Commercial Code ("HGB") and the consolidated financial statements prepared in accordance with IFRSs, as well as the Management Report and the Group Management Report. Based on the results of their audit, PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft issued an unqualified audit opinion for the financial statements and consolidated financial statements.

All members of the Supervisory Board received the audit reports, including all annexes thereto, in good time before the meeting during which the financial statements and the consolidated financial statements were discussed. Having examined the documents provided, the Supervisory Board members formed their own judgement of the audit results. The external auditor representatives attended the meeting of the Supervisory Board, during which the financial statements and consolidated financial statements were discussed, and gave a detailed account of the results of their audit. The representatives of PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft were then available to the Supervisory Board to answer further questions, and to provide additional information. All questions were answered to the full satisfaction of the Supervisory Board.

The financial statements and management report of Aareal Bank AG, prepared in accordance with the HGB, the consolidated financial statements as well as the Group Management Report prepared in accordance with IFRSs, the proposal of the Management Board regarding the appropriation of profit, and the audit reports, were all examined in detail. No objections were raised to the audit results. In its meeting on 24 March 2020, the Supervisory Board approved the results of the audit. The Supervisory Board thus confirmed the financial statements of Aareal Bank AG (in accordance with the HGB), and approved the consolidated financial statements (in accordance with IFRSs). The Supervisory Board examined and discussed with the Management Board its proposal regarding the appropriation of profit. On the basis of this discussion, the Supervisory Board endorsed the proposal for the appropriation of profit submitted by the Management Board.

Non-financial Report

The Audit Committee and the Supervisory Board concerned themselves with sustainability issues and related reporting during their meetings on 21 and 26 March 2019, and on 5 and 12 December 2019.

Moreover, during its meeting on 19 March 2020, the Audit Committee of the Supervisory Board discussed the summarised, separate non-financial report for 2019 and the result of PricewaterhouseCoopers's audit of that report. Representatives of the external auditors attended this Audit Committee meeting and reported on material results of their commercial review in accordance with ISAE 3000 (revised), undertaken to obtain limited assurance for this report. They answered supplementary questions from Committee members. The Audit Committee conducted a plausibility check of the audit results submitted by PricewaterhouseCoopers, and presented its assessment of the non-financial report (and its analysis of PricewaterhouseCoopers's audit results) to the Supervisory Board. The Audit Committee also issued a recommendation to the Supervisory Board to concur with the results of the audit conducted by PricewaterhouseCoopers. The Supervisory Board followed this recommendation; in its meeting on 24 March 2020, it summarised its examination by stating that it had no objections concerning the non-financial report and the results of the audit conducted by PricewaterhouseCoopers.

Communication with Shareholders

In her function as Chairman of the Supervisory Board, Ms Korsch held discussions with shareholder representatives concerning corporate governance at Aareal Bank. Ms Korsch presented the topics within the responsibility of the Supervisory Board, such as the composition of the Management Board and the Supervisory Board, the remuneration systems for Management Board and Supervisory Board members, the role of the Supervisory Board in the strategy development and implementation process as well as its involvement in environmental, social and governance (ESG) matters, the election of the auditor and succession planning.

Training and Continuous Professional Development

The Supervisory Board members made use of the training and continuous professional development measures offered and required for their task at their own account. Aareal Bank AG supported them in an appropriate manner. Introductory programmes, specifically aligned with the needs of the members who had only recently joined the Supervisory Board in the previous year or at the beginning of the year under review, were carried out, and external training courses offered, with the objective of helping the new members to familiarise themselves with their new office.

Aareal Bank's onboarding process for new members of the Company's executive bodies aims to impart deeper knowledge of the business specifics, the strategy, risk management, accounting, and material legal provisions of Aareal Bank. For this purpose, external training and continuous professional measures were offered and discussions with the heads of division of the internal control units, of Finance & Controlling, Group Strategy, and with the Management Board members and chairmen of the Supervisory Board committees were held.

Furthermore, continuous professional development measures take place on a regular basis within the course of Supervisory Board meetings.. In 2019, this included two Risk Committee meetings with an in-depth analysis of current regulatory developments and a plenary meeting of the Supervisory Board assessing the risks and opportunities of digitalisation (particularly cyber, ICT, and IT risks with a focus on the platform business and the application of cloud services). To this end, the Supervisory Board meeting in September in the premises of Aareon AG was used for this purpose. The range of topics to be discussed was also extended accordingly.

In addition to its regular meetings, the Supervisory Board convened for a separate informational meeting, during which auditors PricewaterhouseCoopers provided detailed information on current changes and deliberations within the regulatory and legal framework, as well as on the potential impact of such trends upon Aareal Bank.

In conclusion, the Supervisory Board would like to thank the Management Board and all of the Group's employees for the strong commitment they have shown during the past 2019 financial year. With their enormous continued commitment – and strong motivation – all Group employees have contributed to the Company overcoming all the challenges it faced extremely well, once again making the Company's success possible.

Frankfurt / Main, March 2020

For the Supervisory Board

Marija Korsch (Chairman)

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Glossary

Ad-hoc disclosure

Pursuant to Article 17 of the MAR (Market Abuse Regulation), issuers of financial instruments are obliged to publish any information that may have an impact on the price of these instruments without delay. This obligation is discharged using so-called ”ad-hoc” disclosures which may relate to the issuer’s financial position and performance, or to its general business operations. The ad-hoc disclosure obligation applies in Germany as well as in other major financial centres; it is designed to prevent insider trading.

Advanced Internal Ratings-Based Approach (AIRBA)

Under the ”Advanced Approach”, banks are allowed to use their internal rating procedures to gain an assessment of the credit quality for the supervisory measurement of risk-weighted assets (RWAs).

Associated enterprise (associate)

An enterprise which is accounted for in the consolidated financial statements using the equity method (as opposed to full or partial consolidation), over whose business or financial policies an entity included in the consolidated financial statements exercises significant influence.

Basel III / IV

”Basel III” denotes the regulatory framework for banks, promulgated by the Basel Committee on Banking Supervision at the Bank for International Settlements (BIS) with the objective of stabilising the banking sector. The Basel III regulations, finalised in December 2017, are expected to be implemented by 2022, and are generally known as ”Basel IV”.

Bonds

Generic term for fixed-income securities or debt securities.

Capital ratios

$$\text{Common Equity Tier 1 ratio (CET 1 ratio)} = \frac{\text{Common Equity Tier 1 (CET 1)}}{\text{Total risk exposure amount (RWAs)}} \times 100\,\%$$

$$\text{Tier 1 ratio (T1 ratio)} = \frac{\text{Tier 1 capital (T1)}}{\text{Total risk exposure amount (RWAs)}} \times 100\,\%$$

$$\text{Total capital ratio (TC ratio)} = \frac{\text{Total capital (TC)}}{\text{Total risk exposure amount (RWAs)}} \times 100\,\%$$

Commercial Mortgage Backed Securities (CMBS)

Bonds backed by loans collateralised by commercial and multi-family properties.

Consolidated statement of cash flows

Statement showing the cash flows an enterprise has generated and used during a financial year, from its operating, investment and financing activities, together with the cash and cash equivalents at the beginning and end of the financial year.

Corporate governance

Corporate governance denotes the legal and factual framework for the management and governance of enterprises. The recommendations of the German Corporate Governance Code safeguard transparency and are designed to strengthen confidence in good and responsible corporate governance. They predominantly serve to protect shareholders’ interests.

Cost/Income ratio (CIR)

Financial indicator expressing the ratio of expenses to income within a given reporting period

$$\text{CIR} = \frac{\text{Administrative expenses}}{\begin{array}{c}\text{Net interest income + net commission income} \\ \text{+ net derecognition gain/loss + net gain/loss from financial} \\ \text{instruments fvpl + net gain/loss from hedge accounting} \\ \text{+ net gain/loss from investments accounted for using the} \\ \text{equity method + net other operating income/expenses}\end{array}}$$

Covered bonds

”Covered” bonds is a generic term for debt securities covered by collateral. In Germany, covered bonds are mainly issued in the form of ”Pfandbriefe” pursuant to the German Pfandbrief Act (PfandBG), which provides a legal framework for collateralisation (assets eligible for Pfandbrief cover include mortgages and public-sector loans).

Credit Risk Standard Approach (CRSA)
The CRSA is applied, provided no advanced approach (AIRBA) to assess the credit risk exposure exists, or has been approved.

Deferred taxes
Income taxes payable or receivable in the future, due to temporary differences between the carrying amounts of assets and liabilities in the IFRS statement of financial position and the tax accounts. At the time of recognition, deferred tax assets or liabilities do not yet constitute any actual claims on, or liabilities to the tax authorities.

Derivatives
Derivatives – which include all types of forwards, futures, options and swaps – are financial instruments whose value is derived from the price (and/or the price fluctuations) of an underlying instrument, such as equities, bonds or currencies.

Earnings per share (EpS)
Earnings per ordinary share: financial indicator expressing the ratio of net income after non-controlling interest income to the average number of common shares outstanding.

$$\text{Earnings per share} = \frac{\text{Operating profit/loss ./. income taxes ./. consolidated net income attributable to non-controlling interests ./. AT1 coupon (net)}}{\text{Number of common shares}}$$

EBIT margin

$$\text{BIT margin} = \frac{\text{EBIT (operating profit before interests)}}{\text{Sales revenues}}$$

Effective interest method
Method for amortising the mark-up/mark-down between cost and the nominal value (premium/discount), using the effective yield of a financial asset or liability.

Equity method
Method for measuring shareholdings in enterprises on whose business policy the reporting entity has significant influence ("associates"). When applying the equity method, the associate's pro-rata net income/loss is recognised in the carrying amount of the shareholding; any distributions are recognised via a corresponding pro-rata reduction in the carrying amount.

EURIBOR
European Interbank Offered Rate – the interest rate at which prime European banks offer euro deposits (with fixed terms of one week, and between one and twelve months) to one another.

Fair value
The fair value is the amount for which an asset can be exchanged (or a liability settled) between knowledgeable, willing parties in an arm's length transaction; this is often identical to the market price.

Fair value hedge
Using a swap to hedge the market risk of a balance sheet item with a fixed interest rate (e.g. a receivable or a security); this is measured at fair value.

Financial assets (fvoci)
Financial assets measured at fair value, whose change in value is recognised directly in equity via other reserves (fvoci = fair value through other comprehensive income).

Financial assets/liabilities (ac)
Financial instruments measured by applying the effective interest method at amortised cost (ac = amortised cost). The financial instrument is measured at the amount at which it was initially recognised, minus principal repayments, plus or minus the cumulative amortisation of any premium or discount, and minus any reduction for impairment or non-collectability. The effective interest method amortises the mark-up/mark-down between cost and nominal value (premium/discount) over a residual term.

Financial assets/liabilities (fvpl)
Financial instruments measured at fair value, whose change in value is recognised in income (fvpl = fair value through profit or loss).

Financial instruments
Generic term for loans extended and other receivables, fixed-income securities, equities, shareholdings, liabilities, and derivatives.

FX
Abbreviation for foreign exchange.

Goodwill
The amount which the buyer of an enterprise pays over the fair value of assets less liabilities (the net asset value), taking expected future income into account (the fully-capitalised earnings value).

Hedge accounting
Concept describing the recognition (or other form of accounting) of two or more financial instruments, which together form a hedging relationship. In this context, the relationship between these contracts is based on the equal and opposite specification of contractual elements giving rise to risks (usually financial risks). Given these specifications, such agreements can be used to partially or fully offset and neutralise risks. In the context of hedge accounting, one of the contracts involved (specifically, the contract establishing the risk(s) concerned) is referred to as the "underlying transaction", and the other contract (the one entered into to hedge the risk(s) of the underlying transaction) as the "hedge transaction" or just "hedge".

Impairment
An impairment within the scope of determining loss allowance.

International Financial Reporting Standards (IASs/IFRSs)
IFRSs comprise International Accounting Standards (IASs) and interpretations issued by the Standing Interpretations Committee, as well as International Financial Reporting Standards (IFRSs) and related interpretations published by the International Accounting Standards Board (IASB).

LIBOR
London Interbank Offered Rate; the interest rate at which prime London banks offer deposits to one another.

Liquidity Coverage Ratio (LCR)
A Basel III indicator designed to assess liquidity risk.

Loan-to-value ratio (LTV)
The ratio of loan amount to property value, in the context of property loans.

MDAX
The MDAX® mid-cap index comprises the shares of 60 companies from traditional sectors listed in Deutsche Börse's Prime Standard segment that, in terms of exchange turnover and market capitalisation, rank immediately below the companies included in the DAX® blue-chip index.

Minimum Requirements for Risk Management (MaRisk)
The Minimum Requirements for Risk Management in Banks (MaRisk) are binding requirements for the structure of risk management in German banks, as promulgated by the German Federal Financial Supervisory Authority (BaFin).

Money and capital markets
Markets for short, medium- and long-term investments and borrowing in different forms, such as debt securities or promissory note loans.

Mortgage Pfandbriefe
Debt securities issued by Pfandbrief issuers (Pfandbrief banks), which are collateralised by mortgages with a maximum mortgage lending value ratio of 60 %.

Option
The right to buy or sell a specific asset.

Other Comprehensive Income (OCI)
Other reserves. Equity sub-item, in which the following effects are recognised directly: the reserve from remeasurements of defined benefit plans, the reserve from the measurement of equity and debt instruments at fair value through other comprehensive income, the hedging reserve, the reserve from changes in the value of foreign currency basis spreads, and the currency translation reserve.

Over the counter (OTC)
Financial markets term for off-exchange trading between market participants.

Present value
The present value of a future cash flow, determined by discounting all future cash flows (inflows and outflows) to today's date.

Profit-participation rights
Profit-participation rights are a hybrid of equity and debt. Their creditors' rights are subordinated to those of other creditors, whilst their interest claim takes precedence over the profit entitlements of shareholders.

Public-Sector Pfandbriefe
Debt securities issued by Pfandbrief issuers (Pfandbrief banks), which are collateralised by claims against the public sector.

Purchased or originated credit impaired (POCI)
Financial assets which had already defaulted at the time of acquisition.

Repo or reverse repo transaction (repurchase transaction)
Short-term money-market transaction collateralised by securities.

Return on equity (RoE)
Financial indicator expressing the ratio of net income (or pre-tax profit, for example) to average equity over the period. RoE expresses the return on the capital employed by the company (and its owners/shareholders).

$$\text{RoE before taxes} = \frac{\text{Operating profit ./. consolidated net income attributable to non-controlling interests ./. AT1 coupon}}{\text{Average equity (IFRS) excluding non-controlling interests, other reserves, AT1 bond and dividends}}$$

$$\text{RoE after taxes} = \frac{\text{Operating profit ./. income taxes ./. consolidated net income attributable to non-controlling interests ./. AT1 coupon (net)}}{\text{Average equity (IFRS) excluding non-controlling interests, other reserves, AT1 bond and dividends}}$$

Risk-weighted assets (RWAs)
Risk-weighted assets are determined by multiplying the exposure value of a counterparty credit risk position with the risk weight assigned to the borrower.

Segment reporting
Shows financial information of segments which are material for management, and their contribution to the consolidated net income.

Swap
Generic term for contracts to exchange cash flows, such as the exchange of fixed-rate and variable-rate cash flows in the same currency (interest rate swap), or the exchange of cash flows and/or nominal amounts in different currencies (cross-currency swap).

Swaption
Option to enter into a swap agreement: the right to enter into a swap at a specific point in time, at interest rates and terms agreed upon at the outset.

Value-at-risk (VaR)
Method to quantify risks: it measures the maximum potential future loss which will not be exceeded within a defined period, and given a certain probability.

Financial Calendar

12 May 2020	Publication of results as at 31 March 2020
27 May 2020	Annual General Meeting – Kurhaus, Wiesbaden
13 August 2020	Publication of results as at 30 June 2020
12 November 2020	Publication of results as at 30 September 2020

Imprint

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