QUALITY
made by AAREAL

Setting milestones.
Creating prospects.

Annual Report 2018

Aareal Bank Group

Setting milestones.
Creating prospects.

Aareal Bank Group – clients, segments, solutions

Aareal Bank Group is a leading provider of smart financing, software products and digital solutions for 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.

We offer our clients, most of whom are active in the property and energy industries, a wide array of pioneering solutions, which we have structured into two business segments:

In the Structured Property Financing segment, we support our clients in financing their property investments. Our focus lies on the financing of office buildings, hotels, retail properties, as well as of logistics and residential properties – in most cases, we finance existing buildings. Our clients include especially investment funds, private equity firms, family offices, financial institutions, private individuals, listed property companies and industry experts.

In the Consulting/Services segment, on the one hand, we offer our clients specialised banking services – such as electronic banking, automated mass payments and optimisation of business processes, and develop software through our subsidiary Aareon AG, on the other hand. We also provide numerous IT consulting and other IT services for the digital age. Aareon is the leading consultancy and systems house for the European property industry.

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Setting milestones. Creating prospects.

To our Shareholders

Group Management Report

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Transparency

Aareal Bank Group

Key Indicators

	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Results		
Operating profit (€ mn)	316	328
Consolidated net income (€ mn)	226	213
Consolidated net income allocated to ordinary shareholders (€ mn)[1]	208	191
Cost/income ratio (%)[2]	40.4	40.5
Dividend per share (€)[3]	2.10	2.50
Earnings per ordinary share (€)[1]	3.48	3.20
RoE before taxes (%)[1]	11.6	11.9
RoE after taxes (%)[1]	8.3	7.6

	31 Dec 2018	31 Dec 2017
Statement of financial position		
Property finance (€ mn)[4]	26,395	25,088
Equity (€ mn)	2,928	2,924
Total assets (€ mn)	42,687	41,908
Regulatory indicators[5]		
Risk-weighted assets (€ mn)	13,039	11,785
Common Equity Tier 1 ratio (CET1 ratio) (%)	17.2	19.6
Tier 1 ratio (T1 ratio) (%)	19.5	22.1
Total capital ratio (TC ratio) (%)	26.2	30.0
Common Equity Tier 1 ratio (CET1 ratio) (%) – Basel IV (estimate)[6]	13.2	13.4
Employees	2,748	2,800

	31 Dec 2018	31 Dec 2017
Moody's		
Issuer rating	A3	Baa1
Senior Preferred[7]	A3	–
Senior Non Preferred[8]	Baa1	Baa1
Bank deposit rating	A3	A3
Mortgage Pfandbrief Rating	Aaa	Aaa
Fitch Ratings[9]		
Issuer default rating	A-	BBB+
Senior Preferred	A	–
Senior Non Preferred	A-	BBB+
Deposit ratings	A	A-
Sustainability ratings[10]		
MSCI	AA	AA
ISS-oekom	prime (C)	prime (C)
Sustainalytics	70	70

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) 2018: Proposal to be submitted to the Annual General Meeting
4) Excluding € 0.6 billion in private client business (31 December 2017: € 0.8 billion) and € 0.5 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2017: € 0.5 billion)
5) When calculating own funds, annual profits including negative goodwill were taken into account, based on the Management Board's proposal for appropriation of profits for the 2018 financial year. 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 ECB's NPL guidelines (NPL stock), were taken into account for determining regulatory indicators for 2018.
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"
8) Moody's terminology: "Junior Senior Unsecured"
9) Published on 21 January 2019.
10) Please refer to our website (www.aareal-bank.com/en/responsibility/reporting-on-our-progress/) for more details.

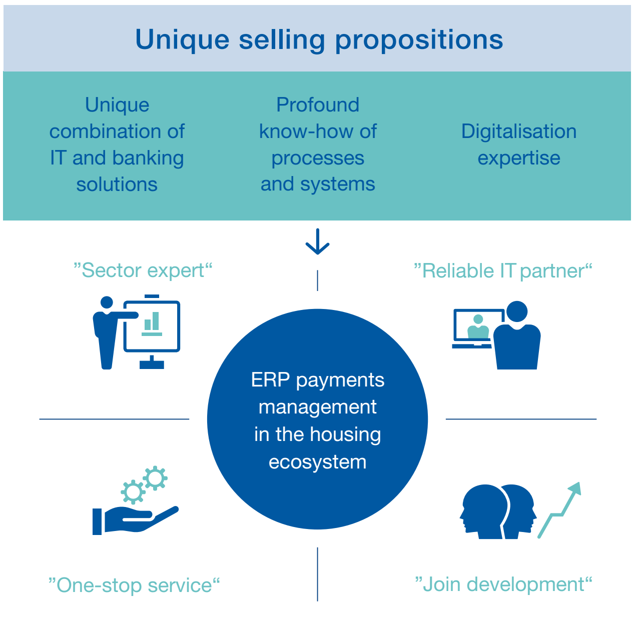
This report contains rounded numbers, which may result in slight differences when aggregating figures and calculating percentages.

Our unique selling points

Key success factors in both business segments are our international expertise, our sector-specific know-how, and our long-standing, close client relationships. Because we look beyond the scope of traditional banking and IT services, we are able to reliably assess material developments, opportunities and risks at an early stage and then implement the insights gained particularly quickly. We place great emphasis on the provision of personal service, and on tailor-made solutions.

In the Structured Property Financing segment, our particular strengths lie in structuring expertise, cross-border financing, and a combination of local market know-how with comprehensive industry knowledge. In other words, in addition to the locally-based experts, we also have dedicated teams for financing logistics, shopping centre and hotel properties at your disposal. We offer our solutions for Europe, North America and the Asia/Pacific region.

Our Consulting/Services business segment can look back at more than 60 years' experience. We are the no. 1 provider of integrated payment and accounting systems to the German institutional housing industry. With our subsidiary Aareon, we are Europe's leading ERP provider for the property industry, offering significant contributions to the networking of market participants and sectors with an integrated range of solutions. For decades, we have been setting standards with regard to the management of complex IT-based business processes.



Our responsibility

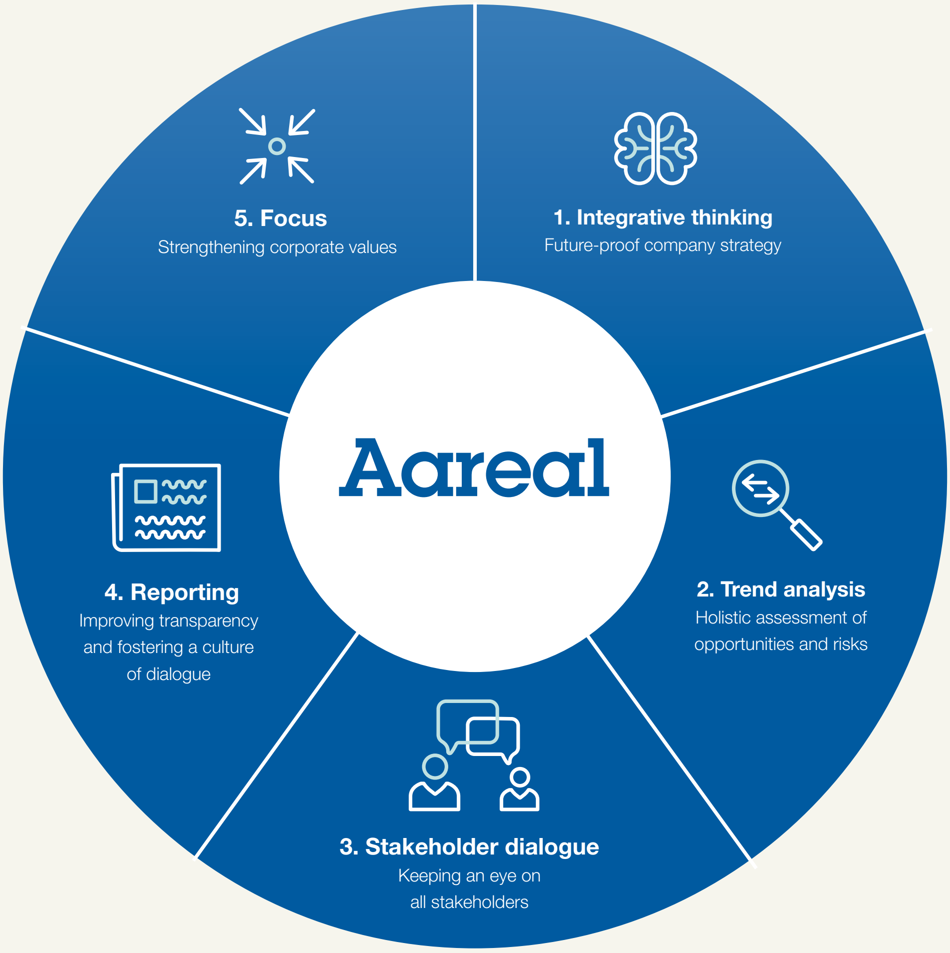
Aareal Bank's sound approach to business, its reliability and sense of responsibility are at the heart of everything we do. Both internally and externally – in our dealings with our employees, shareholders, clients and business partners, and with society as a whole.

For many years now, our **Sustainability Report** has made a clear declaration of the responsibility we feel for our actions. In that report – as in the **Combined Separate Non-financial Report** – we disclose information about our sustainability strategy, our related activities, and the non-financial indicators we deem to be material.

Our sustainability strategy consists of twelve core action areas we identified in a materiality analysis and whose relevance we discuss with our stakeholders on a regular basis. Our overarching goal, as an international property finance and service provider, is to play our part in the transition to global, sustainable growth – by offering tailored financing structures and creating attractive investment opportunities, and by developing innovative payment/software solutions and digital services for the housing and property industries. Bearing in mind the social, ecological and governance aspects of our business decisions allows us to add value sustainably – for all our stakeholders.

Link to the Sustainability Report and the Combined Seperate Non-financial Report 2018 of Aareal Bank:
cr.aareal-bank.com/2018

Our sustainability mission statement



Our principles of corporate responsibility are summarised in our sustainability mission statement:

1	We take an integrated approach and broaden the areas of activity identified in our strategic programme to include social and ecological issues.
2	We analyse trends holistically, evaluate the resulting opportunities and risks, and align our forward-looking sustainability programme with this.
3	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.
4	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.
5	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.

Innovative technologies secure the sustainability of our business model

We believe that developing and using innovative technology is indispensable for the sustainability of our business model. For this reason, the Supervisory Board established a Technology and Innovation Committee as early as in 2015. The Committee discusses market trends, technological developments and resulting business opportunities. The focus lies on the increasing digitalisation of processes, the realignment of banking systems, the optimal establishment of an innovation-friendly environment, the Group's IT security – as well as on developing the range of digital products and services to our clients.

Projects which the Committee discussed in detail and expedited in 2018 included the deployment of a credit management platform which provides relevant deal information at the touch of a button, as well as robot process automation.

// New York-based Aareal Capital Corporation (ACC) is currently in the process of implementing the scalable, cloud-based RealINSIGHT platform, an information management and early warning system which enhances transparency regarding current financing projects, thanks to the centralised availability of the full credit and loan history. Data can be accessed at any time – in addition, the system provides an alert function for changes in financial reporting or shifts in the financing portfolio, thus facilitating swift action. Moreover, the platform facilitates market simulations at portfolio level.

// Robot process automation refers to software robots which support employees in administrative functions in carrying out different processes. Aareal Bank is already implementing these software robots in, for example, time-consuming routine work, such as the entry and matching of ERP data. However, our clients will also soon be benefiting from this technology; software robots can take over name and address changes, account access authorisations, and perform many other comparatively simple processes – very precisely, and with a low error rate. With their help, we can also mitigate occasional personnel shortages, or process client requirements outside normal working hours.

"Due to the rapid progress of digital transformation, the Supervisory Board – in its role as a sparring partner for the Management Board – is also facing new challenges. Contents, thinking patterns, and assessment criteria as well as proven procedures and processes must be reviewed, cultural change actively supported. By establishing the Technology and Innovation Committee, we did just this."

Marija Korsch,
Chairman of the Supervisory Board

"The bank of the future will be digital. Therefore, it will have to focus its financial services even more strongly on client benefit. The focus must lie on the client, rather than concentrating primarily on the products. Central to this development is a flexible IT architecture, also necessary to meet the challenges presented by FinTechs, i. e. start-ups in the financial sector. The Technology and Innovation Committee, for example, deals with questions, how and where to put the advantages of new technologies to optimum use."

Hans-Dietrich Voigtländer,
Member of the Supervisory Board

"Our range of services has already made us a pioneer in digital solutions for our markets. In order to strengthen and further expand this position, we have developed a digital roadmap, equipping our IT landscape to cope with the new challenges – making sure that we have the right tools to continue to be a success story in the digital age."

Hermann J. Merkens,
Chairman of the Management Board

"We, Aareal Bank Group, see ourselves as a driver of innovation in our business segments in the area of digitalisation. Because we look beyond the scope of traditional banking and IT services, joining forces with our long-standing clients, we are able to reliably assess material developments, opportunities and risks at an early stage and then implement the insights gained particularly quickly."

Thomas Ortmanns,
Member of the Management Board

Our strategy

Interview with Hermann J. Merkens

Mr Merkens, how would you describe Aareal Bank's market environment?

Aareal Bank is still facing a challenging and demanding environment, primarily characterised by four factors:

First: strong, intense competition that places margins under pressure in pretty much the entire sector and in all relevant countries and markets;

Second: continuously intensifying regulatory requirements, making it difficult for banks to generate reasonable returns on equity;

Third: historically low interest rates, significantly burdening profitability in the deposit-taking business;

And fourth: rapid technological change that we, as nearly all other companies, are confronted with.

In addition, change is taking place at an ever-faster rate, meaning that something which is still accepted on a broad level today will already be under heavy scrutiny tomorrow.

How does Aareal Bank react strategically to this environment?

When we created our "Aareal 2020" programme for the future three years ago, we already paved the way for continued sustainable growth at our Group. Since then, we have taken comprehensive measures to increase efficiency and optimise structures and processes, significantly boosted the development of the IT landscape, and initiated a large number of initiatives to refine the business models in both segments. In this context, we have also set a focus on the cultural transformation, in order to further develop the way we think and act, as well as on the general attitude and stance with which we conduct our business. We can already see clear evidence of the programme's success.

What is the strategic alignment of the Structured Property Financing segment?

We will continue to focus on the most attractive markets, and reduce the non-strategic portfolios in the Structured Property Financing segment. We will also expand the existing exit channels and open up new ones – in other words, we will systematically broaden our options for acquiring new business without burdening our balance sheet. Furthermore, we will increase our efforts to explore new – and also digital – business opportunities along our value creation chain, regarding process optimisation as well as the development of digital business models in this segment.

Link to the full interview
with Hermann J. Merkens:
ar.aareal-bank.com/2018/en/#sec-1

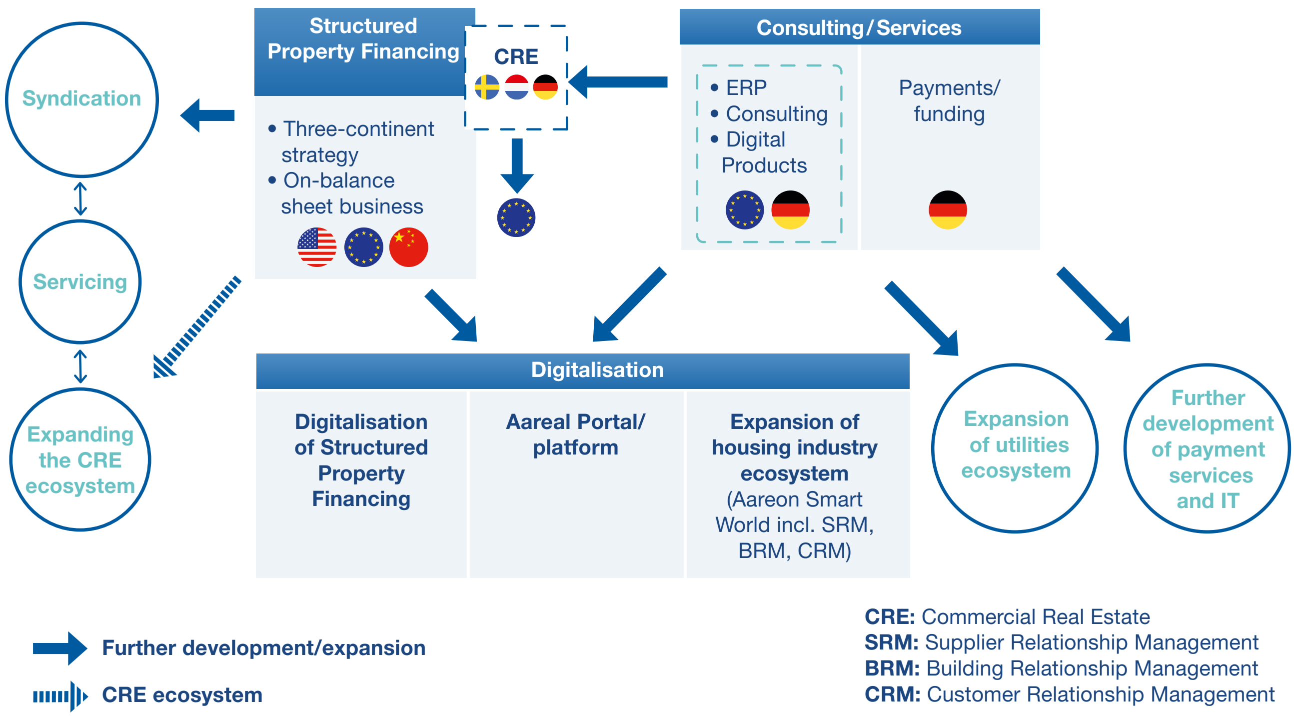
And what strategic options do you see for the Consulting/Services segment?

In the Consulting/Services segment, we aim to continue expanding our promising digital solutions portfolio, to penetrate relevant ecosystems even more systematically, and to drive forward our expansion into neighbouring markets. In addition, we will develop new offers for the property industry and for a direct interaction of our clients with end-customers.

Intensifying existing cooperations with start-ups and expanding our own incubator activities are also two important pillars of our strategic agenda.

Why are you optimistic for Aareal Bank Group's future?

I am convinced that we have established a very good starting position, enabling us to operate successfully in the next years. Firstly: we are more broadly and better positioned in both segments – also in terms of our alignment within them – than many other specialist finance providers. Secondly: we started the adjustment process, which was necessary due to impending changes on the market, very early on, with our "Aareal 2020" programme for the future. Thirdly: thanks to our solid financial position and our robust operating business, we are acting from a position of strength. Fourthly: we can count on a strong, motivated, highly skilled team, with impressive commitment and an intense willingness to embrace change. All of this causes me to be very optimistic for Aareal Bank Group's future.



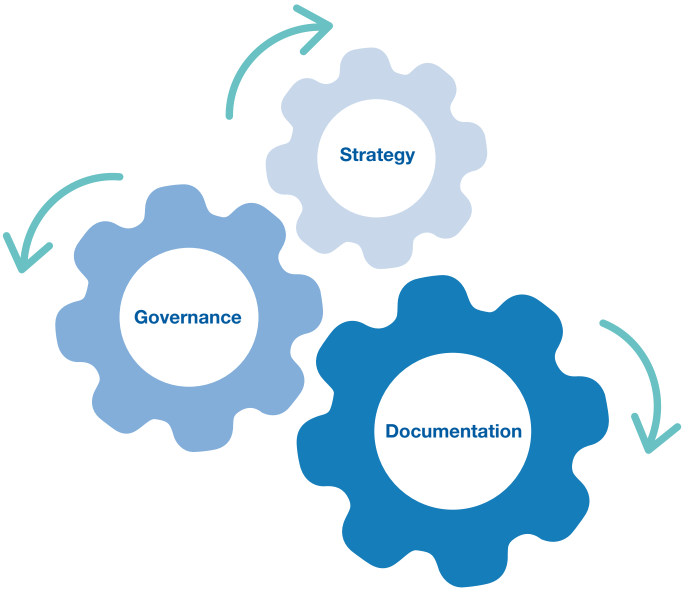
Our risk culture

The ability to correctly identify, assess and manage risk is one of the most important foundations of our business model. This is why Aareal Bank Group attaches so much importance to risk transparency and appropriate risk management.

For many years, we have pursued a conservative risk policy, ensuring a clear, sustainable risk culture. In doing so, we follow the definition of the Basel Committee on Banking Supervision and regard risk culture as a set of principles, attitudes and practices relating to awareness, willingness and management of risk as well as to the controls that influence risk decisions.

We are convinced that it is essential for us to have a risk culture that fits with our long-term business model, in addition to business and market-driven aspects. This has to be a central component of our corporate culture in order for it to be able to exert influence on the decisions our management and employees make on a daily working basis. We therefore ensure that all our employees are familiar with our risk systems and risk appetite.

Our risk culture is based on four pillars: management culture, employee accountability, open communication and challenge, and appropriate incentives.



In this context, strategy, governance and our internal documentation are interlinked: this ensures a consistent and uniform view on our risk appetite – which is derived from our strategy – as well as on risk management and on guidelines which are in line with this. This framework is designed to provide guidance and direction to our staff.

We have laid the foundations of our risk culture in our Risk Appetite Framework. This framework represents a holistic approach comprising guidelines, processes, controls and systems, whilst at the same time describing our values and behaviours. The requirements contained within are binding for all employees and have a direct impact on their responsibilities, goals and objectives. It ties risk culture to strategic planning, ongoing risk measurement and monitoring, as well as to defined risk strategies.

This framework is supplemented by the respective division- and task-specific provisions of the Written Set of Procedural Rules (SFO) as well as by our Code of Conduct.

In our recently revised Code of Conduct, which will be introduced Group-wide in 2019, we provide our employees, members of our executive bodies and employees of our subcontractors with guidelines and advice on how to behave in certain situations. We require our business partners to also behave according to these principles. The Code of Conduct defines our fundamental understanding of working together and contains statements on our corporate responsibility, our fair employment relationships and conditions, as well as our social responsibility. It is inspired by international conventions and guidelines as the Universal Declaration of Human Rights, the International Labour Organisation (ILO) conventions and the United Nations Global Compact. It therefore forms a pivotal document in our corporate culture and translates our values and principles into concrete behaviour guidelines, whilst taking into account the importance of appropriate risk management.

Our digital roadmap,
and our start-up programme

Our digital roadmap is a key element of the ”Aareal 2020” future agenda. We want to enable our clients to benefit from the advantages of digitalisation, by optimising their processes and enhancing their customer satisfaction.

Another opportunity that digitalisation provides is to be able to create the foundation of a modern infrastructure with a comfortable interface, and to enable a system-integrated electronic data interchange with optimised processing operations for our clients and their business models.

The four dimensions of digitalisation

Aareal Bank Group

Optimise organisational performance

- Digital client communications
- 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

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

In order to further expand our pioneering role in the provision of innovative digital solutions to our clients, and in order to structure the many forward-looking ideas, our digital roadmap has four strategic directions:

Development of new financial and payment solutions

We are extending our range of offers with tailor-made payment and data process solutions, creating new platforms for our digital products by implementing online portals.

Development of new digital solutions

This particularly includes innovative solutions in the areas of customer relationship management (CRM), building relationship management (BRM) and supplier relationship management (SRM) – based on a digital platform strategy.

Further development of our existing product portfolio

We are engaged upon further systematic development of our existing products, creating solutions which set technological standards. This includes, in particular, our ERP portfolio and BK 01, the process-optimising payments solution that is integrated into the ERP environment.

Optimisation of organisational performance

We also take advantage of the opportunities that digitalisation provides us, refining our communications channels with clients, and being able to design our own processes as efficiently as possible.

Start-up programme

We are also looking to cooperate with start-ups, so that we can continue to develop our digital solutions. Our Group-wide start-up programme aims to understand the drivers of digital development, to participate in trends, to enhance our innovative strength, to complement and improve our product portfolio, and to achieve added value for our clients through integration and partnerships.

Some examples of the cooperations that our start-up programme has currently established:

// Brickvest (UK)
// DPM Technologies (F)
// Intent Technologies (F)
// Mail2Pay (NL)
// Realxdata (GER)
// Yespark (F)
// Deposit Solutions (GER)
// Immomio (GER)
// KIWI.KI (GER)
// Metry (Scandinavia)
// ValidSign (NL)

As part of the programme, Aareal Bank Group implemented a structured process to select start-up companies. Start-ups are analysed on an ongoing basis and assessed through the lens of the Group's strategy. The positive experiences gained in working with start-ups led Aareal Bank Group to support the first German proptech accelerator "blackprint PropTech Booster" – with Aareon as the strategic partner – and enter into a gold partnership with Frankfurt's TechQuartier.

We also initiated a partnership with the world's largest start-up platform Plug and Play. Within the scope of this cooperation, we became a founding member of the recently launched Fintech Europe platform, established in Frankfurt by Plug and Play together with TechQuartier. This allows us to collaborate with the best start-ups in the financial sector worldwide, and to develop applications relevant to our clients.

In 2018, Aareal Bank acquired a stake in BrickVest, a leading European online platform for commercial property investments. Thus, we are placing our bet on a digital model of the future, which will significantly gain importance in commercial property finance over the coming years.

We also founded AV Management GmbH (Ampolon Ventures) in 2018 as an independent company, the purpose being – going forwards – to identify and test interesting, innovative topics in the market. Ampolon Ventures operates from co-working office premises in Frankfurt, enabling the company to actively network with Frankfurt's start-up scene.

The programme comprises four areas:

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

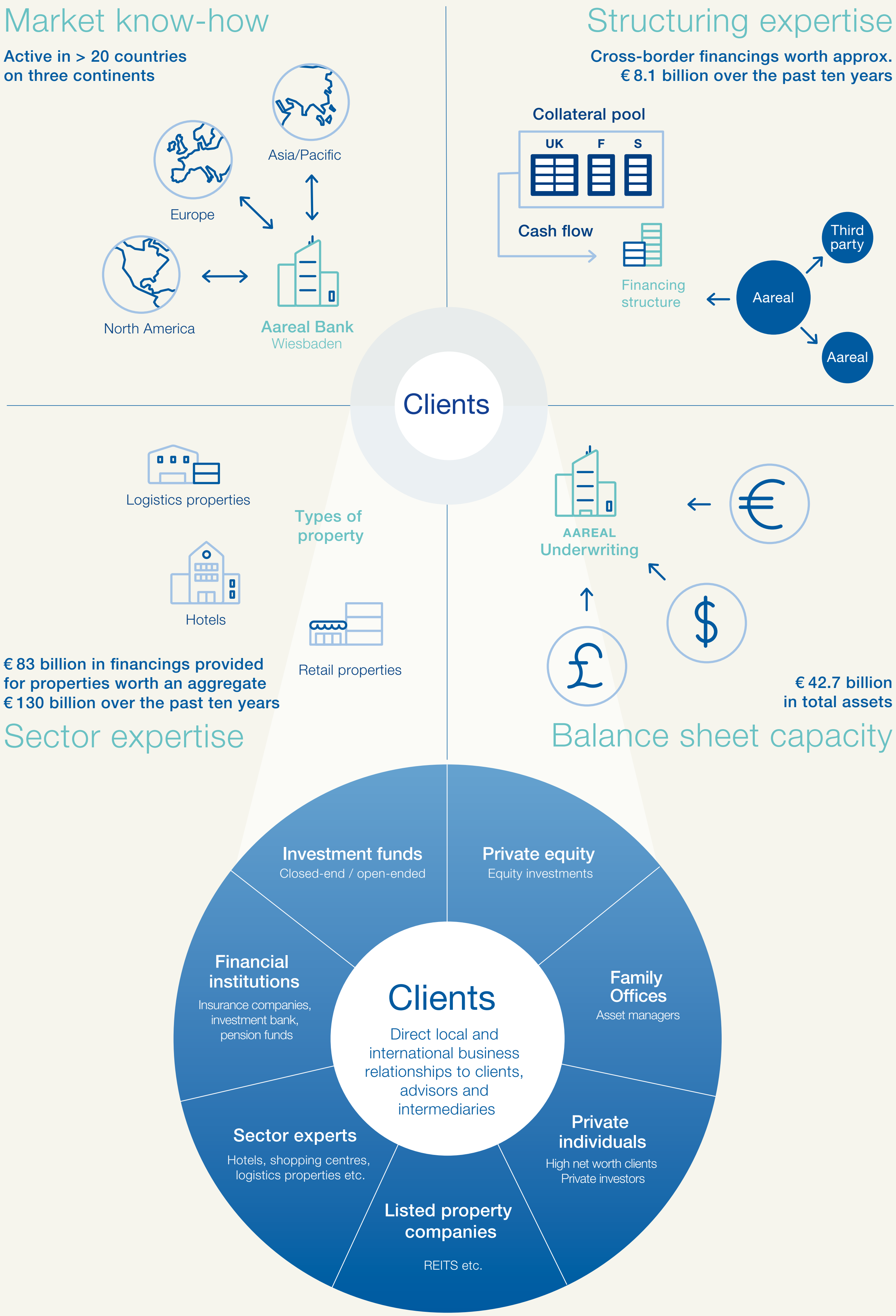
Structured Property Financing

Smart solutions for property investors

Requirements for the lending business of tomorrow

Globalisation, digitalisation, urbanisation: The requirements for financing commercial properties have changed considerably in recent years and the complexity of such transactions has increased significantly. It is fair to expect that these requirements will increase even further in the future, as the new needs triggered by such megatrends will also give rise to new business models, offering structures and financing options.

With our Structured Property Financing segment, we have adapted to these new requirements at an early stage. This includes above all the further expansion of our unique selling points, for which we are renowned in the market: our structuring expertise, the combination of local market know-how and comprehensive industry knowledge, our balance sheet capacity and our reliability. In our Structured Property Financing activities, we rely on international market cultivation and the digitalisation of our business in order to be a strong partner for our clients.


Market know-how
Active in > 20 countries on three continents
Asia/Pacific
Europe
North America
Aareal Bank
Wiesbaden
Structuring expertise
Cross-border financings worth approx. € 8.1 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
€ 83 billion in financings provided for properties worth an aggregate € 130 billion over the past ten years
Sector expertise
AAREAL
Underwriting
€ 42.7 billion in total assets
Balance sheet capacity
Investment funds
Closed-end / open-ended
Private equity
Equity investments
Financial institutions
Insurance companies, investment bank, pension funds
Clients
Direct local and international business relationships to clients, advisors and intermediaries
Family Offices
Asset managers
Sector experts
Hotels, shopping centres, logistics properties etc.
Private individuals
High net worth clients
Private investors
Listed property companies
REITS etc.

"Cross-border and digitalisation expertise are basic."

Mr Winkelmann, what trends and tendencies are you seeing in structured property financing?

The property financing market is currently experiencing numerous changes – which are profound in some cases. This is due in part to megatrends that are having a growing impact worldwide and in part to regulatory requirements. Globalisation, urbanisation and digitalisation are the specific megatrends affecting the commercial property industry and in turn us as a property finance house. At the same time however, regulation is being tightened more and more which means that transactions are becoming much more complex overall.

How is Aareal Bank tackling increasing globalisation?

We have been operating at home and abroad for many years so we have a high level of expertise in cross-border financing. We know the industries and countries in which we operate extremely well and we have spent the last few decades building a wide network within the commercial property industry. This helps us a great deal when syndicating our financings and constitutes a major competitive advantage since the ability to place loans on the market is becoming increasingly important. For this reason, further expanding our network of syndication partners is one of our key strategic goals. At the same time, we have also significantly increased our share of international business such as in the US.

How is the market for property financing changing as a result of technological advances?

First of all, digitalisation means that the needs of property users are changing significantly. This requires a higher level of customer handling and property management that is more active. This is why property finance houses not only need to have corresponding market knowledge, but also need to identify relevant trends in good time and be able to rank and assess their impact. In the case of property financing itself, the significance of digital processes is also increasing – less so in the business itself which requires profound expertise and well-established contacts but more so in the administration of transactions. Digital processes can provide significant ease and efficiency gains for both sides.

In what areas exactly?

Last year we started an extensive digitalisation campaign that covers various areas and interlinks them with one another. An example of this is the Aareal Client Cockpit we developed which will serve as the future digital interface with our clients – it is clear, user-friendly and optimised for the central process workflows in loan origination. In order to be able to gain an overview of all market and property information and analyse it, we have compiled a structured database called market:data with internal and external property market information. And to make our own business processes even more efficient and even faster, we launched several Smart Process digitalisation projects for our back office. Our clients also benefit from these projects since the increasing complexity of transactions makes it necessary for the processes running in the background to execute demanding tasks smoothly, quickly and inexpensively.

Christof Winkelmann,
Member of the Management Board
of Aareal Bank AG

International presence and cross-border financing

Worldwide and around the clock: With our presence in numerous countries in Europe, North America and the Asia-Pacific region, we have been adapting to the increasing globalisation of the financial and property markets for many years. We offer our national and international clients comprehensive property financing solutions and guarantee competent advice and support around the globe.

We have steadily expanded our market positions abroad, most recently in the USA and Canada in particular. We entered the Australian market in 2018. In Europe, too, we were once again the first choice for many international property investors for complex cross-border financing in the past financial year. These included Apollo Global Management and the hotel property company Pandox.

Apollo Global Management

APOLLO

Debt Facility for up to

EUR 800,000,000

For the financing of a
pan-European logistics portfolio

Agent, Arranger and Lender

In the summer of 2018, Apollo Global Management commissioned Aareal Bank to finance a pan-European portfolio of logistics properties. The five-year loan facility of up to € 800 million provides the Apollo Global Management funds with stability, security and flexibility for their growing and diversified portfolio of logistics properties across Europe.

"We are delighted with Aareal Bank's ability to provide our funds with a stable, long-term facility that will support the growth of our logistics property platform over the coming years. Aareal Bank accompanied the entire process extremely efficiently."

Dominik Jais, Partner,
European Principal Finance at Apollo

Pandox AB

In the autumn of 2018, Aareal Bank AG provided a five-year € 447 million financing for a European hotel portfolio owned by Swedish hotel property company Pandox AB. The portfolio comprises a total of 14 high-quality hotels with altogether approximately 3,600 rooms in the upper full-service segment, situated in first-class locations in Belgium, Germany, Austria and the Netherlands – including the Brussels Crowne Plaza, the Radisson Blu in Cologne, and Amsterdam's Park Hotel.

Pandox

EUR 446,700,000

For the refinancing of the
Project Mountain Portfolio
with 14 hotels in Austria, Belgium, Germany and The Netherlands

Agent, Arranger and Lender

"Aareal Bank already supported us with financing for a part of the portfolio in 2016. The working relationship with Aareal Bank has been excellent: thanks to their outstanding expertise in financing complex pan-European hotel portfolios, we were happy to expand and extend this cooperation in 2018."

Liia Nõu, Senior Executive Vice President and CFO at Pandox AB (publ)

Further outstanding international financing projects in the financial year 2018

ANGELO, GORDON & CO.
Normandy
GEORGE COMFORT & SONS, INC

USD 315,000,000

For the senior financing of the
575 Lexington Avenue
Office Building New York, USA

Senior Mortgage Administrative Agent and Lender

ERETZ GROUP

USD 145,000,000

For the senior financing of
The Argonaut Building
New York, USA

Administrative Agent and Lender

savills investment management

EUR 102,243,000

Cross-border investment facility for the financing of a portfolio of
two prime logistics properties
in The Netherlands and Finland

Arranger and Lender

J.P.Morgan Asset Management
LGT Capital Partners
your partner for alternative investments

EUR 171,920,000

For the financing of the
Queen Office Portfolio
in Germany

Arranger and Lender

CAD 287,160,900

For the financing of
a portfolio of 16 hotels
across Canada

Administrative Agent, Arranger and Lender

Additional financing examples:
aareal-bank.com/en/products-consulting-and-solutions/property-investors/deals/

The Aareal Client Cockpit

The Aareal Client Cockpit is a future digital interface between our clients in the area of Structured Property Financing and Aareal Bank. Here they can access all important papers and efficiently exchange documents and information. The aim of the Aareal Client Cockpit is to guarantee our clients a high level of process transparency and to enable them to communicate with us even faster and more efficiently.

”Via the Client Cockpit, clients can access a wealth of information and see at a glance what the status of the credit initiation process is. For example, they can see which process steps have already been completed and which ones are still pending. Clients can create and edit tasks, upload and save documents and send messages to project partners,” says Bastian Haider, Project Manager of the Aareal Client Cockpit. ”During the development of the cockpit, it was particularly important to us that it not only offers a variety of functions and avoids unnecessary media discontinuity, but that it is also very intuitive to use and that our clients find their way around this platform immediately. That is why we worked with users throughout the development of the prototype and directly implemented their comments and requests.”

The new Aareal Client Cockpit was presented to the industry for the first time at Expo Real in autumn 2018. It will be launched on the market in the course of the 2019 financial year.

The smart back office

In our back office we also rely on innovative digital solutions. The special feature: All solutions are coordinated with each other and are complementary. They provide a better data situation, higher efficiency and greater transparency in all our administrative processes.

Our most important projects include market:data, Smart Process and Aareal Loan File 2.0:

// market:data is a database in which numerous information relevant to property financing is summarised. It contains internal and external market data as well as macroeconomic indicators. Using a web-based geo-tool reminiscent of Google Maps, the data is visualised so that the user can quickly gain an overview of the environment and compare it with the figures for the selected location. The data is stored centrally and may be evaluated according to various criteria.

// The purpose of the Smart Process project is to digitalise our business processes. To that end we analyse all processes in which a relatively large number of paper-based documents are still used and media discontinuity frequently occurs. The first process digitalised under the Smart Process project is the credit initiation process, for which we are currently developing a digital solution called DealFlow.

// In 2017, we introduced the Aareal Loan File, an electronic credit file which we are now developing further with the Aareal Loan File 2.0 project. The aim is not only to create a digital archive, but also to provide a comprehensive document management system in order to be able to access drafts, e-mails and supplementary data relating to the credit file with little effort. Aareal Loan File 2.0 is intended to create an end-to-end digital process chain and thus make systematic evaluations and queries possible. This makes daily business in credit processing considerably more convenient and secure.

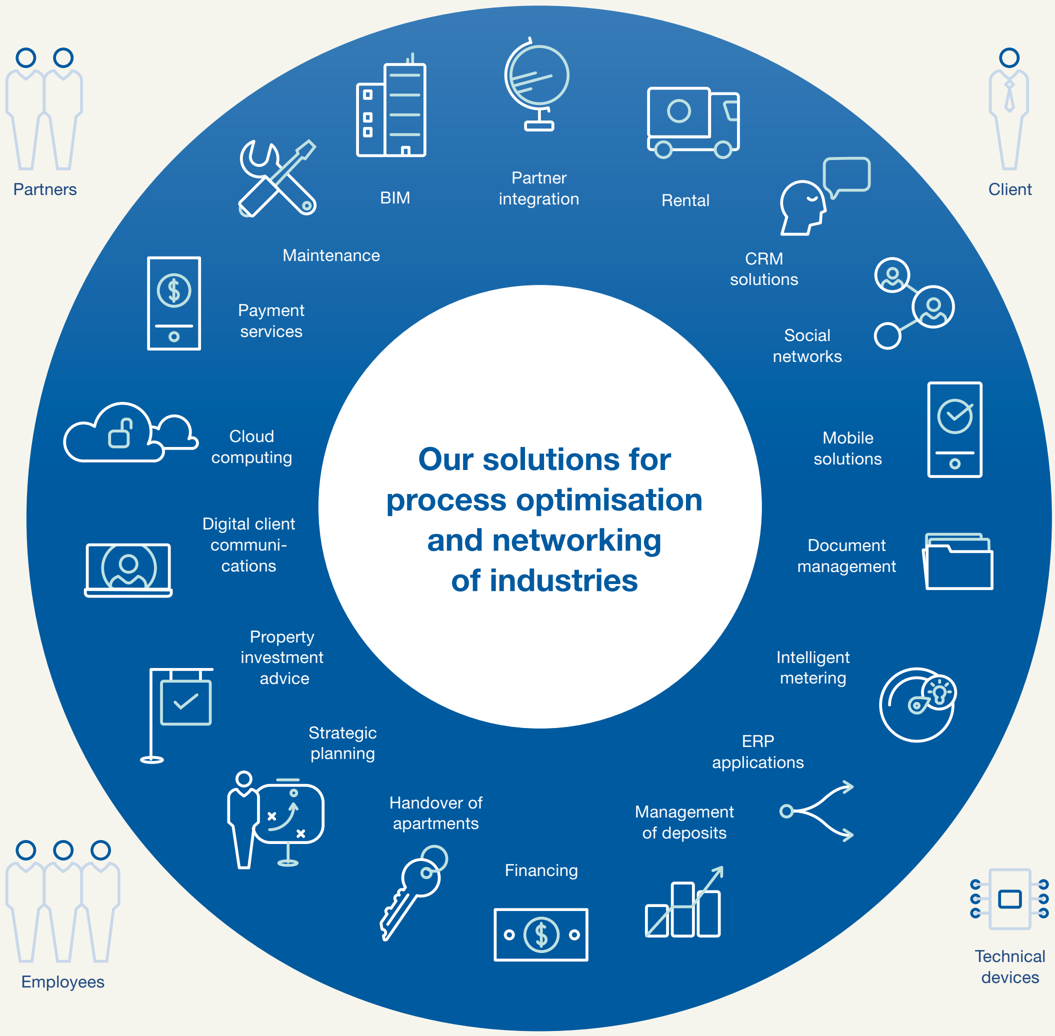
Consulting/Services

Smart ideas for a connected world

A smart future

The property industry is going through disruptive changes, with technological innovations and digital solutions creating a new demand, new opportunities and new potential for value creation. Nobody knows what the property industry will look like in a couple of decades. One thing, however, is for sure: the supply and demand structures that will dominate the market of tomorrow will be more complex, and more challenging than ever before.

Consulting/Services strives to support clients in their digital transformation process to make sure they are future fit, by providing advice and digital solutions. We help to make processes simpler, to connect market participants and industries, to optimise the service property companies provide to their customers and to establish new business models – to the benefit of our clients.



Aareon Group

Consultancy and IT systems
house for the European property industry

No. 1 provider of **ERP systems**
for the institutional housing industry in Europe – e.g. in Germany and France

€ 236.6
million in sales revenues

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

€ 10.4
billion in deposits (2018 avg.)

>145
million entries per year

"We are business enablers"

Mr Ortmanns, the housing, energy and utilities industry is undergoing radical change. Where do you see the biggest challenges for your clients?

It is now common knowledge that technological advances are fundamentally changing business models, needs and supply patterns and most of our clients have already more or less responded intensively to increasing digitalisation. However, there are a large number of changes taking place in parallel: in addition to digitalisation, examples range from demographic change, the trend toward internationalisation and outsourcing, the availability and use of more and more data, the sharing economy, e-mobility, smart cities, and sustainable development to the change in energy policy. I believe that taking all these changes into account to be able to continue operating successfully as a company in the housing, energy and utilities industry is currently the greatest challenge facing our clients.

What does Aareal Bank offer to help its clients with this?

Our forward-looking consulting and services guide our clients through this ever more complex environment. We aim to be a pioneer and a partner by their side in the digital age and to provide them with new development opportunities alongside their established business. That is why we see ourselves as business enablers for our clients. Our international nature enables us to leverage models and experience and adapt to the markets of our clients.

What form do these services take exactly?

We offer our clients a whole host of services. Many link the property and housing industry with closely related ones like the energy and utilities industry. First of all, this encompasses traditional payments products and services, and especially the range of services provided by BK 01 – a system which is integrated with leading ERP systems in the industry, closely connects account maintenance and accounting systems, and thus helps to comprehensively automate payments systems. We have systematically improved and expanded BK 01 over the past few years. We also recently designed and launched the Aareal Portal to enable our clients to carry out their payment transactions even more efficiently and effortlessly. Through our Aareon Smart World we offer property companies and their partners a complete digital ecosystem in which many innovative solutions are available to our clients. Examples include Aareon occupant change management and the Mareon service portal that simplifies the cooperation between property businesses and trade enterprises.

What direction is the market going in?

I am convinced that there are two areas in particular that would allow our clients to leverage much potential and added value: the first is optimisation and efficiency-boosting of business processes. This primarily applies to liaison between the industries since there are media issues and/or incompatible systems between the property industry and closely related sectors all too often. The other area is new communication processes. The way in which property companies exchange information with their customers and/or suppliers will change significantly in the years to come. Preparing for this early on will enable the benefits of digitalisation to be reaped significantly.

Thomas Ortmanns,
Member of the Management Board
of Aareal Bank AG

Connecting payments and data exchange

Aareal Portal

Our Aareal Portal has become an important gate for our clients to access their accounts with Aareal Bank. The portal supports clients in mapping their internal processes – e.g. by offering the ability to structure account access as well as read-only access and payment authorities, through the management of SEPA mandates, or by saving beneficiary templates. Within the portal, users can monitor their transactions, check their account data and manage all major payment procedures. In the future, this will include financings, investment management, communications with Aareal Bank, strategic planning, and much more.

Aareal Portal is a web-based application. As such, there is no need for clients to install additional software. The Portal also allows for accounts held with other banks to be included. An intuitive user experience, together with numerous useful functions such as collective orders, SEPA mandate management or a list of recipients, will make banking through Aareal Portal even more efficient, flexible and transparent.

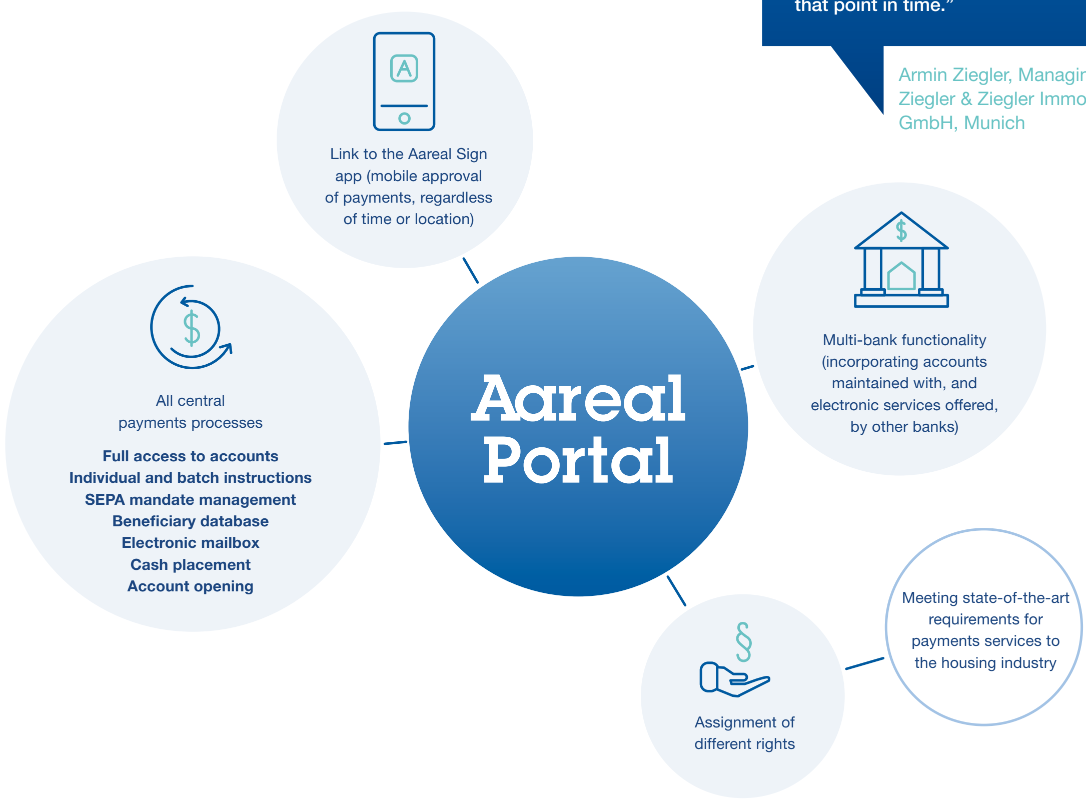
Users can customise the interface to meet their own ideas, and of course clients may grant different rights to different users. Thanks to its online availability, they are able to access Aareal Portal from any location, any device and at any time. In addition, Aareal offers an app – Aareal Sign – for signing off payments in the Aareal Portal from a smartphone.

”Unfortunately, it is not a given that you can integrate accounts held with third-party banks into corporate client platforms, to make sure you stay on top of things. For us, the clearly-structured Aareal Portal is the best solution in this respect as well.”

A. P. Thomas Moraux, shareholder,
1 Berlin x GmbH & Co. KG, Berlin

”Not only is Aareal Portal a better structured and clearer to use alternative than many other payment platforms, it also comes with great value-adding features. Just one example: I can now sign off payments whenever necessary, no matter where I am at that point in time.”

Armin Ziegler, Managing Director,
Ziegler & Ziegler Immobilien und Verwaltung GmbH, Munich



BK01 Family

Aareal BK01

Aareal BK01 offers account management systems that reflect the Company's individual business model, secure and easy-to-use electronic banking functionalities, and many other advantages relating to incoming and outgoing payments. Aareal BK01 is a system for automated payment transactions and relevant processes, and is closely intertwined with the leading ERP systems of the housing and energy industry. For many years, it has been the dominant integrated payment solution in the property and housing industry.

To improve data exchange between the property and housing industry on one side, and energy and waste management on the other side, we have expanded our BK01 family to include BK01 immoconnect and BK01 eConnect. The aim is to better align the processes between these two industries, and ensure efficiency in data exchange.

BK01 immoconnect

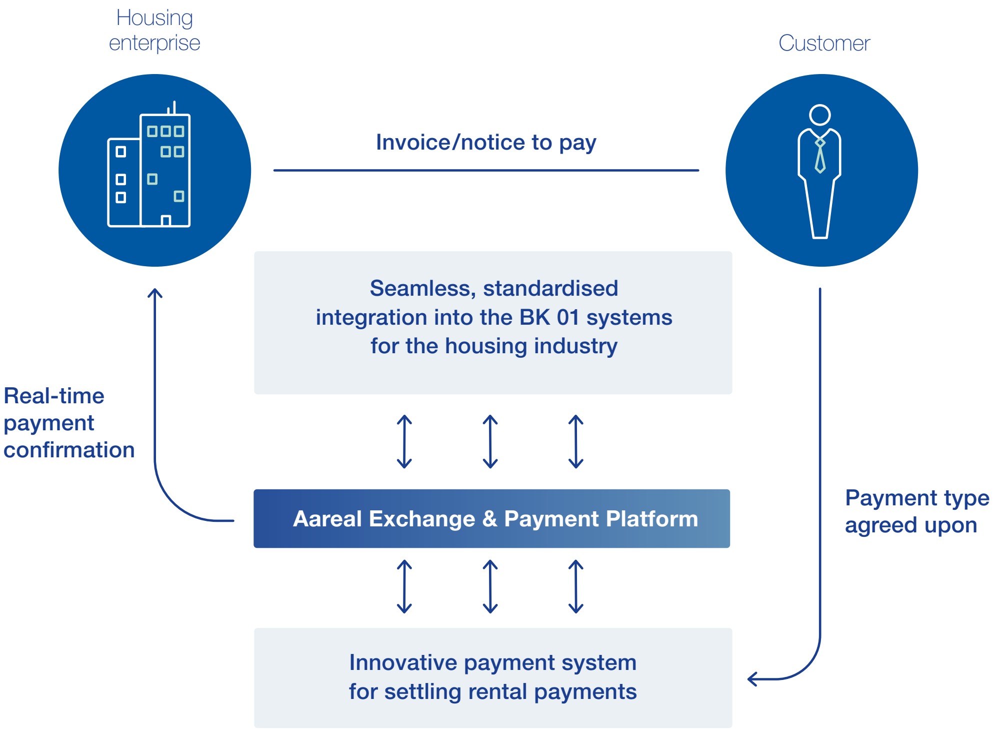
BK01 immoconnect for the energy and waste disposal industry is the perfect counterpart to BK01 Operating Cost Management for the property and housing industry: it allows for a broadly automated data process in the billing of electricity, gas and water supplied by utility providers to housing enterprises, as it reduces the high manual workload that comes with a large number of properties and tenants (for example when managing advance payments on utilities and making out the final invoices, or when allocating lump sum payments to various lines of utilities consumption).

BK01 eConnect

With BK01 eConnect, energy and waste disposal enterprises can issue their electronic invoices in a systematic, standardised and automated manner. The relevant data can be compiled according to individual requirements and in various formats. BK01 eConnect supports all major file formats and modes of transmission so that invoicing data can easily be exchanged between various systems. This reduces the high manual workload associated with preparing electronic invoices for one customer at a time.

During the year under review, we further improved both of these cross-sector products to make processes leaner and increase their scope of application.

Link to the explanatory films on BK01 (available in German, only):
ar.aareal-bank.com/2018/article/our-segments/consulting-services#sec-10



Solutions 4.0

BK 01 for local authorities

Local authorities charge their clients from the property, housing, energy and waste disposal industries with many different types of levies. The complexity of this process results in a high administrative workload – and therefore in high costs – both for the local authorities, and for the relevant companies. Efficiency can be enhanced where action for further digitalisation is taken.

Our BK 01 is a well-established product family dedicated to efficient solutions for digital payments and invoicing systems, so it is only natural to expand it to include a solution for local authorities. This solution will be connected with the existing systems for the property and housing industries, as well as – later on – with the system for the energy and waste disposal industry. Amongst other features, BK 01 for local authorities will allow for payments and debits of various levies to be automatically integrated into property management accounting.

Aareal Exchange & Payment Platform

As digitalisation has accelerated over these past years, the market for alternative methods of payment has grown too. More and more payment methods have become available above and beyond traditional bank payments such as transfers or debits. A vast number of payment solution providers have developed individual processes and interfaces, largely for their own systems.

With our Aareal Exchange & Payment Platform, we would like to enable our clients to manage all major payment solutions in their ERP system – with no need to integrate various payment methods into their respective systems on a project-by-project basis, saving time and money. Users of the Aareal Exchange & Payment Platform can increase customer satisfaction and improve payment behaviour by offering their own clients numerous innovative payment options, while also optimising their own processes.

Connecting market players

Aareon Smart World

Digital applications have changed our daily lives: we communicate, shop and pay using interconnected services and are online most of the time, both in our professional and private space. The property industry is no different. Here, digital solutions generate significant efficiency enhancements and give rise to new business models, services and processes.

Aareon Smart World is Aareon's digital eco-system for property industry enterprises and their partners: it brings together the industry's different players. This includes linking the data streams of the landlords, tenants and service partners registered on this platform with each other, using uniform standards and powerful interfaces, so that data and other information can be exchanged frictionlessly. With this approach, Aareon Smart World offers more transparency, more comfort and faster processes, while also opening up new business models for property industry enterprises.

Aareon Smart World provides the digital platform to manage complex structures and correlations. Both the complete customer management cycle and the various business processes found in the property industry can be managed at every step along their way: from property viewing to signing a rental agreement, from landlords communicating with management agents, tenants with owners and service partners, to terminating a rental agreement. With Aareon Smart World, a lack of interfaces, multiple entries of data that has already been digitalised and inconvenient workflows are things of the past.

Mareon

Mareon is a web-based service portal which connects property companies and craft trade enterprises on a virtual platform. Data which has been compiled once can, henceforth, be used by all contracting parties; furthermore, parties involved are able to determine the order processing status at all times, reducing administrative expenses, accelerating processes, and leading to higher transparency – to the benefit of all parties.

Specific savings potential depends on the depth of processing, with which the collaborating partners incorporate the portal into their workflow. However, experience shows that using the portal saves between 40 and 70 per cent of time required for invoicing processes, and reduces processing cost per invoice by up to 50 per cent.

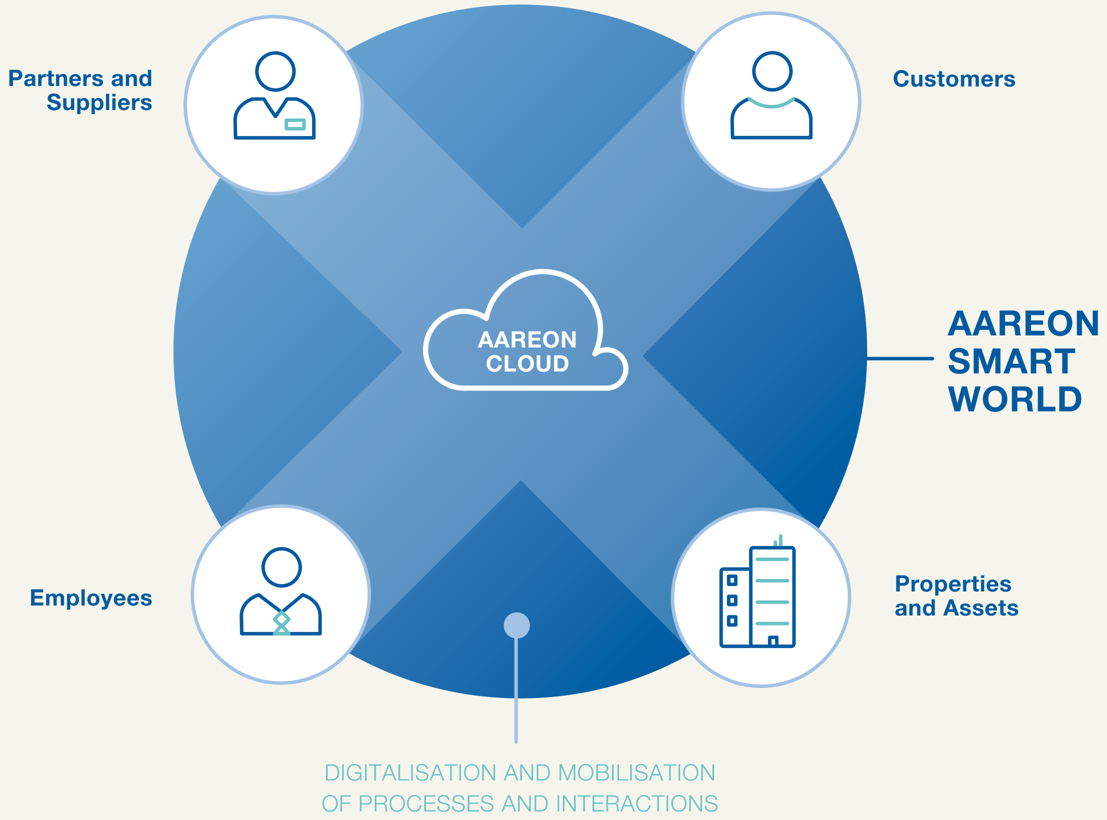
Mareon has been continuously expanded, since it was established more than 15 years ago. The Mareon tradesmen connection comprises a qualified digital signature, the electronic file (a separate archive is no prerequisite), and the opportunity to obtain quotes. The Mareon web app allows craftsmen on the job to access their orders, and further process these orders at all times, e.g. by uploading photographs. In future, Mareon will also support inventory data maintenance; craftsmen will, for example, be able to capture newly created elements when preparing the invoice, and transfer them into the ERP system Wodis Sigma when sending the invoice.

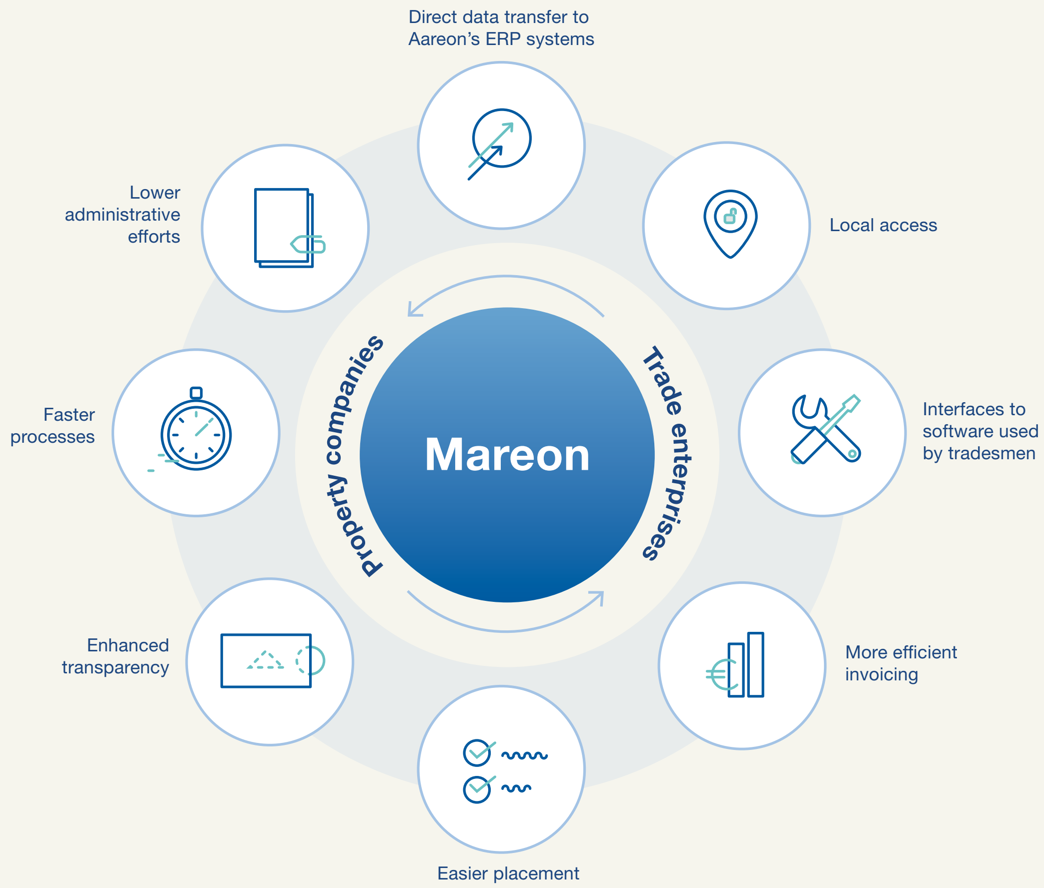
In the meantime, approximately 300 property companies managing more than 2.65 million units use Mareon, along with more than 8,500 craft trade enterprises; to date, 24 million orders and invoices have been settled via the solution.

"We are making savings of between 800 and 1,600 man-hours per year."

Thomas Klapdor, Member of the Management Board of Viersener Aktien-Baugesellschaft AG

Managing supplier relations
youtube.com/watch?v=l1m5qAaS0Qk
Mareon and KIWI (available in German, only):
youtube.com/watch?v=3HZcSHL-aNI


Partners and Suppliers
Customers
AAREON CLOUD
AAREON SMART WORLD
Employees
Properties and Assets
DIGITALISATION AND MOBILISATION OF PROCESSES AND INTERACTIONS


Direct data transfer to Aareon's ERP systems
Local access
Interfaces to software used by tradesmen
More efficient invoicing
Easier placement
Enhanced transparency
Faster processes
Lower administrative efforts
Property companies
Mareon
Trade enterprises

Aareon Occupant Change Management

Occupant changes frequently involve significant efforts, with a variety of data to be collected as part of the handover. This includes meter readings to be documented; in the event of a vacancy (i.e. when the new occupant does not move in on the same day that the previous occupant moves out), this needs to be forwarded to the utility and the metering service. In this case, the housing company has to take over the contracts for the vacancy period – however short it may be. Nowadays, data is exchanged manually, whereby companies often miss relevant deadlines for the transfer of information – or processes cannot be started due to missing information. The number of cases requiring clarification is high; researching facts involves significant efforts for all businesses involved. Often, end-customers are no longer available to clarify facts.

In order to simplify this complex process, Aareon developed Aareon Occupant Change Management. This digital cross-industry solution links the most relevant parties involved in the process: housing companies, heat metering services, and utilities. It also provides all partners with the relevant data they need – on an automated basis, in time, and prepared in the required format. The result: less effort, less mistakes, hardly any need for clarification, and significantly more transparency.

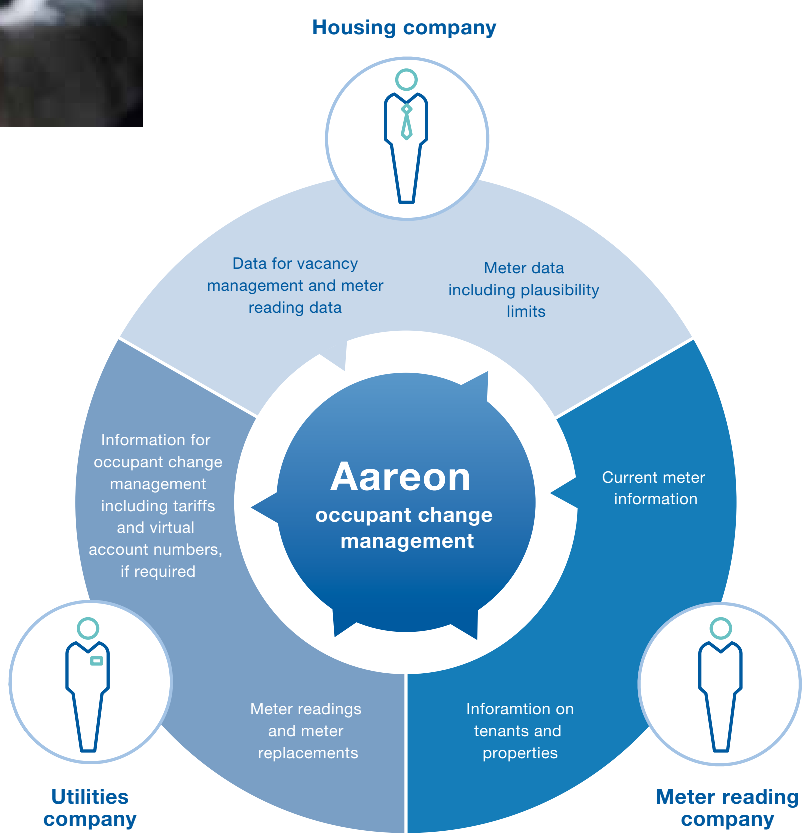
Aareon Wechselmanagement
(available in German, only):
youtube.com/watch?v=vVH_Vx7glyw

”Techem’s definition of plausible intervals for meter readings and the electronic transmission of values significantly reduces susceptibility to errors.“

Harald Lehmeier, Head of Product Management – Digital Services at Techem Energy Services GmbH

”We use Aareon Occupant Change Management for an automated data exchange with the public utilities or the heating cost service company. Within this context, we rely on Aareon. The company cooperates with the partners, sets standards, and ensures the correct exchange formats are prepared. In-house programming cannot accomplish all of this.“

Thomas Harry Strecker, Rheinwohnungsbau GmbH



"Yespark filled 80 % of the parking places they handle for Valophis while these parking places had been vacant for a long time."

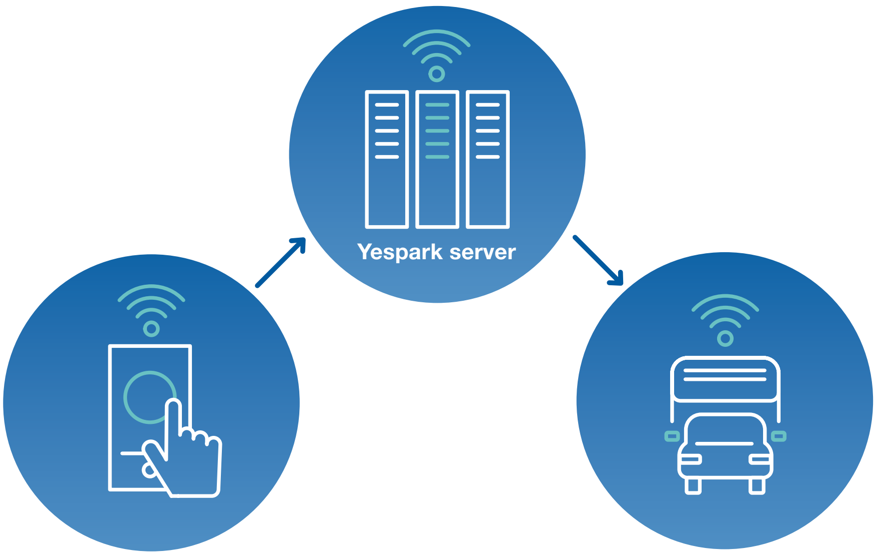
Arnaud Suard, Marketing and Quality Director at Groupe Valophis

Yespark

Aareon has embarked upon in-depth cooperations with numerous other enterprises in order to further expand its range of digital solutions within the Aareon Smart World. This includes PropTechs: collaboration particularly with young start-up enterprises enables Aareon to seize the latest ideas and innovations for the property industry at an early stage, turning them into ground-breaking, value-adding solutions for its clients.

Yespark is one of the PropTechs that Aareon entered into a partnership with in 2018: the French start-up has developed an app offering parking spaces within private residential complexes to vehicle drivers. The Yespark network currently comprises more than 25,000 parking spaces which users can rent in underground car parks across the country.

Using the app, drivers can see available parking spaces which they can book via their smartphone. Once they have made a booking, the app will provide the exact details, as well as access to the private car park, with the fee charged via the app. Since app users searching for a parking space identify themselves in this manner, YesPark ascertains quality, cleanliness and safety – whilst providing housing enterprises with revenue through renting out unused parking spaces. The environment benefits as well: shorter searches mean less fuel consumption as well as reduced noise and pollution. A true "win-win-win" situation.



A new kind of workplace

None of us know what the world will look like in 15 or 20 years' time. One thing is clear though: it is becoming increasingly networked, and it is changing faster than any of us could possibly imagine. This has a significant impact on the way we work and interact within organisations.

Digital technology in particular enables (and requires) new forms of collaboration between employees, and also between employees and machines. This means that the demands placed on those involved continue to grow, as do those placed on business processes and structures.

As part of its "Aareal 2020" programme for the future, Aareal Bank Group is working hard to address the challenges facing tomorrow's working environment, in order to take advantage of opportunities arising from new forms of work and organisation as early as possible. That is why we are heavily involved in developing 'new work' concepts, enhancing our corporate culture and raising our employees' awareness of issues such as agile project management and new workplace infrastructure.

Essentially, the question is how we want to work together in the future – in order to continue being successful as a company. The answer lies in the need for conscious design of communication and collaboration across the board, both of which help to create greater transparency among each other – about where we stand in our ideas for our clients. This is why in 2018 our leadership model has been aligned to these aspects, among other things. There are many more initiatives in our organisation which are helping us to promote this attitude. Here are some examples:

"work4future"

Aareon AG, in its capacity as an innovative company, launched the "work4future" project back in 2017. Based on the existing principles of a human resources policy aligned to different phases in life, it focuses on enhancing work models, especially in light of increasing mobility, effective and smart employee collaboration, and the digital workplace.

Open-space conference area

An open-space conference area with plenty of room for ideas, agility, flexibility and creativity – all of these aspects were at the heart of the redesign of Aareal Bank AG's conference area in Wiesbaden. Not only have new rooms been created, but a supportive infrastructure for "new-work" concepts has been established.

Innovation get-togethers

Aareal Bank AG's innovation get-togethers ensure that knowledge is shared on relevant technology trends and innovation topics. Internal and external speakers provide new insights, ideas and inspiration across all departments.

IT Vernissage

The concept of an IT "vernissage" aims to facilitate the sharing of knowledge among colleagues. The idea behind it is that IT employees present results and findings gained from their own various projects and initiatives to each other, and to any other employees who may be interested. In doing so, they are successfully using agile methods and formats.

Innovation blog

The innovation blog is where employees can share their experience and expertise. These insights, especially into new forms of cooperation with clients, internal divisions and research centres, make it easier for other colleagues to get to grips with similar issues.

Bankathon

Taking part in the Bankathon, a FinTech and banking hackathon that brings together the various players in the financial sector all on an equal level, leads to a flood of new ideas and experiences every year. There really is no other place like this – a place where you will find so many innovative approaches and promising process and product improvement ideas.

”The Enablers“

For things to change, someone needs to enable the transition for others. It’s a whole new form of development work.

Fairy tales for children start with ”once upon a time” and those of adults with ”once upon a time, everything was better” or ”easier” or ”clearer”. What about nowadays? These days people’s heads are spinning from so much complexity, connectivity and all things digital. The transformation is changing every area of life. Can anybody really make sense of it all? Let’s stick to telling fairy tales.

Now fairy tales are fairy tales because they are known for warping reality. What does not fit is made to fit. People need fairy tales to deceive themselves into believing that everything in the world can go well, whether they do something for it or not. Shape? Do? Act? That’s not the stuff that fairy tales are made of. Spoil the idyll and you are in trouble.

There have always been storytellers aplenty and people to listen to them, which is also the case in a world in which affluence and growth are considered self-explanatory and not everyone questions where it comes from. Yet there is no secret formula that automatically guarantees a sound future, a better world for us and our children and grandchildren or more humane solutions than we are aware of today. Nothing changes on its own.

Affluence is always the result of activity, of the ability to decide, to act and to shape the present and the future. Affluence is not a fairy tale, affluence is not fate – it requires hard pragmatic work. That is reality.

And it is something that you ought to be aware of in Europe at least. More than 2,000 years ago, the philosopher Aristotle came up with his Vita Contemplativa concept of an observant, secluded and reflective life, in which the reality of the world is examined and attempts are made to understand it. Aristotle considered it to be the opposite of Vita Activa – an active life in which we shape and change because we are in a position to do so.

Wolf Lotter,
Business journalist
and book author

This was a contradiction for years but it can no longer remain so. If you want to shape the world and not just manage your connectivity and rapid changeability, you have to do both: think carefully, i. e. not believe in fairy tales and want to understand reality, and do, act, and decide. Do both. Shaping requires shapers.

Routine work is increasingly being carried out by robots and algorithms, which will further advance specialisation in all areas. It is about allowing talent to flourish optimally. About doing what you can best. You have to create a suitable framework with much leeway and much development potential, optimising results for everyone. For this to work in business and throughout society, you need leadership. Leadership is much more than management. It is more than the ability ”to do things right” as Peter Drucker, the mastermind of our knowledge-based society, put it. It is more than merely ”running the show”. They are being asked to enable the future.

Enablers are the real innovators of our time. They let others go ahead, they foster talent according to strengths and pave the way for them. Their work is about helping others forward, both clients and employees, because they know that this is what advances everyone. They do their best and allow everyone else to do so. For this work, you need curiosity, optimism, courage, and a sense of reality. Enablers love to venture to gain – an experiment that plays such a major role in modern-day history when identifying a better alternative to what currently exists. For those who like a fairy tale, the word experiment leaves a stale after-taste – you quickly find yourself a guinea pig. However, that only serves to prove how important the enabler is in conveying the culture of self-confidence and independence throughout the world. Helping others to identify and seize their opportunities also gives them the self-confidence they so urgently need today. This results in people who are more entrepreneurial and self-determined with more opportunities. And fewer fairy tales.

The transformation needs realists, shapers and people who can think for themselves. They are the development workers for a better world.

To our Shareholders

Setting milestones. Creating prospects.

from left:

Marc Hess
Member of the Management Board

Dagmar Knopek
Member of the Management Board

Hermann J. Merkens
Chairman of the Management Board

Thomas Ortmanns
Member of the Management Board

Christof Winkelmann
Member of the Management Board

Christiane Kunisch-Wolff
Member of the Management Board

Letter from the Management Board

Dear shareholders,
business associates and staff members,

The 2018 financial year, which we will give an account of in this report, presented Aareal Bank Group – and our entire sector – with major challenges once again: whilst the economy has proved relatively robust to date, albeit less dynamic than in the previous year, the outlook became more clouded towards the year-end. The low interest rate environment persisted, a wide range of political uncertainties increasingly overshadowed global economic affairs, and competition intensified further in our most important markets. The conditions under which we operate turned even more difficult – not least due to persistently high regulatory requirements.

In this challenging environment, Aareal Bank Group remained on its positive trajectory during 2018, thus following on seamlessly from the previous successful years. And that was not all: we have taken further important steps to cement our way to a sustainable and successful future. Our Company remains in a good shape today, and we are prepared to meet the challenges that lie ahead: robustly and soundly capitalised, even taking into account (or in anticipation of) all current and foreseeable regulatory projects, profitable in the operating business, regardless of all uncertainties and adversities, and strategically well positioned in all of this.

The good figures of the previous financial year are once again an impressive testimony to this. At € 316 million, consolidated operating profit, which is our central operating indicator, was within the previously communicated target corridor of € 312 million to € 352 million that had already been increased. As previously announced, this result includes a positive non-recurring item (negative goodwill) in the amount of € 55 million from the acquisition of Düsseldorfer Hypothekenbank AG (Düsselhyp), a transaction that was closed at the end of 2018, with all material financial indicators being in line with our forecasts. The return on equity before taxes, including the Düsselhyp effect, exceeded the original target range. We were able to increase the earnings allocated to ordinary shareholders by 9 per cent over the previous year.

Aareal Bank wants its shareholders to once again participate adequately in a good result. The Management Board and the Supervisory Board will therefore propose at the Annual General Meeting – to be held on 22 May 2019 – to pay a dividend of € 2.10 per share. Based on the earnings per ordinary share (excluding the non-recurring Düsselhyp effect), this distribution equates to a payout ratio of 82 per cent; the ratio is thus at the upper end of the spread of 70 to 80 per cent that had been announced. Furthermore, our proposal generates a dividend yield of around 7.8 per cent, based on the 2018 year-end price. In our view, the payout is therefore attractive.

Our dividend proposal for 2018 strikes a balance between our shareholders' interests on the one hand – and the increasingly uncertain market environment on the other hand. At the same time, it allows us to take advantage of the potential and opportunities that present themselves to our Company. Even though we cannot be satisfied with the share price performance in 2019, this has predominantly been influenced by the general business environment in which we – and other European banks – operate.

In our operative business, we seized opportunities which arose for the Company in 2018, in both segments. This included the value-creating acquisition of Düsselhyp, for example. In the Structured Property Financing segment, we not only expanded our credit exposure in North America. We also enlarged our geographical footprint with first steps such as our market entry in Australia, and explored new asset classes such as student housing. At the same time, we maintained our syndication activities at a high level. Likewise, we continued to advance our digitalisation campaign, positioning ourselves with our investment in BrickVest, a leading European online platform for commercial property investments.

We also reported strong new business in our established financing business, which significantly exceeded the target corridor we had announced. As a result, we were able to moderately expand our loan portfolio. Last year's controlled portfolio growth also represented an efficient use of surplus capital, with targeted margins that remained good, yet without compromising quality.

In the Consulting/Services segment, our IT subsidiary Aareon further consolidated its market leadership in the area of ERP products, whilst successfully marketing its growing portfolio of digital solutions. Aareal Bank also recently acquired plusForta GmbH, a market-leading broker of tenant deposit guarantees in Germany, thereby strengthening its digital solutions offering for the housing industry and the housing industry's clients.

All in all, we can claim to have set the right course with our "Aareal 2020" programme for the future, and to have made significant progress again last year in the implementation process. We thus considerably improved our starting point for future growth in line with our strategy.

What are the focal points we are setting now for the current year – both operative and strategic?

Having built a strong foundation in 2018, with strong new business origination, we can operate selectively in structured property financing in an increasingly difficult market environment. Our main focus will be on maintaining our property lending volumes 2019, in line with the level at the 2018 year-end. Our broad-based position allows us to allocate new business to the markets and asset classes offering the most attractive risk/return profile, while adhering to our conservative risk policy at the same time. Nonetheless, Aareal Bank is – and remains – ready to provide financing solutions on all of its key markets.

Our focus in the Consulting/Services segment in 2019 will be on significantly accelerating Aareon's growth in digital products and solutions. We already generated double-digit growth rates in digital products in previous years, having firmly established ourselves as a high-profile point of contact beyond the traditional ERP business – with our existing client base as well as with new clients. On this basis, we are now expanding with a dedicated investment programme, whereby significant additional investment resources will be made available, primarily for internally-developed digital products, in order to accelerate growth. Thanks to the performance levels achieved, together with the underlying growth, Aareon will be in a position to finance these additional initiatives internally. As in the past, growth will be supported by targeted acquisitions. These measures aim at considerably helping to double Aareon's earnings contribution over the medium term – that is, until 2025.

As was outlined in "Aareal 2020", our earnings mix at Group level will continue to shift increasingly in favour of net commission income. Accordingly, Aareon's contribution will grow noticeably, as will the contribution of non-interest business in the Consulting/Services segment.

The continued expansion of initiatives launched with "Aareal 2020" is our response today to a business framework which we believe will not change favourably for Aareal Bank Group and the banking sector over the medium-term. Higher capital requirements and the persistent low-interest rate environment are key aspects in this connection. Thanks to these initiatives, we will be in a position to maintain our medium-term target return on equity of at least 12 per cent before taxes – despite burdens on income from said factors and additional investment.

We anticipate various special effects to materialise in 2019. Besides the integration costs associated with Düsselhyp, Aareal Bank's investment programme will have a burdening effect. Moreover, the prevailing low-interest rate environment – as well as the fact that Düsselhyp's portfolio is slightly smaller than originally anticipated – will impact net interest income. Nonetheless, we are confident that we will once again achieve a good consolidated operating profit, in a range between € 240 million to € 280 million. This would mean that we maintain the earnings level of the past financial year, adjusted for negative goodwill – which would represent a great success in a deteriorating environment.

Our interim conclusion is that overall, we can look back at the previous year with satisfaction: we can look ahead to the current year with cautious optimism and undiminished confidence as regards our medium- and long-term prospects, as set out in our strategic programme. 2019 will continue to challenge us on the way to our strategic target, namely of being the leading provider of smart financing, software products and digital solutions for the property sector and related industries.

We would like to express our heartfelt gratitude for the confidence you have placed in us, and our chosen path, so far. 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 2020"). 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 ten international capital markets conferences and conducted 15 roadshows in Europe and the US and maintained market communication at a high level overall in 2018 too. Investors greatly appreciate the fact that Management Board members also regularly attend conferences and roadshows in order to be available for personal meetings.

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 2019 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

	2018	2017
Share price (€)[1]		
Year-end price	26.990	37.730
High	42.800	38.400
Low	26.010	33.710
Book value per ordinary share (€)	43.88	43.80
Dividends per ordinary share (€)[3]	2.10	2.50
Earnings per ordinary share (€)	3.48	3.20
Price/earnings ratio[2]	7.76	11.79
Dividend yield (%)[2]	7.8	6.6
Market capitalisation (€ mn)[2]	1,616	2,258

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] 2018: Proposal to be submitted to the Annual General Meeting

Shareholder structure

since 3 February 2015

Analysts' opinions

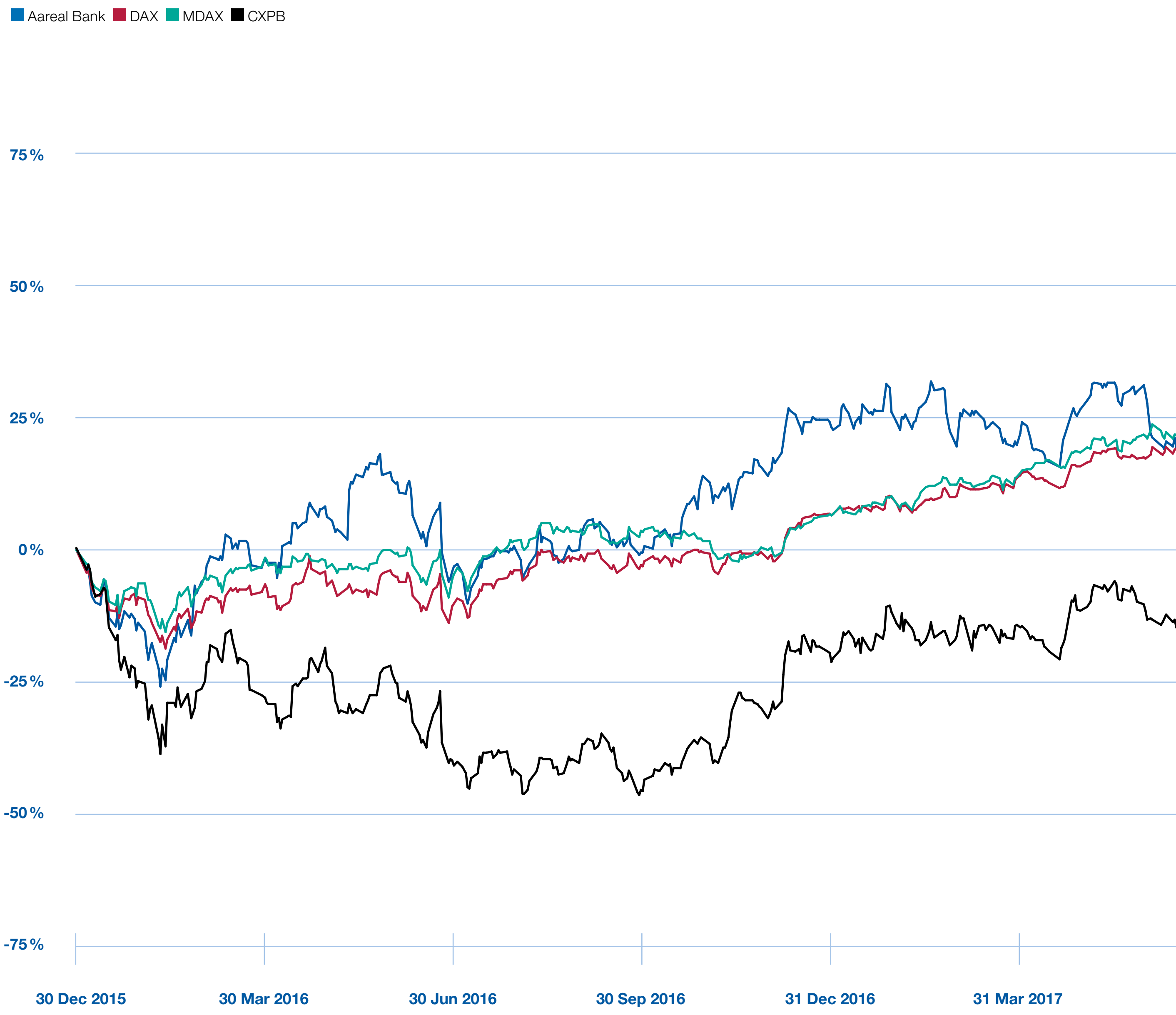
On top of the 14 brokerages and analyst firms that regularly covered Aareal Bank at the start of the financial year, another firm initiated coverage of Aareal Bank, so that at the end of 2018 the number of brokerages and analyst firms publishing independent studies and comments about developments at Aareal Bank Group rose to 15.

Having finished the 2017 financial year on a positive note, Aareal Bank also needed to meet expectations by market participants and analysts in 2018. Aareal Bank fulfilled these high expectations – currently six "buy" recommendations, compared with nine "neutral" recommendations, and no "sell" recommendations at the end of 2018.

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

2016-2018



(1) 28 February 2018
Aareal Bank Group proposes a marked increase in the dividend, from € 2.00 to € 2.50 per share, reflecting a strong financial year 2017

(2) 28 March 2018
Aareal Bank Group publishes its Annual Report 2017

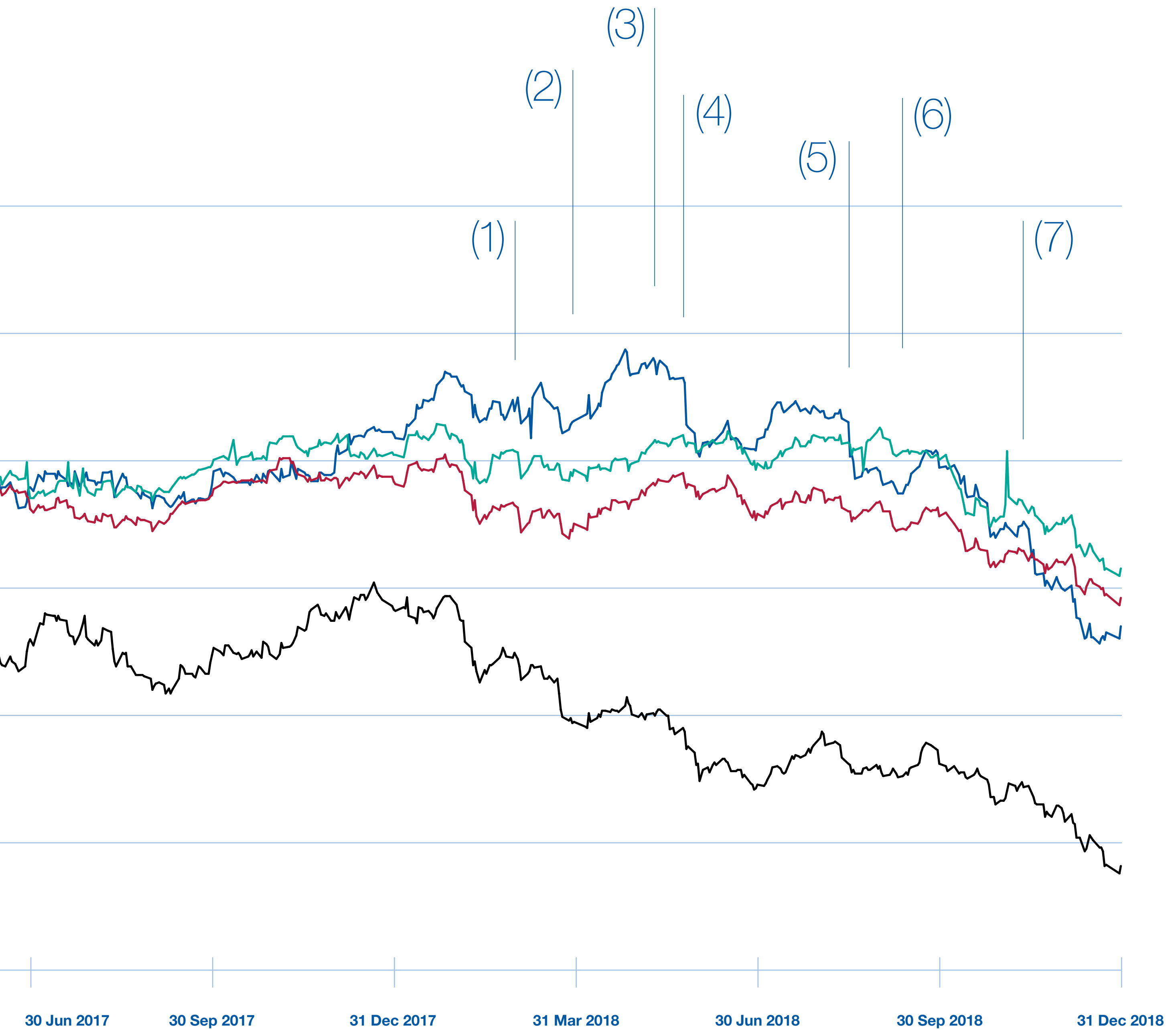
(3) 9 May 2018
Aareal Bank Group posts a solid start to the 2018 financial year

(4) 23 May 2018
Annual General Meeting of Aareal Bank AG resolves to pay a dividend of € 2.50 per share for the 2017 financial year

(5) 14 August 2018
Aareal Bank Group maintains positive business development during the second quarter, affirms earnings forecast for the full year 2018

(6) 10 September 2018
Aareal Bank Group reaches agreement on the acquisition of Düsseldorfer Hypothekenbank AG (Düsselhyp) and raises the earnings forecast

(7) 13 November 2018
Aareal Bank Group affirms its raised full-year profit forecast, after successful third-quarter results



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 a leading 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.

Aareal Bank Group's strategic business segments comprise commercial property finance as well as 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. It stands out here especially for the direct and long-standing relationships it has established with its clients. Aareal Bank finances commercial property investments, especially for office buildings, hotels, retail, logistics and residential properties, with a focus on existing buildings. Its particular strength lies in its success in combining local market expertise and sector-specific know-how. This allows Aareal Bank to offer tailor-made financing concepts that meet the special requirements of its national and international clients. In particular, the Bank excels with its structuring expertise, as well as in 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 Central and Eastern Europe, Northern Europe, and the UK. 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. The branch office in Brussels was closed at the end of 2018. 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 has a broad and solid refinancing base. It has established itself as an active issuer of Pfandbriefe, which account for a major share of its 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. 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. 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.

Consulting / Services

In the Consulting / Services segment, Aareal Bank Group offers its clients from the property 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 can boast the leading international consultancy and IT systems house for the property sector in Europe.

Aareon Group offers its customers consulting, software and services to optimise IT-supported business processes in the digital age. With its Enterprise Resource Planning (ERP) systems distributed from 37 locations in Austria, Finland, France, Germany, the Netherlands, Norway, Sweden and the UK, Aareon generates stable, long-term business volume. 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 Group benefits from a transfer of cross-border 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 process optimisation, electronic banking and asset management and markets its BK 01 software which is the leading 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 AG and the Bank's Housing Industry division work closely together. A large number 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 indicators set out below are key financial performance indicators for Aareal Bank Group; they are used for the purposes of managing the business and the Group's profitability.

- **Group/consolidated:**
  - » Net interest income (in accordance with IFRSs)
  - » Loss allowance (in accordance with IFRSs)
  - » Net commission income (in accordance with IFRSs)
  - » Administrative expenses (in accordance with IFRSs)
  - » Operating profit (in accordance with IFRSs)
  - » Return on equity (RoE; before taxes)[1]
  - » Earnings per ordinary share (EpS)[2]
  - » Common Equity Tier I ratio (CET I ratio) – Basel IV (estimate) –
  - » Liquidity Coverage Ratio (LCR)
- **Structured Property Financing segment**
  - » New business
  - » Credit portfolio of Aareal Bank Group
- **Consulting/Services segment**
  - » Aareon's contribution to consolidated operating profit (in accordance with IFRSs)

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. For example, we manage our new business in this segment using lending policies which are specific to the relevant property type and country, and which are monitored within the scope of the lending process.

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

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

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

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

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, management of the Group entities allocated to the segment is oriented on specific indicators, depending on each entity's business focus – primarily Aareon's contribution to consolidated operating profit. We also use specific performance indicators that are typical for consulting and services in the IT business, the focus of this segment. These include indicators relating to regular client satisfaction surveys, as well as capacity utilisation indicators in the consultancy business. The volume of deposits is a key indicator for the Bank's Housing Industry division.

Report on the Economic Position

Macro-economic environment

In the financial year 2018 the environment was defined by geopolitical uncertainties. Besides the protectionist measures taken in the US, economic imbalances in some emerging markets fuelled uncertainty. The economy remained intact and economic expansion was robust, albeit at a slightly less dynamic pace than the year before. The economic cycle is likely to have peaked overall.

Economy

While economic growth in the euro zone was robust in 2018, it was significantly lower than the year before. This was largely attributable to a fall in external demand and to one-off effects in the respective countries. Spain and the Netherlands recorded the strongest growth within the euro zone, while growth in Germany, France and Italy was markedly below the average. New emissions tests in Germany led to a marked slump in car sales, while growth in France was lower as a result of industrial action. Italy fell into a technical recession in the second half-year as growth eased due to weaker domestic demand in response to political uncertainties.

Economic growth in other countries within the European Union (EU) was higher than in the euro zone. As was the case in the previous year, growth in Poland and Sweden was considerably stronger than in the euro zone.

Growth in the UK on the other hand was weaker, although the economy proved more robust than originally assumed. In addition, considerable uncertainty was created by the exit agreement that was negotiated with the EU towards the end of the year and then rejected by a large majority in the UK Parliament on 15 January 2019. This took enterprises planning certainty.

Solid fundamental data and fiscal stimulus led to strong growth in the US in the year under review while the budget deficit rose significantly. Higher import duties imposed on important trading partners, counter-reactions by the countries in question, and the unilateral termination of international projects heightened political uncertainty and the risk of an open trade war. Growth in Canada was markedly lower year-on-year, on account of less pronounced investment and lower oil production.

Economic growth in Australia was significantly stronger year-on-year. The Chinese economy lost momentum during the course of the year, with slightly weaker exports and the negative effects of high levels of private debt cited as some of the reasons for this. China responded to the import tariffs imposed by the US by also levying import taxes on a raft of US products.

Global labour markets benefited from the fundamentally good economy and the sustained economic cycle. In the euro zone, unemployment rates continued to fall slightly during the year under review, whilst they remained stable, at a low level, in the UK and the US.

Annual rate of change in real gross domestic product

%	2018[1]	2017[2]
Europe		
Euro zone	1.8	2.5
Austria	2.6	2.7
Belgium	1.4	1.7
Finland	2.4	2.8
France	1.5	2.3
Germany	1.4	2.5
Italy	0.9	1.6
Luxembourg	3.0	1.5
Netherlands	2.6	3.0
Spain	2.5	3.0
Other European countries		
Denmark	1.1	2.3
Poland	5.3	4.9
Russia	1.6	1.5
Sweden	2.3	2.4
Switzerland	2.6	1.6
Turkey	2.9	7.4
United Kingdom	1.4	1.8
North America		
Canada	2.1	3.0
USA	2.9	2.2
Asia/Pacific		
Australia	3.0	2.4
China	6.6	6.8
Japan	0.8	1.9

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

Financial and capital markets, monetary policy and inflation

The year 2018 on the financial markets was defined by slightly higher volatility compared with the previous year, triggered by geopolitical events and changes in monetary policy. This resulted in negative effects for some emerging markets in particular. Particular noteworthy in this context was the political situation in Italy, which drove up Italian government bond yields. The fear of a trade war and political turmoil surrounding Brexit also weighed on the markets.

The ECB set the course in the first half of 2018 for a turnaround in its monetary policy. In June, it announced that the net asset purchase programme would finish at the end of 2018. This was confirmed again in December. Monthly purchase volumes of € 30 billion were reduced to € 15 billion in the fourth quarter. No additional assets have been purchased since January 2019 – with only maturing securities being reinvested. Furthermore, the ECB plans to keep key interest rates low through summer 2019. The Bank of England raised the base rate in August by 25 basis points to its present level of 0.75 %. The US Federal Reserve (Fed) increased its Fed Funds corridor four times during the year, by 25 basis points each time – most recently in December, to 2.25 %-2.50 %. The Bank of Canada raised its base rate during the year in three stages, to reach 1.75%. Sweden's Riksbank lifted its main interest rate from -0.50 % to -0.25 % in December.

The US dollar appreciated significantly against the euro, following an initial marked depreciation. The pound sterling on the other hand remained virtually constant vis-a-vis the euro, before losing slightly in value towards the end of the year, due to the political uncertainty surrounding the Brexit agreement. The Canadian dollar weakened considerably against the euro in the first half of the year but managed to appreciate again slightly in the second half, before losing significant ground again at the end of the year. The Swedish krona weakened slightly against the euro over the course of the year.

Short-term interest rates[3] exhibited significant differences between different currencies throughout the year under review, not least due to differences in monetary policy. They increased considerably during the year in pound sterling, the Canadian dollar and the US dollar. They were constant initially in Swedish krona before rising slightly at year-end

[3] Calculated on the basis of 3-month Euribor or the corresponding LIBOR or other comparable rates for other currencies

in the wake of the key interest rate hike. On the other hand, they remained relatively constant at a negative level in the euro zone.

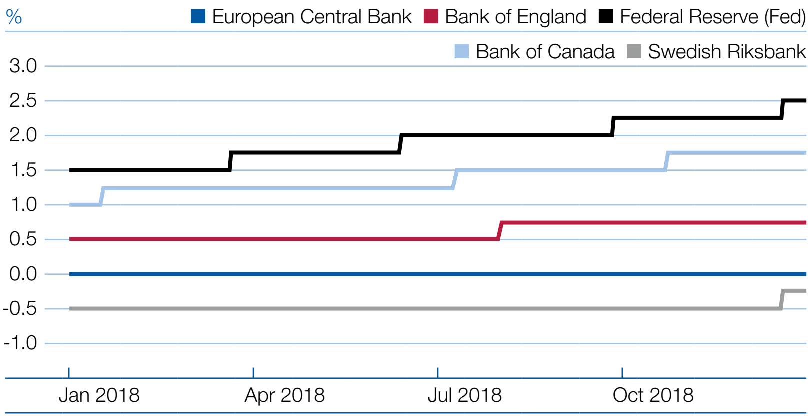
Long-term interest rates[2] in the currency areas that are relevant to Aareal Bank initially rose consistently compared with the end of the previous year, whereas US dollar, Canadian dollar and pound sterling rates were markedly higher at the end of the year, compared to the 2017 year-end. Towards the year-end, euro zone and Swedish krona rates fell back again to (or slightly below) the levels seen at the end of 2017.

The performance of ten-year government bond yields diverged during the year, owing to geopolitical uncertainty and adjustments in monetary policy. They fell in Germany, particularly at the end of the year, to a lower level than at year-end 2017, owing to safe-haven demand. On the other hand, yields in Italy increased strongly. In the first half-year, the Italian government announced a far-reaching, expansive fiscal policy to replace the reform policy of the previous years – which meanwhile triggered a budget debate with the Euro Group. Although yields fell again slightly at the end of the year, they remained high by European standards. The continuous – albeit moderate – upward trend continued in the US, with ten-year government bond yields climbing above the 3.0 % threshold in some instances.

Euro zone inflation rose by just under 2.0 % compared with the previous year. Inflation in the US also rose during the year to average 2.5 %. In the UK, it fell again slightly from the highs of the previous year and remained at 2.5 % for 2018 on average. The driver here was higher energy prices.

Also in 2018 the Pfandbrief market continued to be significantly influenced by the ECB's asset purchase programme. However, the impact declined due to the programme's termination at the year-end and the reduction in purchasing volumes, from an initial level of 50 % of new issues to merely 10 % in October 2018. Credit spreads of new issues increased, especially during the fourth quarter. The volume of private placements continued to decline, whereas the volume of benchmark issues increased.

Key rate developments in 2018[1]



[1] The upper level of the corridor for the Fed Funds is shown in the chart.

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 proposals to revise supervisory regimes (CRR, CRD IV, BRRD and SRMR) 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. In addition, the amendments proposed by the ECB, EBA and the EU Commission on the treatment of non-performing loans must also be taken into account. New requirements related to resolution, such as BaFin's "MaBail" (Minimum Requirements for the Implementation of a Bail-in), which is currently being consulted on, present new challenges. Moreover, both national and inter-

[2] Based on the 10-year swap rate

national 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.

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.

Sector-specific and business developments

Structured Property Financing segment

Unlike previous years, no uniform trend in traded volumes of commercial property could be observed in the course of the year. Whilst volumes in North America rose considerably, they fell sharply in Europe compared with the previous year, remaining stable in the Asia/Pacific region. However, traded volumes remained high overall.

The commercial property markets have been subject to significant changes for quite some time. As a market participant itself, Aareal Bank continuously analyses the environment so that trends can be identified early on. The development in retail trade must be emphasised here initially. Digitalisation has led to a marked change in consumers' buyer and leisure behaviour. Likewise, the demands of a retail property – and of retail traders – have changed. At the same time, we find ourselves in a phase in the economic cycle, in which investor and financing circumstances are changing, the effects of which stand out most in the retail sector. Accordingly, new concepts are being established that support and define the change. Retail property will have a future as new concepts also need to have a physical presence, as is becoming increasingly apparent.

New office property concepts are also being established, such as co-working or the serviced office, where the general trends of the sharing economy and pay-per-use are being applied. One provider offers fully-equipped office space, which users can rent on a variable basis. This will make office rental more flexible, as users are not tied to specific premises and some providers worldwide offer modern office space that can also be used for short periods of time only, if required. These providers already represent the largest tenant group in terms of floor space at some locations.

Very low prime yields were observed on numerous commercial property markets around the world. This compares with the increases seen in secondary market yields on many markets. Rents for prime properties partly were in different phases of their business cycles. In the US, average rental growth in the office market flattened out. In Europe, on the other hand, average rental growth in the office market continued to rise slightly, supported in particular by the high rental volume. In contrast, rental growth for European retail property stagnated, but was still slightly positive in the US.

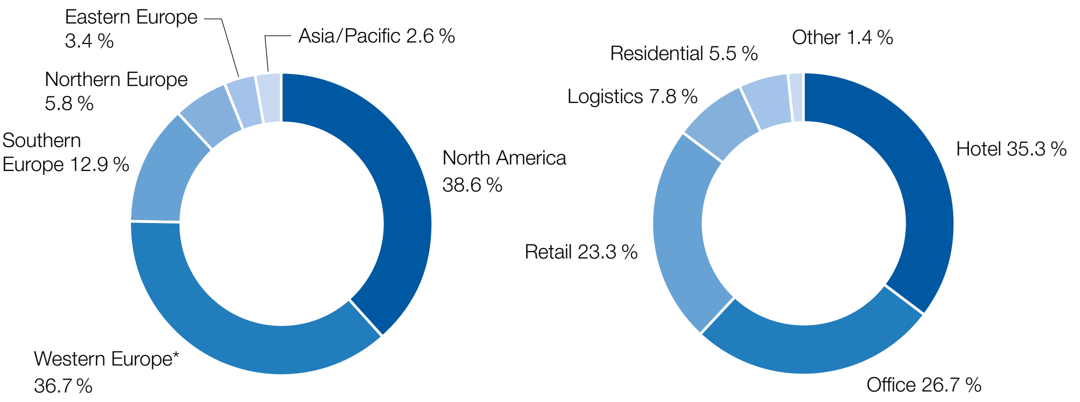
Fierce competition for the financing of commercial properties persisted in many markets. Margins in the European and US markets were under pressure during the year, although they remained considerably higher in the US than in Europe.

In a highly competitive business environment that is defined by a wealth of uncertainty factors, Aareal Bank succeeded in generating new business of € 9.5 billion in 2018, which exceeded the previous year's figure of € 8.8 billion. The target that was originally announced – and then raised in the third quarter – was clearly exceeded due to the high volume of early renewals and larger portfolio financings. Newly-originated loans amounted to € 7.2 billion (2017: € 6.5 billion).

At 58.8 % (2017: 64.4 %), the highest share of our new business was originated in Europe, followed by North America with 38.6 % (2017: 34.8 %). 2.6 % of new business was originated in the Asia/Pacific region (2017: 0.8 %). The increase in the

New business[1] 2018

by region | by type of property



[1] New business, excluding former WestImmo's private client business and local authority lending business
* Including Germany

North American share is in line with the targets of our "Aareal 2020" programme for the future.

Europe

Commercial property transaction volumes generated in Europe were noticeably lower, compared with the previous year, yet remained at very high levels for the fourth year in a row. Growth shifted towards smaller markets. Whilst France, Germany, the Netherlands, Spain and the UK saw noticeable declines, slightly higher volumes were observed in Poland. Cross-border and institutional investors were on the buy side for the most part, whereas private investors tended to be sellers. REIT structures had balanced positions.

Rents for prime commercial properties in the European economic centres showed a largely stable to slightly rising trend in 2018 compared with the end of the previous year. In the office property segment, slight increases were visible in some markets such as Berlin and Madrid. Average rents were stable in numerous markets, as were prime rents for logistics and retail property.

Prime yields for commercial property showed a mixed picture in the European economic centres.[2] For office properties, yields – which were already at very low levels in some cases – continued to decline in only a few markets, such as the Netherlands and in Warsaw, compared to the end of the previous year. Yields for retail properties continued to decline in Germany and the Netherlands, whilst they increased slightly in France and in the UK. Yields for prime commercial logistics properties fell noticeably in 2018, compared with the end of 2017. Political uncertainty in Italy had no direct impact on property market yields there – in fact, they even declined slightly. For office properties outside the top-class range, yields tended to be stable to slightly lower. Yields on retail property beyond the prime locations were stable. However, they increased noticeably in some cases – particularly in France, Italy, the Netherlands, and the UK.

The hotel markets in the European economic centres painted a diverging picture in 2018. Occupancy rates rose compared with 2017 in some markets such as Brussels, London, Madrid and Paris. They

[2] Falling yields are associated with rising property market values, whilst rising yields correspondingly produce falling values, all other things remaining equal.

fell slightly in Hamburg and Munich, for example, and to a slightly greater extent in Barcelona and Warsaw. The indicator of average revenue per available room (which is important for hotel markets) recorded a slight increase in most markets, such as Amsterdam and London; strong increases were seen in Brussels and Paris. Average revenues per available hotel room in Hamburg and Munich were down slightly on the previous year. Barcelona and Warsaw, however, reported marginally greater declines.

Aareal Bank originated new business of € 5.6 billion (2017: € 5.6 billion) in Europe during the year under review. As in the previous years, Western Europe accounted for the largest share of € 3.5 billion (2017: € 4.2 billion), followed by Southern Europe with € 1.2 billion (2017: € 0.9 billion) and Northern Europe with € 0.6 billion (2017: marginal new business). New business of € 0.3 billion was generated in Eastern Europe (2017: € 0.5 billion).

North America

Transaction volumes in commercial property rose markedly in comparison with the previous year. The volume was in a higher range by historical standards. Investor interest thus remained high, despite rising interest rates.

REIT structures were clearly on the sell side, while private investors reported balanced investment positions. Cross-border and institutional investors were active market participants, and clearly on the buy side.

Rents for office and retail properties were virtually stable on a national average in the US, compared to the final quarter of 2017. There were marginal differences in the regional centres. Rents for office properties rose slightly in, for example, Atlanta, Chicago and Los Angeles. By contrast, they stagnated in Boston, New York and Washington, DC. Retail property rents rose for example in Atlanta and Denver, but showed a slightly declining trend in New York and San Francisco.

The year under review was characterised by largely constant yield developments. On a national average, investment yields in the US hardly moved – compared to the year-end 2017 – for office and retail properties. A slight increase was observed for office properties in Washington DC, both in and outside prime locations.

In the US, average occupancy rates for hotel properties remained stable compared with the previous year. Average revenue per available hotel room climbed slightly, when measured against the comparable value from 2017. In Canada, occupancy rates rose slightly, whilst average revenue per available hotel room increased significantly.

Aareal Bank originated new business of € 3.7 billion in North America during the year under review (2017: € 3.1 billion). This business was originated in the US and in Canada.

Asia/Pacific

Transaction volumes in the Asia / Pacific region were stable compared to the previous year in 2018. The volume was very high, historically.

Cross-border and institutional investors were on the buy side for the most part, while REIT structures and private investors were clearly on the sell side.

Rents for prime office properties hardly changed compared to the 2017 year-end, whilst they declined slightly in Shanghai. Rents for retail properties in Beijing declined significantly; they remained stable in Shanghai. Yields were stable to slightly rising for office properties, whereas they declined marginally for retail properties. By contrast, prime rents for office properties in Australia rose slightly in Melbourne and Sydney. Prime retail rents remained stable, while rising slightly for logistics property in (for example) Adelaide and Melbourne.

Investment yields for newly-acquired, high-quality office property remained stable in Beijing and Shanghai. Yields for retail property were stable in Beijing, whilst a slight decline was observed in Shanghai. In Australia, yields for office, retail and logistics properties fell in most markets.

Developments on the hotel markets in Beijing and Shanghai varied during the year under review, compared with the corresponding prior-year period. Whilst the average revenue per available hotel room rose markedly and occupancy rates increased slightly in Beijing, occupancy figures in Shanghai fell slightly on stable average revenues per available hotel room.

Aareal Bank originated new business of € 0.2 billion in the Asia / Pacific region during the year under review (2017: € 0.1 billion).

Acquisition of Düsseldorfer Hypothekenbank AG (Düsselhyp)

Aareal Bank Group successfully closed the acquisition of Düsseldorfer Hypothekenbank AG (Düsselhyp), announced on 10 September 2018. The purchase was completed with effect from 31 December 2018 (the closing date). Düsselhyp is therefore now a legally independent subsidiary under the umbrella of Aareal Bank Group. The purchase price paid amounted to € 149 million. Aareal Bank will not pursue any further strategic objectives with this acquisition, and will consistently pursue the orderly run-down.

Items acquired within the scope of the acquisition included € 0.3 billion in loan receivables, and money and capital market receivables of € 2.0 billion. The acquisition resulted in a negative goodwill of € 55 million, which was recognised in income. Further information is included in the section "Consolidation".

Consulting / Services segment

Bank division Housing Industry

Business development in the German housing industry proved solid in 2018 as well. Largely constant rental income and long-term funding structures secure a solid foundation and facilitate entrepreneurial investments in conjunction with the very low interest rates. The German Federation of German Housing and Real Estate Enterprises (Bundesverband deutscher Wohnungs- und Immobilienunternehmen – "GdW") expected a record number of new builds (31,000 apartments) in 2018 from the housing enterprises that are organised in its regional associations. Nationwide rent levels in Germany were up by around 2.9 % year-on-year in 2018 – a slight slowdown compared to the third quarter when the increase over the previous year's figure still amounted to 3.5 %.

However, market development varied from region to region. The contrast observed – up to 2017 – between rising demand for housing in the major cities and university cities, and the constant population loss in rural areas, eased in the year under review. Although population figures continued to rise in the big cities due to ongoing migration into Germany and a record number of students, many of those searching for accommodation turned to the outskirts of the urban centres.Despite the falling trend in Germany, the vacancy ratio in the classic shrinking regions continues to rise. The vacancy ratio based on the housing stock managed by GdW enterprises is stable, forecast for 2018 at 1.6 % (2017: 1.7 %) in the former West German Federal states and at 8.1 % (2017: 8.2 %) in the former East German states.

The Bank's Housing Industry division further strengthened its market position in the 2018 financial year, bringing in more business partners from the institutional housing industry and the commercial property sector – managing around 160,000 residential units between them – for the payments and deposit-taking businesses. Moreover, it intensified existing business relationships. We also continuously expanded our client base in the energy and waste disposal industries, 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. Projects were started – together with clients – which are aimed at further improving and automating cross-sector cooperation.

In addition, the Housing Industry division is analysing the development of alternative online payment systems very intensively. Projects were also launched here to integrate these into existing programmes and processes.

At present, just under 4,000 business partners throughout Germany are using our process-optimising products and banking services. The high volume of deposits, averaging € 10.4 billion (2017: € 10.0 billion) in the year under review, is in line with the "Aareal 2020" programme for the future. The share of rent deposits and reserves in accordance with the German Residential Property Act was increased once again. Deposits averaged € 10.4 billion in the fourth quarter of 2018 (2017: € 10.4 billion). All in all, this reflects the strong trust that clients place in Aareal Bank.

Aareon

Aareon is the leading international consultancy and IT systems house for the property industry in Europe. It is pursuing a profitable growth strategy, and continued to grow during the 2018 financial year. Key factors to its success are customer orientation, the growth in digital solutions, further strengthening of the ERP systems and exploration of new markets and related sectors associated with the property industry. The process of internal optimisation to enhance the organisational performance and profitability also continued.

With € 36 million (2017: € 34 million), Aareon exceeded its contribution to earnings figure for the previous year. This was achieved especially by the increased licence and maintenance business. Non-recurring effects incurred with three large-scale projects, in terms of higher costs and delays, prevented a better performance in the advisory business, on which the original forecast was based. Moreover, Aareon increased research and development investments in order to boost future growth.

As expected, numerous additional customers opted for Wodis Sigma in Germany during the course of 2018, bringing the total number to around 1,000. As expected, the favoured version is the one that uses Wodis Sigma as a service from the exclusive Aareon Cloud. The volume of business conducted with SAP® solutions and Blue Eagle is down slightly on the previous year, due to the aforementioned higher costs incurred on a major project. Additional commercial property customers were acquired for the RELion ERP solution. In the Netherlands, several key accounts opted for the Tobias AX ERP solution within the scope of a tender – some products were rolled out, too. Demand for the ERP service range increased in France, as legal requirements had to be implemented in the software. Further customers also opted for a Platinum contract with higher service levels. Despite intense competition in the UK, Aareon UK succeeded in winning several tenders for Aareon QL. Likewise, Aareon Sverige won key tenders with its Incit Xpand ERP solution. Aareon Sverige has also proved successful in the Finnish market. The business in Norway was burdened by delays and higher costs incurred on two major projects.

Digitalisation is becoming increasingly important for the property industry. With its Aareon Smart World digital ecosystem, Aareon offers integrated solutions for automating the business process 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. With the digital solutions, the cross-border development of Aareon CRM to simplify customer relationship management between the tenants/owners in particular was driven forward. In addition, Aareon Smart World is being expanded to include digital solutions from PropTech cooperation partners. In order to participate to a greater extent in interesting and innovative enterprises, Aareon Group founded AV Management GmbH. It operates under the brand name Ampolon Ventures and is strongly linked to the start-up scene.

The business volume of the digital solutions has continued to grow strongly year-on-year, driven in particular by migration business related to the ERP solutions, since customers usually acquire one or several new digital solutions when switching.

Within the area of add-on products, Aareon was able to extend its outsourcing business in Germany. BauSecura's insurance business has been running at the previous year's level. On the international market, the outsourcing business in the Netherlands made a significant contribution to the increase in revenue. Following the full acquisition of the Dutch company SG2ALL B.V. in 2016, it was merged into Aareon Nederland on 1 January 2018, together with its outsourcing business.

Aareon is now targeting new markets, such as utilities. The marketing process for the Aareon Occupant Change Management solution has started: several customers have already decided in favour of it.

Financial Position and Financial Performance

Financial performance

Group

Consolidated operating profit in the 2018 financial year amounted to € 316 million (2017: € 328 million), thus corresponding to our raised profit forecast. The figure includes the € 55 million negative goodwill from the initial consolidation of Düsselhyp. The comparative figure for the previous year's period also included material non-recurring income of € 50 million in net reversals of provisions in connection with the acquisition of Corealcredit in 2014, recognised in net other operating income/expenses, as well as a corresponding income tax expense of € 26 million. The expected decrease in net interest income was more than offset by increased commission income, lower loss allowance and reduced administrative expenses. However, the volatile market-driven net derecognition gain was significantly below our expectations and the previous year's figure. After taking taxes into consideration, the segment result rose slightly in comparison with the previous year.

Net interest income totalled € 535 million, an expected reduction from the previous year (2017: € 584 million), which was largely due to the portfolio decline seen in 2017, reflecting – amongst other factors – the scheduled reduction of the former WestImmo and Corealcredit portfolios.

Consolidated net income of Aareal Bank Group

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017 [1]
Net interest income	535	584
Loss allowance	72	82
Net commission income	215	206
Net derecognition gain or loss	24	50
Net gain or loss from financial instruments (fvpl)	-2	14
Net gain or loss from hedge accounting	-2	-7
Net gain or loss from investments accounted for using the equity method	0	–
Administrative expenses	462	511
Net other operating income/expenses	25	74
Negative goodwill from acquisitions	55	–
Operating profit	**316**	**328**
Income taxes	90	115
Consolidated net income	**226**	**213**
Consolidated net income attributable to non-controlling interests	2	6
Consolidated net income attributable to shareholders of Aareal Bank AG	224	207

[1] Comparative amounts reclassified according to the new classification format

Loss allowance amounted to € 72 million (2017: € 82 million) and was thus in line with our expectations as well.

Net commission income increased to € 215 million (2017: € 206 million), which was mainly due to higher sales revenue at Aareon.

The volatile, market-driven net derecognition gain of € 24 million (2017: € 50 million) declined due to lower effects from early loan repayments and was thus significantly below our expectations.

The net loss from financial instruments (fvpl) and on hedge accounting in the aggregate amount of € -4 million (2017: € 7 million) mainly resulted from exchange rate fluctuations and changes in the measurement of hedging derivatives (fvpl).

At € 462 million (2017: € 511 million), administrative expenses were reduced slightly more than expected, thanks to lower transformation costs and lower running costs.

All in all, consolidated operating profit for the 2018 financial year totalled € 316 million, after € 328 million in 2017. Taking into consideration tax expenses of € 90 million and non-controlling interest income of € 2 million, consolidated net income attributable to shareholders of Aareal Bank AG amounted to € 224 million (2017: € 207 million). Assuming the pro rata temporis accrual of net interest payments on the AT1 bond, consolidated net income allocated to ordinary shareholders stood at € 208 million (2017: € 191 million). Earnings per ordinary share amounted to € 3.48 (2017: € 3.20) and return on equity (RoE) before taxes stood at 11.6 % (2016: 11.9 %).

Structured Property Financing segment

Operating profit in the Structured Property Financing segment was € 338 million, below the previous year's figure of € 351 million. The figure includes the € 55 million negative goodwill from the initial consolidation of Düsselhyp. The comparative figure for the previous year's period also included material non-recurring income of € 50 million in net reversals of provisions in connection with the acquisition of Corealcredit in 2014, recognised in net other operating income/expenses, as well as a corresponding income tax expense of € 26 million. The expected decrease in net interest income

Structured Property Financing segment result

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Net interest income	547	596
Loss allowance	73	82
Net commission income	9	7
Net derecognition gain or loss	24	50
Net gain or loss from financial instruments (fvpl)	-2	14
Net gain or loss from hedge accounting	-2	-7
Net gain or loss from investments accounted for using the equity method	0	–
Administrative expenses	241	296
Net other operating income/expenses	21	69
Negative goodwill from acquisitions	55	–
Operating profit	**338**	**351**
Income taxes	99	123
Segment result	**239**	**228**

[1] Comparative amounts reclassified according to the new classification format

was more than offset by lower loss allowance and reduced administrative expenses. However, the volatile market-driven net derecognition gain was significantly below our expectations and the previous year's figure. After taking taxes into consideration, segment result rose slightly in comparison with the previous year.

Segment net interest income of € 547 million showed an expected decline from the previous year (€ 596 million), which was largely due to the portfolio decline seen in 2017, reflecting – amongst other factors – the scheduled reduction of the former WestImmo and Corealcredit portfolios.

Loss allowance amounted to € 73 million (2017: € 82 million) and was thus in line with our expectations as well.

The volatile net derecognition gain of € 24 million (2017: € 50 million) declined due to lower effects from early loan repayments and was thus significantly below our expectations.

The net loss from financial instruments (fvpl) and on hedge accounting in the aggregate amount of € -4 million (2017: € 7 million) mainly resulted from exchange rate fluctuations and changes in the measurement of hedging derivatives (fvpl).

At € 241 million (2017: € 296 million), administrative expenses were reduced slightly more than expected, thanks to lower transformation costs and lower running costs.

Overall, operating profit for the Structured Property Financing segment was € 338 million (2017: € 351 million). Taking income tax expenses of € 99 million into consideration (2017: € 123 million), the segment result was € 239 million (2017: € 228 million).

Consulting/Services segment

As expected, sales revenue generated in the Consulting/Services segment developed positively, driven particularly by Aareon's higher sales revenues in the amount of € 242 million (2017: € 226 million). The persistent low interest rate environment continued to burden margins from the deposit-taking business that are reported in sales revenues.

Consulting/Services segment result

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017 [1]
Sales revenue	242	226
Own work capitalised	8	4
Other operating income	7	7
Cost of materials purchased	42	35
Staff expenses	159	151
Depreciation, amortisation and impairment losses	15	12
Other operating expenses	63	62
Interest and similar income/expenses	0	0
Operating profit	**-22**	**-23**
Income taxes	-9	-8
Segment result	**-13**	**-15**

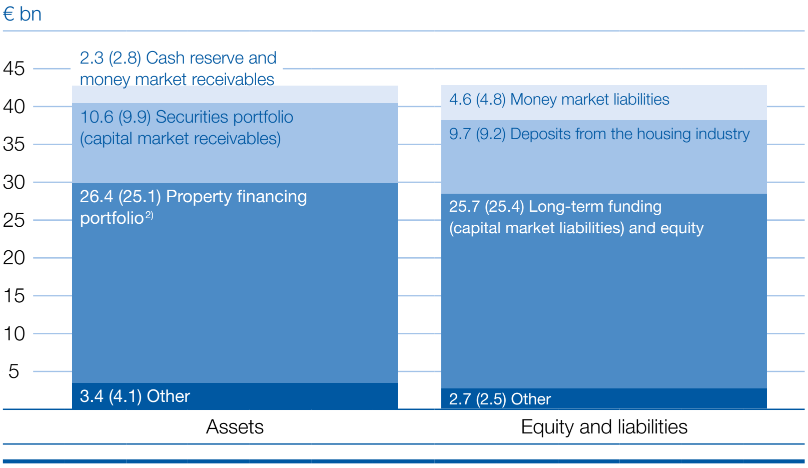
[1] Comparative amounts reclassified according to the new classification format

Both cost of materials purchased and staff expenses increased as expected to € 42 million (2017: € 35 million) and € 159 million (2017: € 151 million), respectively.

Overall, segment operating profit for 2018 was € -22 million (2017: € -23 million). Aareon's contribution was € 36 million (2017: € 34 million).

Taking income taxes into consideration, the segment result amounted to € -13 million (2017: € -15 million).

Statement of financial position – structure as at 31 Dec 2018 (31 Dec 2017[1])



[1] Comparative amounts reclassified according to the new classification format
[2] Excluding € 0.6 billion in private client business (31 December 2017: € 0.8 billion) and € 0.5 billion in local authority lending business by the former Westdeutsche ImmobilienBank AG (WestImmo) (31 December 2017: € 0.5 billion), and excluding loss allowance

Financial position

Consolidated total assets as at 31 December 2018 amounted to € 42.7 billion, after € 41.9 billion as at 31 December 2017.

Cash reserve and money market receivables

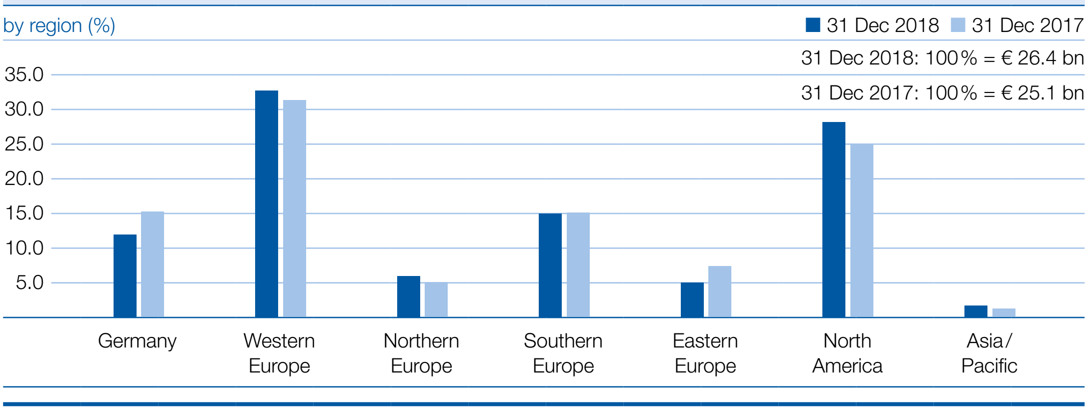
The cash reserve and money market receivables position contains excess liquidity invested at short maturities. As at 31 December 2018, this comprised predominantly cash funds and deposits with central banks and money-market receivables from banks.

Property financing portfolio

The volume of Aareal Bank Group's property financing portfolio stood at € 26.4 billion as at 31 December 2018, up by approx. 5 percentage points from the year-end level 2017 (€ 25.1 billion). This was especially due to both the scheduled expansion of the strategic business as well as the acquisition of Düsselhyp (€ 0.3 billion). The international share of the portfolio increased to 88.0 % (31 December 2017: 84.8 %).

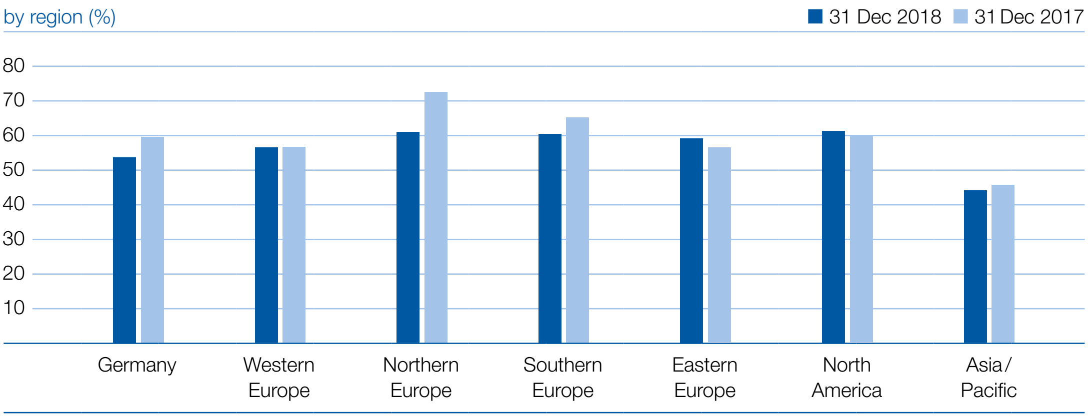
At the reporting date (31 December 2018), Aareal Bank Group's property financing portfolio was composed as shown in following graphs, compared with year-end 2017.

Property financing volume[1] (amounts drawn)



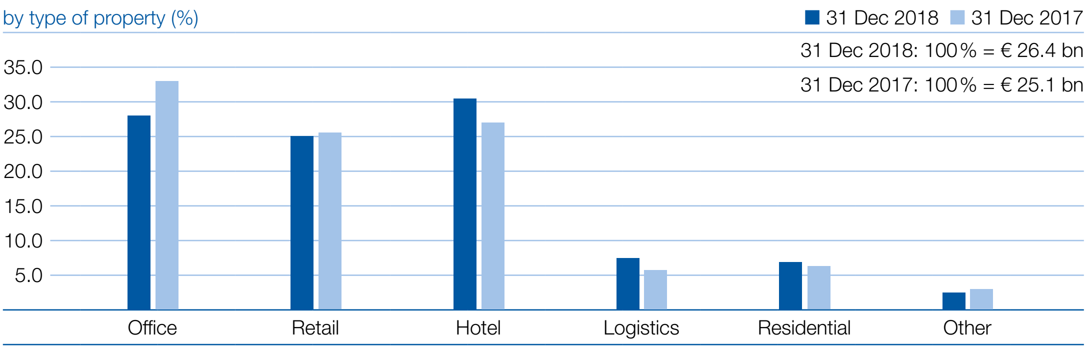
[1] Excluding former WestImmo's private client business and local authority lending business

Average LTV of property financing[1)]

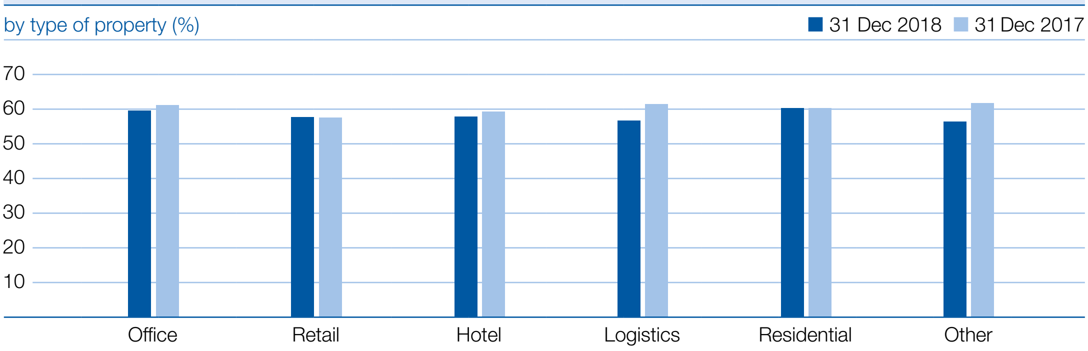


Note that the loan-to-value ratios are calculated on the basis of drawdowns and market values, including supplementary collateral with sustainable value, excluding defaulted property financings.

Property financing volume[1)] (amounts drawn)



Average LTV of property financing[1)]



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

Portfolio allocation by region and continent changed only selectively compared with the end of the previous year. Whilst the portfolio share of exposures in North America rose by about 3.1 percentage points, it was down by around 3.2 percentage points for Germany, and approx. 2.5 percentage points down for Eastern Europe, remaining relatively stable for all other regions.

The breakdown of the portfolio by property type did not change significantly during the reporting period. The share of hotel property increased by 3.5 percentage points compared to year-end 2017, whilst the share of office property was reduced by 4.9 percentage points. The share of financings for residential, logistics, and retail property as well as other financings in the overall portfolio remained almost unchanged compared to the year-end 2017.

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.

Securities portfolio

Aareal Bank holds a portfolio of high-quality securities, used as economic and regulatory liquidity reserve as well as for the cover management of Pfandbriefe.

As at 31 December 2018, the nominal volume of the consolidated securities portfolio[1] was € 8.7 billion (31 December 2017: € 8.3 billion), of which € 1.4 billion was contributed by the portfolio of Düsselhyp.

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. The securities portfolio comprises three asset classes: public-sector borrowers, covered bonds and Pfandbriefe, as well as bank bonds.

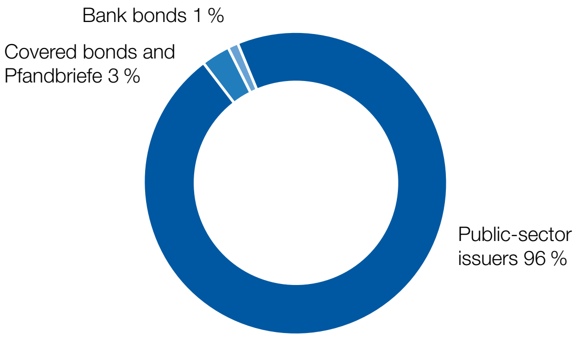
99 % of the overall portfolio is denominated in euro. 99 % of the portfolio has an investment grade rating.[2] More than 75 % of the portfolio fulfils the requirements for "High Quality Liquid Assets" (as defined in the Liquidity Coverage Ratio (LCR)).

Public-sector borrowers are the largest asset class held, accounting for a share of approx. 96 %. These include securities and promissory note loans that qualify as ordinary cover for Public-Sector Pfandbriefe. 99 % of these issuers are headquartered in the EU. Around 72 % are rated AAA or AA, and a further 7 % are rated single-A.

The share of Pfandbriefe and covered bonds at year-end was 3 %, exclusively including European covered bonds and Pfandbriefe, of which more than 85 % were rated AAA.

Securities portfolio as at 31 December 2018

% Total volume (nominal): € 8.7 bn



Financial position

Money-market liabilities and deposits from the housing industry

Generally, in addition to customer deposits, 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 2018, Aareal Bank had € 9.7 billion at its disposal in deposits generated from the business with the housing industry (31 December 2017: € 9.2 billion). Money-market

[1] As at 31 December 2018, the securities portfolio was carried at € 10.6 billion (31 December 2017: € 9.9 billion).

[2] The rating details are based on the composite ratings.

liabilities amounted to € 4.6 billion (31 December 2017: € 4.8 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's funding remains very solid indeed, as evidenced by the high proportion of long-term refinancing. 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 (AT 1) issues.

As at 31 December 2018, the long-term refinancing portfolio amounted to € 23.1 billion. Of this amount, Mortgage Pfandbriefe accounted for € 10.9 billion, public-sector Pfandbriefe for € 3.0 billion, uncovered long-term refinancing for € 7.9 billion and subordinated long-term refinancing for € 1.3 billion.

The Liquidity Coverage Ratio (LCR) at Group level exceeded 150 % on the reporting days during the period under review.

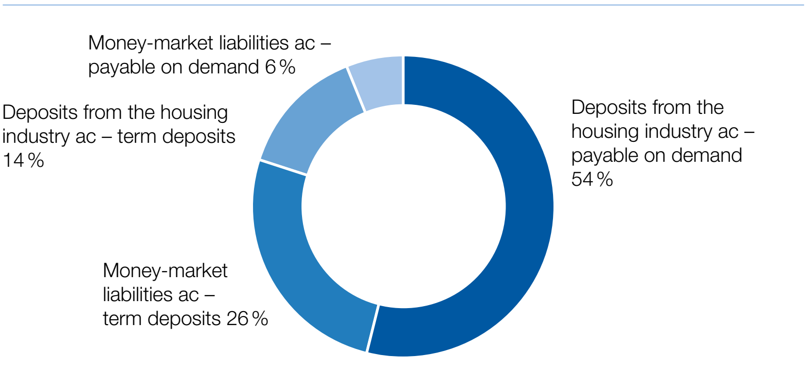
Refinancing activities

Throughout the financial year 2018 Aareal Bank Group was able to very successfully raise liquidity in the amount of € 3.4 billion on the capital market. Of this volume, € 2.5 billion are attributable to Pfandbriefe, € 0.7 billion to Senior Preferred Bonds and € 0.2 billion to Senior Non-Preferred Bonds.

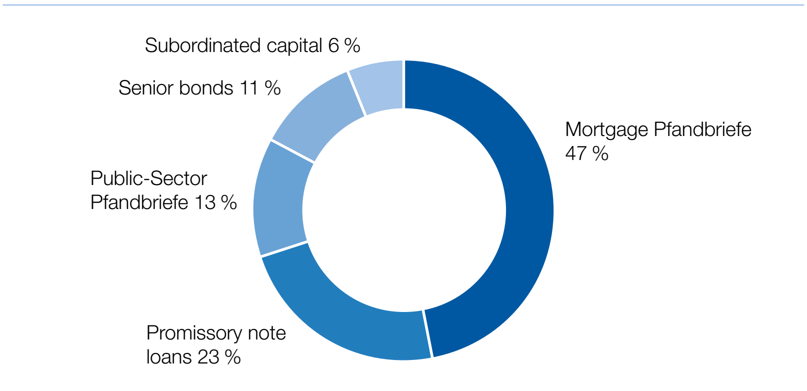
It contains, among other things, four Mortgage Pfandbriefe of € 0.5 billion each, as well as a Pfandbrief transaction amounting to £ 0.3 billion. The remaining volume was raised via private placements.

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.

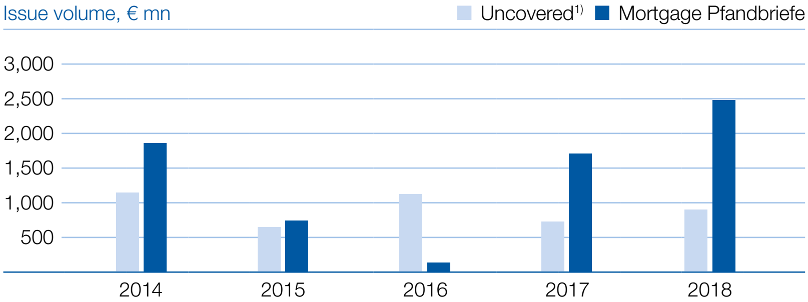
Money market funding mix as at 31 December 2018



Capital market funding mix as at 31 December 2018



Issuing activities – 2014 to 2018



[1)] Excluding SoFFin-guaranteed issues and subordinated capital

Equity

Aareal Bank Group's total equity as disclosed in the statement of financial position amounted to € 2,928 million as at 31 December 2018 (31 December 2017: € 2,924 million), comprising € 300 million for the Additional Tier 1 (AT 1) bond. Please also refer to the statement of changes in shareholders' equity, and to our explanations in Note 55.

For further information on the transitional effects resulting from the introduction of IFRS 9, please refer to the section "First-time application of IFRS 9 Financial Instruments" in Note 2 "Changes in accounting policies".

Regulatory indicators[1)]

	31 Dec 2018[2)]	31 Dec 2017
€ mn		
Common Equity Tier 1 (CET 1)	2,241	2,305
Tier 1 (T1)	2,541	2,600
Total capital (TC)	3,419	3,536
%		
Common Equity Tier 1 ratio (CET 1 ratio)	17.2	19.6
Tier 1 ratio (T1 ratio)	19.5	22.1
Total capital ratio (TC ratio)	26.2	30.0
Common Equity Tier 1 ratio (CET 1 ratio) (%) – Basel IV (estimate) – [3)]	13.2	13.4

[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 including negative goodwill were taken into account, based on the Management Board's proposal for appropriation of profits for the 2018 financial year. 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 ECB's NPL guidelines (NPL stock), were taken into account for determining regulatory indicators for 2018. Due to the fact that the ECB has not yet approved the application for inclusion of profits (including negative goodwill) as at 31 December 2018, the corresponding regulatory report did not incorporate attributable annual profits (including negative goodwill), nor the effects of the TRIM exercise. CET1 amounted to € 1,994 million, with T1 at € 2,294 million and TC at € 3,172 million. The CET1 ratio thus stood at 18.5 %, the T1 ratio at 21.3 %, and the TC ratio at 29.4 %. Assuming the ECB's approval, the regulatory report as at 31 December 2018 would incorporate annual profits including negative goodwill, but excluding the TRIM effects. CET1 would amount to € 2,263 million, with T1 at € 2,563 million and TC at € 3,442 million. The CET1 ratio would amount to 21.0 %, the T1 ratio 23.8 %, and the TC ratio 31.9 %.
[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

Employee data as at 31 December 2018

	31 Dec 2018	31 Dec 2017	Change
Number of employees at Aareal Bank Group	2,748	2,800	-1.9 %
Years of service	12.7 years	12.9 years	- 0.2 years
Staff turnover rate	5.8 %	4.0 %	

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.

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, as well as SAP HANA® training. Expanding professional knowledge of the Aareon Smart World, within the scope of a weekly WodisSigma University WebEx session, was another focal area. Both Aareal Bank and Aareon also attached great importance to further building language and communications skills: to this end, a digital language learning portal was introduced, 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.

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.

The Bank's "Junior Training Programmes" provided support for young people in terms of training, including trainees for office management (within training courses at the Chamber of Commerce and Industry (IHK)), work-study students in the fields of business administration, banking, and business information systems from the Baden-Württemberg Cooperative State University (Duale Hochschule Baden-Württemberg/DHBW), Mannheim, as well as business administration students from the University of Applied Sciences Mainz (Hochschule Mainz).

Besides training programmes, Aareon offers the dual course 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, as well as with 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 working remotely 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 enhancing work models, effective and smart employee collaboration, and the digital workplace.

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, management and employee workshops on the topics of healthy leadership and remaining healthy in times of change, stress prevention and management measures, health checks, colon cancer screening, skin screenings and flu vaccinations. The motto for Aareon's occupational health management in 2018 was "#fit4work4future" and numerous measures for supporting employees in a digital working world were implemented to this end.

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. We therefore continued to drive the development of our processes for identifying, measuring, limiting and managing risks in the financial year under review, too – with a focus on implementing the ECB's new guidelines for the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). During the course of the year, this resulted – inter alia – in a changed risk taxonomy, as already outlined in the half-yearly report.

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 controlling.

Overall responsibility for risk management and risk monitoring remains with the Management Board and the Supervisory Board of Aareal Bank AG. The adjacent diagram 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 (the "going-concern" approach). 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 Com

Overall responsibility: Management Board and Supervisory Board of Aareal Bank AG

Type of risk		Risk management	Risk monitoring
Credit risks	Property Financing	Loan Markets & Syndication Credit Risk Project & Credit Portfolio Management Credit Transaction Management	Risk Contolling
Credit risks	Treasury business	Treasury	Risk Controlling
Credit risks	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
Credit spread and migration risks in the banking book (CSRBB)		Treasury; Transaction Committee	Risk Controlling
Other market risks		Treasury; Transaction Committee	Risk Controlling
Operational risk		Process owners	Risk Controlling
Investment risks		Group Strategy	Risk Controlling Finance & Controlling Controlling bodies
Property risks		Aareal Estate AG	Risk Controlling
Business and strategic risks		Group Strategy	Risk Controlling
Liquidity risks		Treasury	Risk Controlling

Process-independent monitoring: Revision

pliance 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 ensures the timely and independent risk monitoring to 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 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 is a core determining factor governing the structure of its risk management system. To ascertain its uninterrupted risk-bearing capacity, Aareal Bank Group has adopted a dual management approach whereby its risk management is primarily based on the assumption of a going concern. This approach ensures that risk positions are only established to an extent that the institution's continued existence will not be threatened should the risks materialise. A secondary management process ensures that risk positions are only established to an extent that even in the event of liquidation there will still be sufficient potential risk cover in order to service all liabilities (the "gone concern" approach). The statements below relate to the going-concern approach which the Bank has implemented as a primary management process.

In accordance with this approach, potential risk cover is determined using data derived from the income statement and from the statement of financial position; this derivation also forms the basis for determining regulatory capital. The risk-bearing capacity concept is based on the conservative planning of Tier I capital until the next year-end date, and the subsequent year-end, respectively. This involves setting aside the maximum amount of own funds required as potential risk cover to offset risks without causing a breach of minimum requirements pursuant to the Capital Requirements Regulation (CRR). Aareal Bank has set Tier I (T1) capital (as defined by the CRR) at a level of 7.75 % of forecast risk-weighted assets (RWA) as a deductible, in accordance with regulatory requirements. Only free own funds exceeding this level are applied as potential risk cover.

The reduction of regulatory capital, in the course of the changeover to IFRS 9, had an identical impact on aggregate risk cover. Given the use of planned Tier 1 capital, this effect was already accounted for as at 31 December 2017. The regular rolling forward of aggregate risk cover to the planning date of 31 December 2019 took place during the second quarter [of 2018].

We are also currently working intensively on the implementation of the ECB's ICAAP guideline, published for consultation. In this context, and within the scope of regular adjustments to the cover assets pools, we adjusted the risk taxonomy in line with regulatory expectations. Specifically, the previous category of market price risk has been broken up with the introduction of risk categories IRRBB (interest rate risk in the banking book) and CSRBB (credit spread risk in the banking book), in line with regulatory requirements; individual limits have been set for these new categories. Foreign exchange risk remains assigned to other market risk. The risk-reducing inclusion of inter-risk correlations is no longer permitted for the purposes of determining risk-bearing capacity utilisation – a key cause for the increase of this indicator. Property risk has been excluded from credit risk, now forming a separate risk type with specific limits. Likewise, "Other risks" has been split, with specific counterparty credit risk (CVA exposure) having been reclassified to CSRBB; business and strategic risks remain within "Other risks".

As a result, we have distinguished eight risk categories since April 2018 (instead of five previously), each with separate limits.

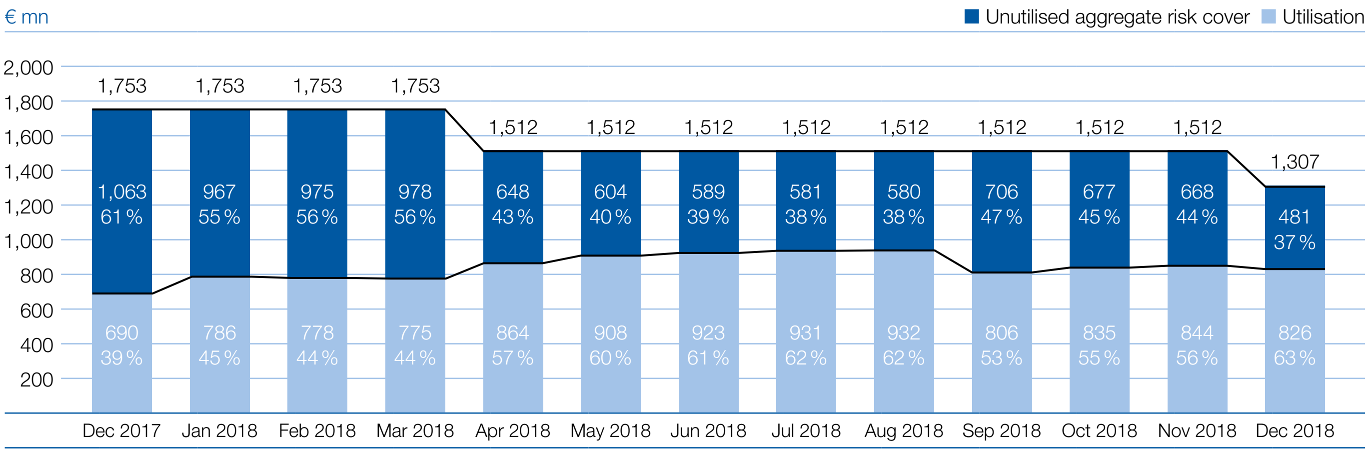
We adopt a conservative stance with respect to setting risk limits. The aggregation of individual limits is based on the assumption that no risk-mitigating correlation effects exist amongst different types of risk. Taking into account the prior deduction of a minimum Tier 1 ratio of 7.75 % of RWA (including the expected impact of the TRIM exercise on commercial property financings, and the SREP recommendations concerning ECB's NPL guidelines (NPL stock)), the value-at-risk (VaR) models used to quantify risks are based on a confidence interval of 95 % and a one-year holding period (250 trading days). Limits are defined at Group level, as well as for the individual Group entities. 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.

€ mn	31 Dec 2018
Own funds for risk cover potential	2,521
less 7.75 % of RWA[1]) (Tier 1 capital)	1,214
Freely available funds	**1,307**
Utilisation of freely available funds	
Loan loss risks	195
Interest rate risk in the banking book (IRRBB)	54
Credit spread and migration risks in the banking book (CSRBB)	327
Other market risks	95
Operational risks	85
Investment risks	21
Property risks	27
Business and strategic risks	21
Total utilisation	**826**
Utilisation as a percentage of freely available funds	**63 %**

[1]) Including the expected impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning ECB's NPL guidelines (NPL stock).

€ mn	31 Dec 2017
Own funds for risk cover potential	2,623
less 7.75 % of RWAs (Tier 1 capital (T1))	870
Freely available funds	**1,753**
Utilisation of freely available funds	
Credit risks	265
Market risks	145
Operational risks	86
Investment risks	21
Other risks	173
Total utilisation	**690**
Utilisation as a percentage of freely available funds	**39 %**

Development of risk limit utilisation during the course of 2018



Given the change in the risk taxonomy in April 2018, comparison with the values as at the previous year-end is not possible.

Utilisation of risk limits developed during the course of the year as shown above.

The expected increase in utilisation in April 2018 was the result of the changeover effect (as outlined above), whereby utilisation levels for new types of risk are now being aggregated. In addition, aggregate risk cover as well as RWAs used to calculate prior deductions are regularly extrapolated to expected year-end values for 2019 in April. The higher utilisation in December 2018 resulted from the acquisition of Düsselhyp as at 31 December 2018, and from the expected impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning ECB's NPL guidelines (NPL stock).

Since aggregate risk cover 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 started analysing the impact of Brexit at an early stage: besides the usual (risk) management tools, this has included monitoring the impact on Aareal Bank's risk exposures and business activities by reference to a Brexit Plan. 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 are consistently geared towards Group-wide effective and professional risk management. This includes the extensive implementation of regulatory requirements regarding the organisational structure and procedures in the credit business.

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, adequately 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.

An "On-watch Committee" has been established in order to enhance the Bank's procedures for the early detection of risks. Whenever there are indications of specific risks, this Committee has global authority – regardless of exposure size – to classify exposures as "normal" or "subject to intensified handling", and to decide on the measures to be taken as well as the composition of the Deal Team handling the exposure. The transfer of know-how is enhanced through the cross-divisional representation on the Committee.

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 guidelines, 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, and 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 credit risk – or counterparty credit risk – as the risk of losses being incurred due to (i) a business partner defaulting on contractual obligations; (ii) collateral being impaired; or (iii) 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

Aareal Bank's structural organisation and business processes are consistently geared towards effective and efficient risk management. Regulatory requirements are fully 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 classification procedures, and in the valuation of collateral. The respective procedures and parameters are subject to permanent review and adjustment. Responsibility for development, quality assurance, and monitoring implementation of procedures, is outside the Sales units.

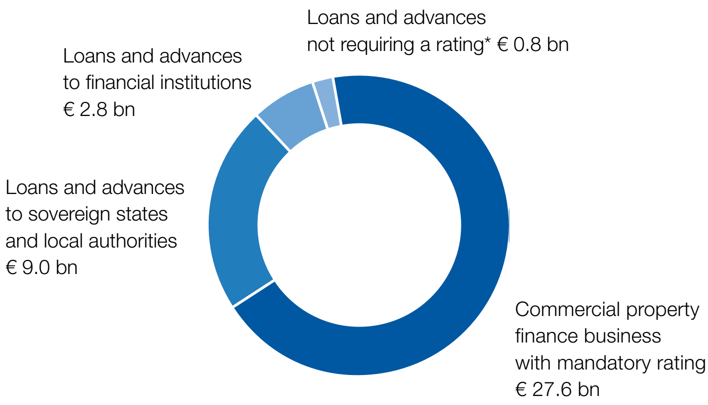
Methods used to measure, control and monitor concentration and diversification effects on a portfolio level include two different credit risk models. Based on these models, the Bank's decision-makers are regularly informed of the performance and risk content of property financing exposures, and of business 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

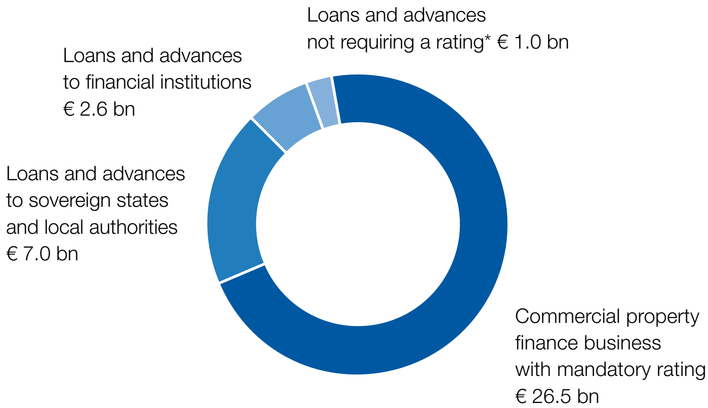
Breakdown of on-balance sheet and off-balance sheet business

by rating procedure, € bn 31 Dec 2018



Breakdown of on-balance sheet and off-balance sheet business [1)]

by rating procedure, € bn 1 Jan 2018



[1)] Excluding hedge adjustment
* Including the private client business of former WestImmo

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. To facilitate comparison, figures as at 1 January 2018 including adjustments pursuant to IFRS 9 (excluding hedge adjustments) were shown as previous year's values.

On-balance sheet commercial property finance business with mandatory rating

31 December 2018

€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	1 Jan 2018
Class 1						
Class 2	117				**117**	88
Class 3	255				**255**	399
Class 4	1,486				**1,486**	1,345
Class 5	3,566			94	**3,660**	3,025
Class 6	3,966	21		256	**4,243**	3,717
Class 7	3,420				**3,420**	3,242
Class 8	5,166	112		181	**5,459**	5,620
Class 9	3,463	42		116	**3,621**	3,335
Class 10	1,510	28			**1,538**	1,368
Class 11	285	91		39	**415**	480
Class 12	531	62			**593**	518
Class 13		66			**66**	261
Class 14						3
Class 15				3	**3**	
Defaulted			1,564	22	**1,586**	1,614
Total	**23,765**	**422**	**1,564**	**711**	**26,462**	**25,015**

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

Off-balance sheet commercial property finance business with mandatory rating

31 December 2018

€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	1 Jan 2018
Classes 1-2						
Class 3						57
Class 4	39				**39**	25
Class 5	32			6	**38**	33
Class 6	190			25	**215**	365
Class 7	175				**175**	242
Class 8	312	5			**317**	254
Class 9	120				**120**	223
Class 10	75				**75**	106
Class 11	5				**5**	17
Class 12	29				**29**	12
Classes 13-15						
Defaulted			78		**78**	108
Total	**977**	**5**	**78**	**31**	**1,091**	**1,442**

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

On-balance sheet loans and advances to financial institutions

31 December 2018

€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	1 Jan 2018
Class 1	1,242				**1,242**	
Class 2	32				**32**	1,398
Class 3	15				**15**	25
Class 4	85				**85**	55
Class 5	514				**514**	5
Class 6	100				**100**	43
Class 7	387			35	**422**	466
Class 8	284				**284**	516
Class 9	16			43	**59**	30
Class 10	25			26	**51**	51
Classes 11-18						
Defaulted						
Total	**2,700**			**104**	**2,804**	**2,589**

[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

31 December 2018

€ mn	Stage 1	Stage 2	Stage 3	fvpl[1]	Total	1 Jan 2018
Class 1	2,621				**2,621**	1,601
Class 2	2,666			76	**2,742**	1,579
Class 3	797			70	**867**	1,784
Class 4	145			32	**177**	348
Class 5	239			62	**301**	57
Class 6	436				**436**	207
Class 7	163			105	**268**	119
Class 8						104
Class 9	711	805		89	**1,605**	1,186
Classes 10-20						
Defaulted						
Total	**7,778**	**805**		**434**	**9,017**	**6,985**

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

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.

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; any discrepancies 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 credit processes provide for the regular review of collateral value. The risk classification is adjusted in the event of material changes in collateral value, and other measures taken as deemed appropriate. 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.

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.

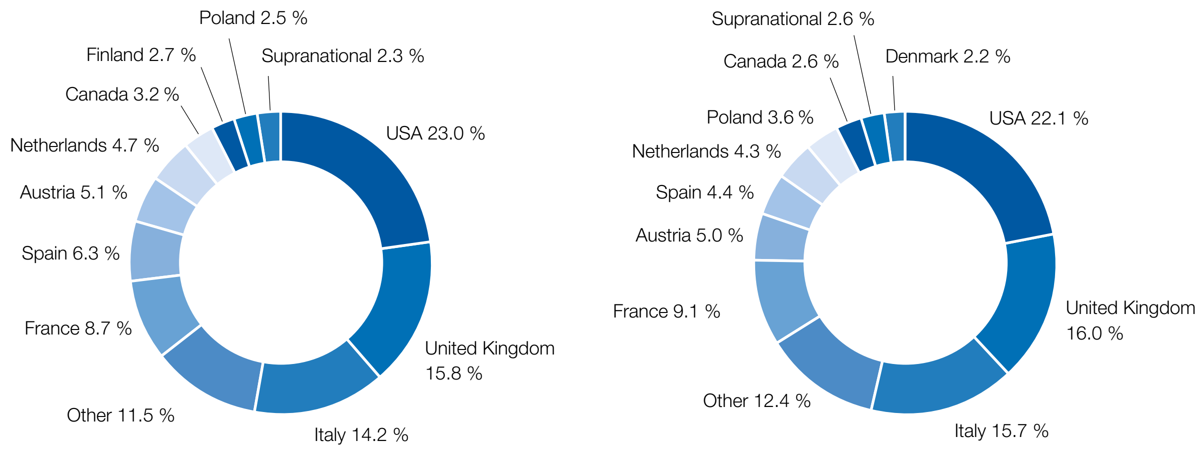
Country risks

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 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

[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").

Breakdown of country exposure in the international business

% 31 Dec 2018 | 31 Dec 2017



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 below 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 95 % confidence interval. As part of the implementation of the new ICAAP requirements imposed by the ECB, this will increase to 99.9 % from 2019 onwards.

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 overnight deposits which are factored into calculations for a period of up to five 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 in accordance with section 25a of the KWG

The following table provides a breakdown of present value changes by currency as at the reporting date, based on interest rate shock scenarios prescribed by banking regulators for external reporting purposes. For this purpose, the yield curve is subjected to a parallel 200 basis point downshift, down to the zero per cent line at the maximum, unless the relevant interest rate was already negative to start with. As in the previous years, the ratio

31 December 2018

	Present value change	
	-200 bp	+200 bp
€ mn		
EUR	-140	204
GBP	-12	-12
USD	-10	-10
Other	-12	-12
Total	**-174**	**170**
Percentage ratio to regulatory capital	**5.3**	**5.2**

of the aggregate of all foreign-currency amounts to Aareal Bank Group's regulatory capital is clearly below the prescribed threshold of 20 %.

Interest rate gap analysis

Further, the gap analysis per currency provides information on all of the Bank's positions in respect of which the interest rate has been fixed. In addition to disclosing the net gap positions in the respective maturity bucket, this data allows for specific analyses concerning the risks and returns from the current portfolio.

Credit spread and migration risks in the banking book

Definition

We define credit spread and migration risks in the banking book (CSRBB) as any type of spread risk exposure of instruments held in the banking book which are sensitive to changes in interest rates, where the risk cannot be assigned to IRRBB nor to counterparty credit risk.

Specifically, for Aareal Bank this includes:

- valuation risks that are dependent upon spreads (credit spread risk);
- specific price risks from the bond portfolio, wherein the bonds are mainly sovereign bonds (sovereign risk);
- exposure of loans to rating migration (migration risk); and
- replacement risk (CVA buffer).

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 credit spread risk in the banking book on a daily basis.

Risk measurement differentiates between underlying exposures and sub-risks. Accordingly, credit spread risks from securities and sovereign risk are calculated using VaR concepts, in line with the methods described in connection with interest rate risk in the banking book. In this context, VaR quantifies risk as the loss that will not be exceeded 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 for this risk category. 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 95 % confidence interval. As part of the implementation of the new ICAAP requirements imposed by the ECB, this will increase to 99.9 % from 2019 onwards.

Loan migration risks are determined by reference to stressed migration matrices: risk is defined as the change in expected loss over the lifetime of the loan, based on a 95 % confidence interval. The CVA buffer amount is taken from the amount determined in accordance with CRR requirements.

Other market risks

Definition

Other market risks are broadly defined as the threat of losses due to changes in market parameters.

Residual market risks which are not assigned to IRRBB or CSRBB are summarised under "market risk". Specifically, for Aareal Bank this includes:

- risks resulting from fluctuations of spot foreign exchange (FX) rates;
- risks resulting from fluctuations of forward foreign exchange rates (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 have been concluded during the year under review, trading book risks were not relevant during the period under review.

Commodities are irrelevant for the Bank's business. Hence, the market risk exposures are currently related to the relevant risk parameters of spot and forward foreign exchange rates only. These exchange rate risks are largely eliminated through hedges.

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 95 % confidence interval. As part of the implementation of the new ICAAP requirements imposed by the ECB, this will increase to 99.9 % from 2019 onwards.

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.

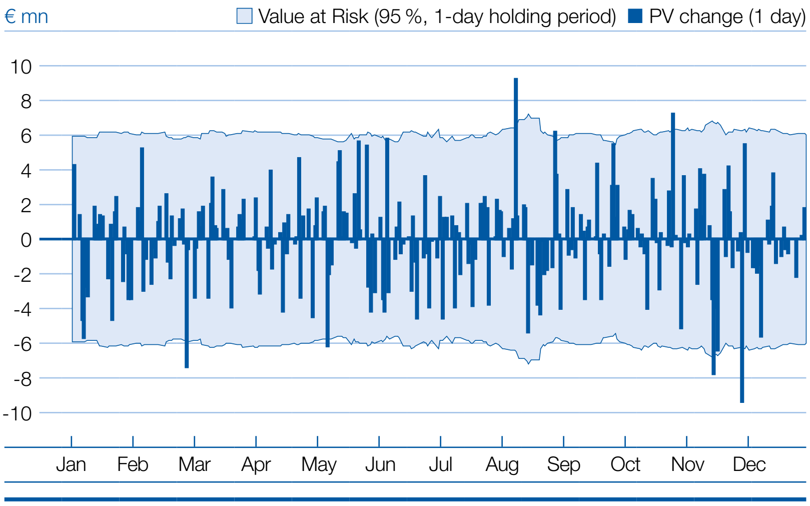
Backtesting

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 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 95 %, only a small number of events are expected to break out of the VaR projection (≤ 17 for a 250-day period).

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

Four negative outliers at Group level occurred during the last 250 trading days, affirming the high forecasting quality of the VaR model we use.

Present values and 1-day VaR during the course of 2018



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

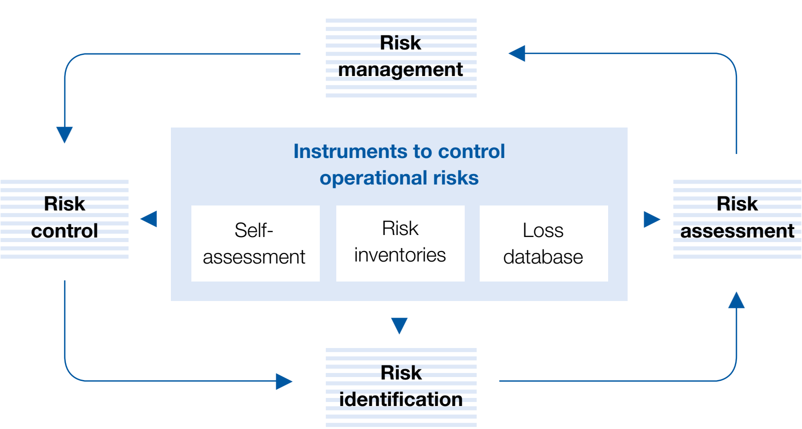
It is the objective of the policy pursued by Aareal Bank to achieve a risk-minimising or loss-limiting effect at an early stage by employing a pro-active approach.

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.

Management of operational risks



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 as well as historical scenarios and 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.

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. There were no significant changes in property risk during the period under review.

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 95 % confidence interval. As part of the implementation of the new ICAAP requirements imposed by the ECB, this confidence interval will increase to 99.9 % from 2019 onwards. 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.

From our point of view, the most significant scenario is the institution-specific "idiosyncratic stress" scenario, which simulates a withdrawal of funds deposited by public-sector entities and banks, as well as a 30 % reduction in current account balances. 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 chart above 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 2019. The chart demonstrates that the liquidity stock will always exceed liquidity requirements, even under adverse conditions.

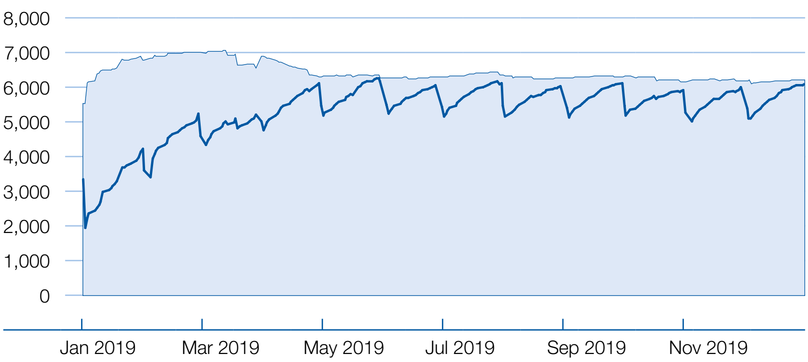
Further details are provided in the comments on the Bank's liquidity in the section on the "Financial position".

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.

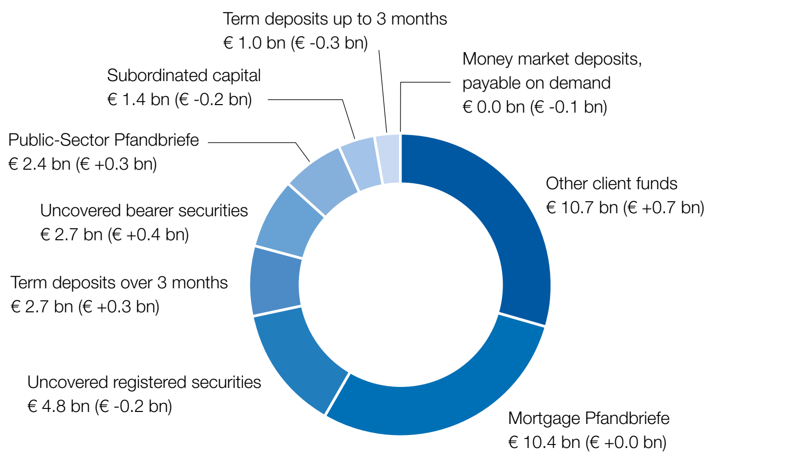
Liquidity development

€ mn ■ Liquidity requirement □ Inventory



Refinancing portfolio diversification by product

as at 31 Dec 2018 versus 31 Dec 2017 Total volume (nominal): € 36.1 bn



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.

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.

Taking the prevailing regulatory reporting as a basis for the LCR forecast, LCR is projected for future dates, incorporating short-term business activities as well as portfolio developments in the planned scenario.

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.

Taking the prevailing regulatory reporting as a basis for the NSFR forecast, NSFR is projected for future dates, incorporating portfolio developments in the planned scenario.

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 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, 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 consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs). The Finance & Controlling division controls Group accounting processes and is responsible for ensuring compliance of Group accounting with legal requirements, as well as with any further internal and external provisions. Based on the IFRSs, the Finance & Controlling division establishes accounting-related requirements that have to be applied consistently throughout the Group. These requirements are set out in the IFRS Group Accounting Manual.

Aareal Bank Group entities prepare an IFRS package as at the relevant balance sheet 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 consolidation software and aggregated for the purpose of preparing the consolidated financial statements. The number of employees within Aareal Bank's Finance & Controlling division is adequate, as are their qualifications. Furthermore, they possess the necessary knowledge and experience relevant for their functions.

The Supervisory Board is responsible for monitoring the Management Board. 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. The committee analyses and assesses the financial statements submitted to it, the internal risk reports, and the annual Internal Audit report. 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 has a process-independent monitoring function. 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. The functional separation 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. For further information on measurement, please refer to the relevant Notes to the consolidated financial statements.

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 Group accounting IT systems for material transactions, this has been integrated and documented in the manual process workflows.

Adherence of Group accounting to generally accepted accounting principles is ensured by both preventive and detective controls within the accounting process itself, as well as through a comprehensive 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. Adequate 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, IT reviews are conducted independently from processes, by Internal Audit.

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 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, changing monetary policy and the impact of a weakening economy.

Changing monetary policies, with rising interest rates or the expectation of rising interest rates in an environment of abating quantitative measures, represent a risk. Sudden or excessive changes in interest rates may trigger a revaluation and changes in investor behaviour, potentially leading to a collapse in asset prices arising from a change in asset 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 adopted by the US pose a threat to both macro-economic performance and the financial markets. An open trade war cannot currently be ruled out, which, in addition to the reduction in trade in goods and services, could also cause turbulence on the financial markets.

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, and in Italy. Besides the loss of political clout, this can also have negative implications for the economy.

Higher and continuing high levels of indebtedness in some instances pose another risk 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

A multitude of risks, easing fiscal measures and muted global trading are expected to slow down the pace of global economic growth in 2019. This could generate more pronounced regional differences than the year before. Moreover, risks and uncertainty factors, were they to materialise to a substantial extent, could mute the economic development, or even cause recessive tendencies in certain regions.

Although the euro zone is expected to continue showing slightly weaker growth in 2019, the threat of a recession is rated as low. The weaker growth is explained above all by a lower trade balance. We expect growth rates to be slightly lower for the most part in the euro zone markets that are relevant for Aareal Bank, while the Italian economy is likely to stagnate. Possible positive impetus from an expansionary fiscal policy in Italy should counter negative effects resulting from higher interest rates. Despite robust domestic demand, growth in the Netherlands is expected to be noticeably lower.

Economic growth in the EU this year is expected to exceed the euro area slightly. Expectations for the UK will be influenced significantly by the planned exit from the EU; the high degree of uncertainty surrounding the planned Brexit at the moment makes any forecast difficult. At present, it is fair to expect economic development to be stable at first – unless a hard Brexit (without an agreement with the EU) were to occur, in which case growth would likely be significantly weaker, possibly even tilting into recession.

Various indicators in the US suggest that the economic cycle has peaked there. Although considerably weaker growth is expected in 2019, it should nonetheless be much higher than in Europe. Slightly weaker growth is forecast in Canada, reaching a sustainable level following the previously very high growth rates.

Owing to easing investment in the energy sector, we see slightly weaker growth in Australia in 2019, which should however be better supported by investment in other areas.

In China, we expect the trend of slowing real GDP growth rates to continue. Factors influencing economic development in China are the targeted reduction of over-capacity in heavy industry and the transition to an overall lower investment ratio. We are still witnessing uncertainty with regard to the increase of macro-economic debt. Moreover, protectionist measures could also have a negative impact on trade, which is why federal support measures can be expected this year too.

Against a backdrop of positive economic growth, we expect most labour markets across the euro zone as well as in other European countries to register slowly decreasing to virtually stagnating unemployment rates for 2019. The US unemployment rate is also likely to continue to fall moderately.

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 a possible moderate increase in, for example, deposit interest rates in the second half of the year and no renewed expansion of the quantitative measures, the ECB will slowly distance itself this year from the expansionary measures resulting from the financial crisis. In the US, the Fed has signalled a cautious stance regarding further interest rate hikes; therefore, only a slight increase in key interest rates is anticipated during the current year. In the UK, the Bank of England has tied its monetary policy orientation to the effects of Brexit. It will likely raise the base rate further in the event of an orderly Brexit.

Besides changes in monetary policy, the robust economy supports a further interest rate hike this year in the US, which is expected to be followed by another moderate rise in short and long-term interest rates. However, the yield curve will flatten increasingly and short-term interest rates will rise more sharply than at the long end of the curve. Developments in the US could exert a certain upside pressure on euro zone interest rates, especially for long-term rates. This must also be seen in the face of the expired asset purchase programme. Nevertheless, levels in the euro zone should remain low, with the exception of Italy.

Noticeably lower energy prices lead us to expect lower inflation in the euro zone, the UK and the US in 2019. This could have a positive effect on economic growth and limit interest rate hikes by the central banks.

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").

Furthermore, the EBA has finalised its Guidelines related to the Internal Capital Adequacy Assessment Process (ICAAP) and the Internal Liquidity Adequacy Assessment Process (ILAAP). In addition, the expectations of the Single European Supervisory Mechanism (SSM) regarding the structure of ICAAP and ILAAP must be implemented, based on a multi-year plan.

Moreover, the Target Review of Internal Models (TRIM) of ECB-supervised institutions within Pillar I has not yet been completed. Finalisation of new requirements under CRR II, CRD V and BRRD II is imminent. In addition, EBA has published guidelines on PD and LGD estimates, the treatment of risk exposures, and the determination of downturn LGDs – which will need to be implemented.

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.

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 requires that areas and systems classified as "critical infrastructure" must be certified by mid-2019. The Bank has launched a corresponding project and commissioned this certification.

Sector-specific and business developments

Structured Property Financing segment

Demand for commercial properties will vary in 2019, depending on the region and property type. A shortage of sought-after top-class properties, along with reticence among different investors to invest in specific markets (such as Italy and the UK) or in specific property types (such as retail), will make itself felt in global transaction volumes. These are likely to be lower this year than in 2018.

Group Management Report
Consolidated Financial Statements
Transparency

Commercial property markets, as well as the economy, are exposed to major risks and threats. An excessively sharp interest rate hike could have a negative effect on performance. Moreover, other uncertainty factors and risks in the macroeconomic environment are also relevant for commercial property markets.

Several factors will influence the market value of commercial property over the course of the year. Whilst the still-robust economy and historically low interest rates will support property values, political uncertainty, a potential strong rise in interest rates, or investor reticence might have an adverse effect on values. Despite the sustained 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 in the market values of commercial property in many markets this year.

We expect a stable development of market values in 2019 in most European countries, such as Finland, France, Germany, the Netherlands, Poland, Russia and Sweden. For Spain, on the other hand, we consider slightly positive growth to be possible. Brexit is creating uncertainty in the UK, whereby a hard Brexit may lead to declining values. 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 markets or for some property types.

We assume property values in the US will remain stable on the whole. Increasing interest rates pose certain risks for this development. A stable performance also looks likely for Canada.

In Australia and China, stable market values for commercial property are expected.

The trends described above are expected to apply to office, retail and logistics properties.

As was the case last year already, the European hotel markets are for the most part expected to report growth in average revenues per available room. Occupancy rates remain very high in most markets. Relocations on the back of Brexit could lead to higher occupancies in individual continental European markets. Stable indicators are expected in the UK hotel market. Although the weak pound is boosting tourism, Brexit is likely to have a negative effect.

A less dynamic economy in the US is expected to lead to stagnating growth in occupancy rates in the hotel market there in 2019. However, higher average disposable income among consumers is likely to lead to a further increase in average room rates, so that average revenue per available room is expected to increase slightly in 2019. In Canada, the positive development of occupancy and average revenue per available room is likely to continue. However, the slowdown in the pace of economic growth should lead to a marginally smaller increase than in previous years.

For the Asia/Pacific region, we anticipate occupancy ratios and average revenues per available room to remain stable throughout 2019 in the hotel markets of many metropolitan areas.

The intense competition in commercial property financing is also likely to persist in many markets during the current year and we believe lenders are willing to lower margins, even if this might slowly lead to the formation of a plateau. We anticipate a virtually stable development in loan-to-value ratios across the various regions. Banks are expected to continue adhering to their preference for financing first-class properties in top locations.

We have incorporated various market aspects and our "Aareal 2020" programme for the future, amongst other factors, 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 2019 financial year, whereby the focus is set to remain on the high-margin US market. Aareal Bank Group's property financing portfolio should amount to between € 26 billion and € 28 billion at the end of 2019, 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.

Consulting/Services segment

Bank division Housing Industry

The German housing and commercial property industries are expected to continue showing solid development in 2019, on the back of stable rental income and a high degree of stability in property values.

Companies in this sector will continue to pursue sustainable portfolio optimisation. Energy-efficient renovation, deployment of technical assistance systems, expanding the digital infrastructure and serial construction activity are developments currently shaping investment trends.

Political developments and their impact on the profitability of individual measures may be affecting future corporate investment activities. Stricter regulations regarding energy efficiency measures to be incorporated during renovations, and rising requirements for new construction, might restrict the volume of investments.

The stable development on the residential property market is expected to prevail in 2019. Regional differences are expected to further increase, as a consequence of migration driven by education and labour market factors. 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 be able to benefit from these market developments.

We see good opportunities during 2019 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 "Aareal 2020" programme for the future, 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. We will continue to intensify our activities in the projects for connecting alternative payment systems. We also see potential in techniques that facilitate direct communication between a large number of paying agencies in the so-called Internet of Things (IoT), thus facilitating standardised settlement for a growing number of micro payments. We will also examine cooperations with Fintech and Proptech companies in order to realise corresponding approaches to development.

Besides these future technologies, we are also confident about the economic viability of established processes and procedures, which is why we will continue, for example, to expand the range of services we offer in the area of deposit management.

We expect the volume of deposits taken to remain on a high level. The persistent 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 2019 to pursue the growth strategy based on its strategy programme integrated in the "Aareal 2020" programme for the future. Sales revenue is expected to rise significantly, especially driven by higher market penetration with digital solutions, a strengthening of the ERP business, and by an expansion of activities in the energy utility and commercial property markets. Furthermore, Aareon plans to make significant investments in expanding its range of digital products, solutions related to new technologies, and to participate in the start-up scene, to accelerate organic growth. These investments serve to further develop the entire Aareal Bank Group in the long term.

We anticipate a slight increase in sales revenue in the ERP business. The focus in this context will be on the migration of GES clients to Wodis Sigma in Germany, which in 2019 will continue to account for a significant part of the consultancy business. There is potential for several complex major projects to be concluded in Germany and on international markets, which will lead to a higher volume of business in 2019. Projects are also expected to be completed in the energy utility and commercial property markets, which will lead to a higher volume of advisory business. Licence revenue from the ERP products will fall, as the migration business is expiring in Germany and no significant licence revenues are expected with key accounts in 2019. We will see a decline in ERP products business with international clients, as only a few regular licence extensions are scheduled for Dutch clients in the 2019 financial year.

The digital solutions will help realise growth potential, as they are poised to become more important in the property industry and to attract greater customer interest. Further product roll-outs are expected to lead to a marked increase in sales revenue, particularly for the digital solution Aareon CRM and mobile services. New CRM product generations will be introduced in the UK and the Netherlands, which will drive up demand. Further revenue growth will be realised in Sweden, as digital products will be marketed there in the future independent of the ERP products.

The volume of business generated with add-on products, such as insurance management with BauSecura and outsourcing services will remain on par with last year.

Based on the explanations outlined above, Aareon envisages a marked overall increase in sales revenue for the following year. Excluding strategic investments into accelerated growth, Aareon plans for a contribution to consolidated operating profit of around € 41 million; including these investments, the contribution to consolidated operating profit is expected to amount to around € 35 million.

Business strategy

Aareal Bank Group's strategy focuses on sustainable business success. With its Group-wide "Aareal 2020" programme for the future, the Bank is addressing the challenges of the future. In an environment characterised by technological change, further growing regulatory requirements, altered client needs and fiercer competition, this programme allows us to secure our strong foundation while also leveraging new revenue potential. Aareal Bank developed an extensive strategic roadmap for the implementation of "Aareal 2020", including various initiatives and projects for the further development of the Group. The measures introduced within the scope of the programme to increase efficiency and optimise structures and processes were implemented successfully, and most of the organisational and personnel changes they entail are applied.

We are also on the right track with our strategic initiatives to further develop the business models in both segments. This included expanding the business of the Structured Property Financing segment in attractive markets such as the United States, exploring additional options along the value creation chain through the partnership with Mount Street or the investment in BrickVest, and winning new syndication partners. In the Consulting/Services segment, Aareal Bank Group has grown its business beyond the core housing industry business, moving into related industries such as energy utilities or the commercial property sector. Having established digital platforms, the Bank has built a good foundation and sees opportunities for further growth with digital solutions. Moreover, to boost the segment's innovative strength and to supplement the product portfolio, partnerships with start-ups were agreed upon.

Group targets

We anticipate the challenging business environment to prevail during the current financial year – with continued low interest rates in Europe, strong competitive and margin pressure on key target markets, combined with an increasingly uncertain market environment and persistently strict regulatory requirements. Against this background, we will continue to adhere to our business policy with a strict focus on risks and returns. We will further accelerate our strategic development, within the framework of the "Aareal 2020" programme for the future – especially through our enhanced digital offensive in the Consulting/Services segment.

We expect net interest income (excluding net derecognition gain or loss) for the full year 2019 in a range between € 530 million and € 560 million. We estimate the volatile, market-driven net derecognition gain to be between € 20 million and € 40 million. Loss allowance is expected to remain in a range between € 50 million and € 80 million. Net commission income, whose importance for the Group is continuously rising due to the expansion of business activities in the Consulting/Services segment, in line with the strategy, is anticipated to rise further, to between € 225 million and € 245 million. Administrative expenses, including Aareon's additional investments to accelerate growth as well as integration costs for Düsselhyp, are expected between € 470 million and € 510 million.

Against this background, we expect consolidated operating profit for the current year to be in a range between € 240 million and € 280 million; this is in line with the previous year's figure, adjusted for the positive non-recurring effect related to Düsselhyp. We envisage RoE before taxes of between 8.5 % and 10 % for the current financial year, with earnings per share at around € 2.40 to € 2.80. We affirm our medium-term target RoE of at least 12 % before taxes.

We will continue the reduction of non-strategic portfolios in the Structured Property Financing segment during 2019. At the same time, our core credit portfolio is planned to grow in line with respective market conditions. Overall, subject to exchange rate fluctuations, Aareal Bank Group's aggregate property financing portfolio is expected to range between € 26 billion and € 28 billion. We are targeting new business of between € 7 billion and € 8 billion for the current year, with a continued focus on the high-margin US market. Our IT subsidiary Aareon is expected to contribute approximately € 35 million to consolidated operating profit, taking strategic investments into accelerated growth into account (excluding strategic investments: approximately € 41 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 % to be appropriate. The Liquidity Coverage Ratio (LCR) is expected to be at least 150 %.

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 current 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).

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 entrepreneurial goals and targets, within the framework of the defined risk appetite and risk strategies. 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 comprises a fixed component (including ancillary benefits and contributions to retirement provisions) and a variable component, the structure of which is governed by law. Variable remuneration must not exceed fixed remuneration.

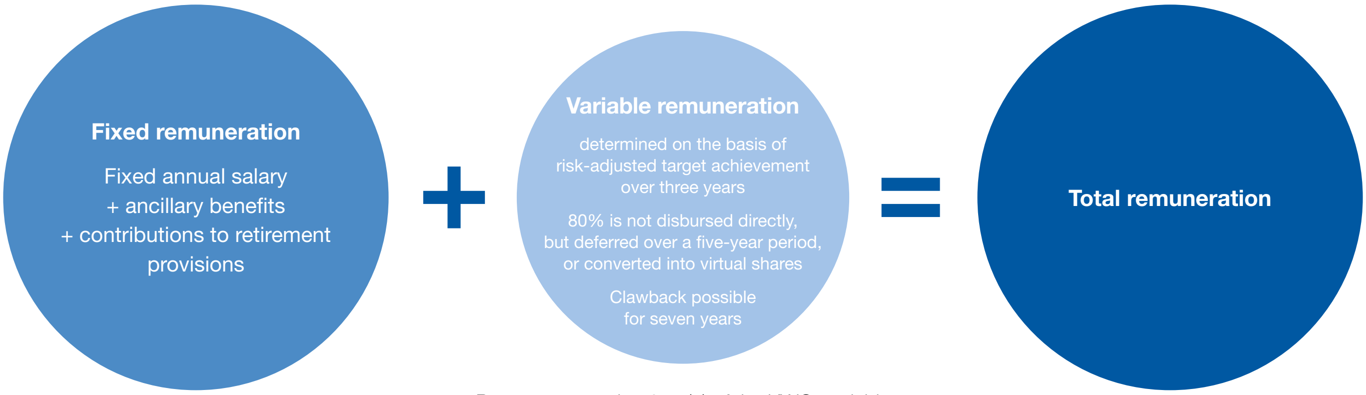
In a first step, pursuant to the InstVergV, the amount of variable remuneration must be determined in line with the degree of achievement of specific targets, which are based on a three-year period. Such targets must be derived from the business strategy, and must relate to three levels: targets related to Aareal Bank Group, to the respective Management Board member's area of responsibility, as well as that member's individual targets. Targets have both quantitative and qualitative, as well as financial and non-financial components. The Supervisory Board has not provided any discretionary components; it has capped the overall level of target achievement at 150 %.

Disbursement of 80 % of variable remuneration is deferred, in accordance with the InstVergV; 60 % of variable remuneration must be retained for up to five years. 50 % each of deferred and non-deferred variable remuneration components are converted into virtual shares, which allow Management Board members to participate in Aareal Bank's performance for up to six years. Performance of virtual shares is capped at 300 %.

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. 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 roughly equivalent to the fixed annual salary, Management Board members will have regularly earned virtual shares equivalent to their fixed annual salary level after two 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 and share-based remuneration"). At present, active Management Board members hold – on average – around 150,000 virtual Aareal Bank AG shares, equivalent to a single-digit million euro amount – which not least creates a parallel interest with shareholders.

Achievement of initial targets is regularly reviewed during the deferral period, and the amount of variable remuneration originally agreed upon (and hence, variable remuneration) adjusted ex-post if necessary **(back-testing).** Variable remuneration for a given financial year may be reduced in the event of inappropriate behaviour, or behaviour in breach of duties. 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

General breakdown of Management Board remuneration



Pursuant to section 25a (5) of the KWG, variable remuneration must not exceed fixed remuneration

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.

Service contracts with Management Board members do not provide for any severance pay in the event of a contract being terminated prematurely by way of mutual consent, without good cause. In such cases, severance pay may be made on the basis of an individual agreement, which however is capped at a maximum of two annual remuneration amounts, or the value of the remaining contract term (severance cap).

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. Ordinary members of Aareal Bank AG's Management Board, for whom the so-called "newcomers rule" does not apply, receive a fixed annual salary of € 880,000; the Chairman of the Management Board receives € 1.3 million.

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 the 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. 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 may be entitled to claim benefits prior to turning 60 or 62, respectively.

The pension claims are adjusted to take account of the development of standard wages within the private banking sector as from the beginning of actual payments of pensions, to the extent that these are based on defined benefit plans. If the payments refer to defined contribution plans, the guaranteed amount is adjusted by 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.

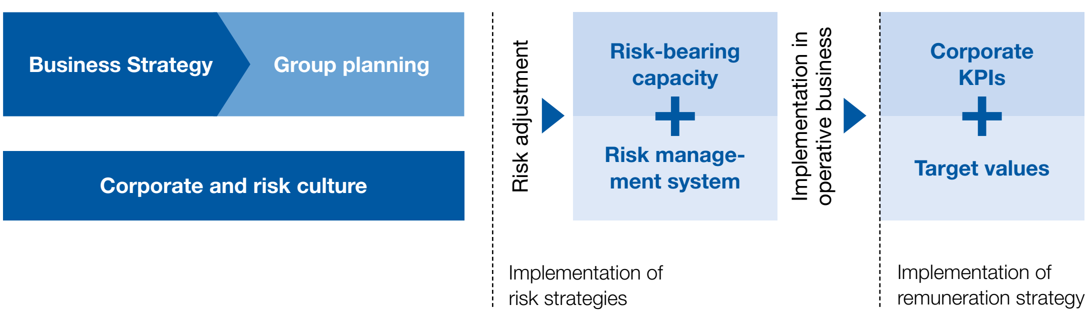
Performance-related variable remuneration

Management Board members receive variable remuneration, the amount of which depends upon achievement of pre-determined three-year targets derived from the strategy. In addition, the amount of variable remuneration also depends upon the performance of virtual shares, which allow Management Board members to participate in the Company's ongoing performance for a six-year period (for details, please refer to the following chapter). This means that the variable remuneration effectively reflects a period spanning nine years in total (three-year assessment basis plus five-year deferral period and one-year holding period for the virtual shares) and is largely of a forward-looking nature. There are no discretionary components besides this. The reference value for 100 % target achievement amounts to € 1.4 million for the Chairman of the Management Board, and to € 800,000 for ordinary Management Board members for whom the so-called "newcomers rule" does not apply.

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, and risk-adjusted in line with the Bank's risk strategies. Hence, the target parameters (KPIs) derived from the strategy are geared towards the 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.

Derivation of remuneration strategy, indicators, and target values



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 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 the 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 objectives set out in the Bank's business and risk strategies **(pay-for-performance principle).** When setting targets, the Supervisory Board pays attention to defining ambitious but 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.

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 % target achievement level. 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

Methodology for the calculation of annual target achievement

Example shown: financial year 2018

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, among other things, specific target values for new business, or regarding credit portfolios, or the contribution of material subsidiaries such as Aareon AG. In accordance with Aareal Bank Group's risk management system, these income targets 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.

Individual targets are related to each Management Board member's individual performance, and also comprise specific sustainability (environmental, social, governance – "ESG") targets: 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. They also need to achieve material sustainability aspects, such as the implementation of Aareal Bank Group's cultural objectives; targets include assessments as to whether communication with employees is effective, if the Management Board member complies with his or her own governance requirements, and whether he or she acts as a role model.

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, with the other two target levels weighted at 15 % each.

As the strategy refers to a period of several years, targets are also set to refer to multiple years. To measure and monitor target achievement, annual targets are derived from the overall strategy; the level of achievement is, however, viewed over a three-year period **(three-year assessment basis).**

To date, only Group performance targets covered a period of several years. Due to new regulatory requirements set out by the InstitutsVergV, this multiple-year assessment must be extended to cover all target levels for remuneration determined for the 2019 financial year for the first time. In order to continue setting ambitious targets and a strong incentive for successful Management Board work, target achievement levels are set to be 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 period will end with the 2021 financial year.

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:

- 20 % of the variable remuneration is disbursed as a cash bonus after the Supervisory Board has determined the overall target achievement level.

- A further 20 % of the variable remuneration is awarded as a share bonus subject to a holding period (and forms part of the share-based bonus plan), in the form of virtual shares, also after the Supervisory Board has determined the overall target achievement level.

- 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).

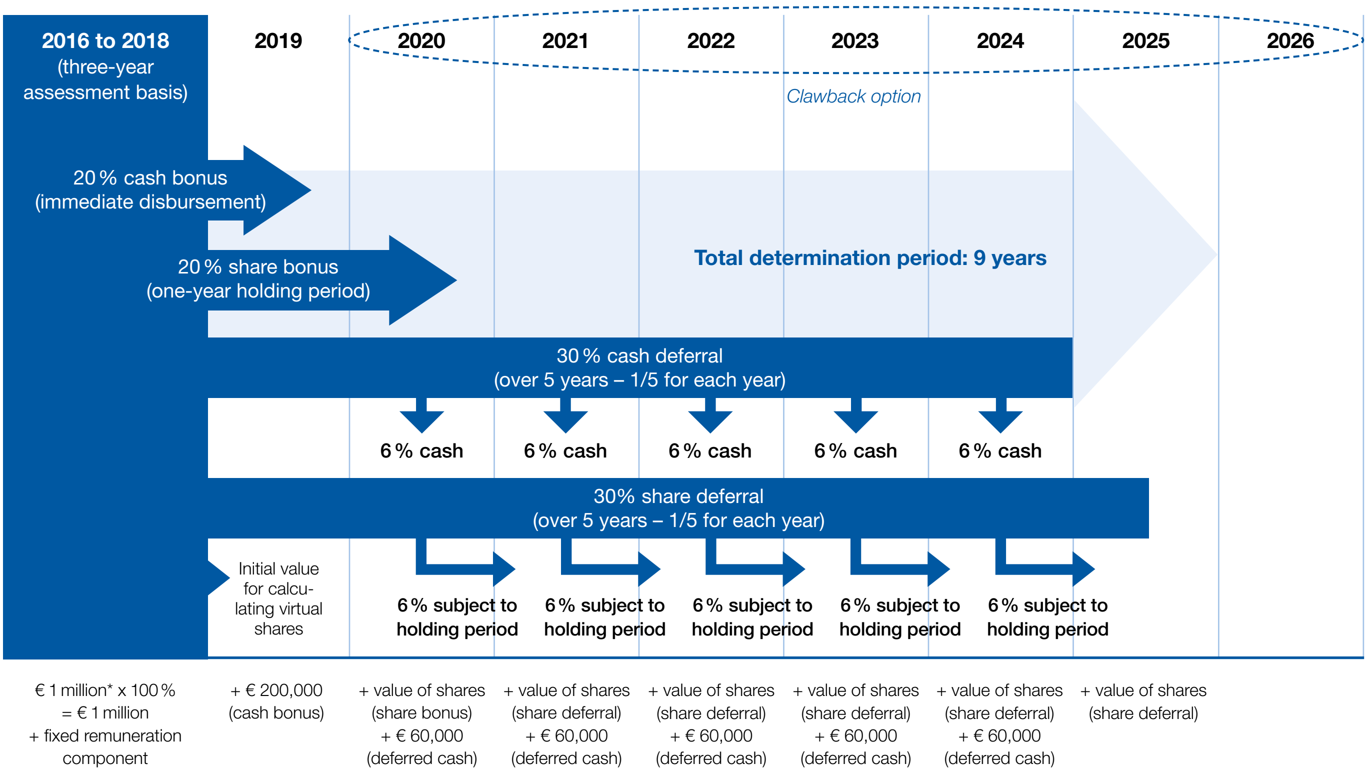
This means that deferred disbursement over a period of up to six years applies to 80 % of variable remuneration determined.

Five-year deferral period

With regard to 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 third of the amount, as well as the associated interest, in the five years following the determination of the performance-related remuneration (retention period – cf. "Ex-post review of target achievement and behaviour of the Management Board").

Sample disbursement methodology, based on 100 % target achievement for the 2018 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.

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) 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).

Remuneration system prior to the 2018 financial year

The remuneration system for Management Board members was adjusted in various places, reflecting amendments to the InstVergV. Specifically, the deferral period for variable remuneration determined from 2018 onwards was extended from three to five years. Accordingly, decisions concerning remuneration for financial years prior to 2018 refer to one-third of deferred remuneration in each case; for variable remuneration determined for financial years from 2018 onwards, decisions refer to one-fifth for each deferral period. For variable remuneration determined prior to the 2018 financial year, the applicable holding period is three years for the share bonus, and two years for the share deferral. A uniform one-year holding period applies from the 2018 financial year onwards.

Given that these changes were mandatory under banking regulations, they were not submitted to the Annual General Meeting for approval. In principle, Aareal Bank endeavours to obtain the Annual General Meeting's approval for the Management Board remuneration system in regular intervals of at least four to five years. However, considering the Bill to Implement the Second EU Shareholder Rights Directive ("ARUG II"), which is yet to be forthcoming, and possible new recommendations on remuneration provided by the German Corporate Governance Code (which is currently being revised), the Supervisory Board will have to deal with potential further adjustments to the remuneration system for the Management Board (and related reporting). The Supervisory Board intends to submit this system to the Annual General Meeting for approval once this process has been concluded.

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, breaches of the Code of Conduct and/or Compliance guidelines, 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.

Clawbacks

Starting with variable remuneration for the 2018 financial year, agreements concluded with members of the Management Board ensure that variable remuneration already disbursed may be reclaimed ("clawed back") in the event of certain cases of negative performance contribution – for instance, if supervisory authorities of Aareal Bank AG demand that a Management Board member be removed due to lack of aptitude.

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.

1:1 cap, plus 150 % cap for variable remuneration

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 remuneration is additionally capped at 150 %. Hence, variable remuneration determined cannot exceed 150 % of the reference level.

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 a target level for the Common Equity Tier I ratio (CET I ratio) as the measurement threshold in order to secure adherence of the regulatory capital adequacy and a suitable liquidity measure (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 InstitutsVergV. 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 InstitutsVergV. 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 within the meaning of section 4.2.3 of the German Corporate Governance Code (hereinafter referred to as the "Code"), 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 ancillary 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, in accordance with section 4.2.3. of the Code.

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 InstitutsVergV, 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 InstitutsVergV, 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.

Remuneration of the Management Board

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.

€	Year	Fixed remuneration	Variable remuneration: Cash component – Cash bonus	Cash deferral[1]	Share-based component – Share bonus	Share deferral[1]	Target achievement level[2]	Total	Ancillary benefits	Total remuneration
Hermann J. Merkens	2018	1,300,000	304,248	456,372	304,248	456,372	108.7 %	1,521,240	34,024	2,855,264
	2017	1,300,000	343,994	515,991	343,994	515,991	122.9 %	1,719,970	39,557	3,059,527
Marc Hess[3]	2018	220,000	40,329	60,493	40,329	60,493	100.0 %	201,644	3,244	424,888
	2017	–	–	–	–	–	–	–	–	–
Dagmar Knopek	2018	880,000	164,256	246,384	164,256	246,384	102.7 %	821,280	19,598	1,720,878
	2017	880,000	196,568	294,852	196,568	294,852	122.9 %	982,840	32,605	1,895,445
Christiane Kunisch-Wolff	2018	704,000	139,085	208,627	139,085	208,627	108.7 %	695,424	25,466	1,424,890
	2017	704,000	157,254	235,882	157,254	235,882	122.9 %	786,272	27,922	1,518,194
Thomas Ortmanns	2018	880,000	173,856	260,784	173,856	260,784	108.7 %	869,280	18,504	1,767,784
	2017	880,000	194,168	291,252	194,168	291,252	121.4 %	970,840	55,260	1,906,100
Christof Winkelmann	2018	704,000	139,085	208,627	139,085	208,627	108.7 %	695,424	70,329	1,469,753
	2017	704,000	159,174	238,762	159,174	238,762	124.4 %	795,872	24,062	1,523,934
Total	**2018**	**4,688,000**	**960,859**	**1,441,287**	**960,859**	**1,441,287**	**107.2 %**	**4,804,292**	**171,165**	**9,663,457**
	2017	**4,468,000**	**1,051,158**	**1,576,739**	**1,051,158**	**1,576,739**	**122.9 %**	**5,255,794**	**179,406**	**9,903,200**

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

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 € 3.0 million (2017: € 2.9 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 higher than the fixed annual salary that makes up the fixed remuneration component. 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 the fixed component after two 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 following table shows the portion of the variable component attributable to share-based payment arrangements as well as the corresponding number of virtual shares granted in 2018 and 2017, respectively – as well as the number of virtual shares already held as at the reporting date:

		Share-based remuneration		Total quantity of virtual shares held (31 Dec)
	Year	Value (€)	Quantity (number)[1]	Quantity (number)
Hermann J. Merkens	2018	760,620	28,182	55,340
	2017	859,985	21,995	50,638
Mark Hess[2]	2018	100,822	3,736	–
	2017	–	–	–
Dagmar Knopek	2018	410,640	15,215	36,772
	2017	491,420	12,568	31,924
Christiane Kunisch-Wolff	2018	347,712	12,883	9,726
	2017	393,136	10,055	3,798
Thomas Ortmanns	2018	434,640	16,104	38,112
	2017	485,420	12,415	41,136
Christof Winkelmann	2018	347,712	12,883	7,659
	2017	397,936	10,177	2,389
Total	**2018**			**147,609**
	2017			**129,885**

[1] The stated number of virtual shares granted for 2018 is a preliminary figure, based on the price of Aareal Bank AG's share on 31 December 2018 (€ 26.99). The final conversion rate may only be determined after publication of preliminary results for 2018. The stated number of virtual shares granted for 2017 differs slightly from the previous year's figure since the former was calculated using a final conversion rate of € 39.10.

[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 sections 4.2.4 and 4.2.5 of the German Corporate Governance Code:

Remuneration granted	Hermann J. Merkens – Chairman of the Management Board			
	2017	2018	2018 (min)[1]	2018 (max)[2]
€				
Fixed remuneration	1,300,000	1,300,000	1,300,000	1,300,000
Ancillary benefits	39,557	34,024	34,024	34,024
Total	**1,339,557**	**1,334,024**	**1,334,024**	**1,334,024**
Variable remuneration based on a single-year assessment	280,000	280,000	–	420,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2018 (March 2024)	–	420,000	–	630,000
Share bonus 2018 (March 2019)	–	280,000	–	420,000
Share deferral 2018 (March 2024)	–	420,000	–	630,000
Cash deferral 2017 (March 2021)	420,000	–	–	–
Share bonus 2017 (March 2018)	280,000	–	–	–
Share deferral 2017 (March 2021)	420,000	–	–	–
Total	**1,400,000**	**1,400,000**	**–**	**2,100,000**
Benefit expense	726,347	847,178	847,178	847,178
Total remuneration	**3,465,904**	**3,581,202**	**2,181,202**	**4,281,202**

Remuneration granted	Marc Hess[3]			
	2017	2018	2018 (min)[1]	2018 (max)[2]
€				
Fixed remuneration	–	220,000	220,000	220,000
Ancillary benefits	–	3,244	3,244	3,244
Total	**–**	**223,244**	**223,244**	**223,244**
Variable remuneration based on a single-year assessment	–	40,329	–	60,493
Variable remuneration based on a multiple-year assessment				
Cash deferral 2018 (March 2024)	–	60,493	–	90,740
Share bonus 2018 (March 2019)	–	40,329	–	60,493
Share deferral 2018 (March 2024)	–	60,493	–	90,740
Cash deferral 2017 (March 2021)	–	–	–	–
Share bonus 2017 (March 2018)	–	–	–	–
Share deferral 2017 (March 2021)	–	–	–	–
Total	**–**	**201,644**	**–**	**302,466**
Benefit expense	–	148,056	148,056	148,056
Total remuneration	**–**	**572,944**	**371,300**	**673,766**

[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	Dagmar Knopek			
	2017	2018	2018 (min)[1]	2018 (max)[2]
€				
Fixed remuneration	880,000	880,000	880,000	880,000
Ancillary benefits	32,605	19,598	19,598	19,598
Total	**912,605**	**899,598**	**899,598**	**899,598**
Variable remuneration based on a single-year assessment	160,000	160,000	–	240,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2018 (March 2024)	–	240,000	–	360,000
Share bonus 2018 (March 2019)	–	160,000	–	240,000
Share deferral 2018 (March 2024)	–	240,000	–	360,000
Cash deferral 2017 (March 2021)	240,000	–	–	–
Share bonus 2017 (March 2018)	160,000	–	–	–
Share deferral 2017 (March 2021)	240,000	–	–	–
Total	**800,000**	**800,000**	**–**	**1,200,000**
Benefit expense	399,791	488,691	488,691	488,691
Total remuneration	**2,112,396**	**2,188,289**	**1,388,289**	**2,588,289**

Remuneration granted	Christiane Kunisch-Wolff			
	2017	2018	2018 (min)[1]	2018 (max)[2]
€				
Fixed remuneration	704,000	704,000	704,000	704,000
Ancillary benefits	27,922	25,466	25,466	25,466
Total	**731,922**	**729,466**	**729,466**	**729,466**
Variable remuneration based on a single-year assessment	128,000	128,000	–	192,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2018 (March 2024)	–	192,000	–	288,000
Share bonus 2018 (March 2019)	–	128,000	–	192,000
Share deferral 2018 (March 2024)	–	192,000	–	288,000
Cash deferral 2017 (March 2021)	192,000	–	–	–
Share bonus 2017 (March 2018)	128,000	–	–	–
Share deferral 2017 (March 2021)	192,000	–	–	–
Total	**640,000**	**640,000**	**–**	**960,000**
Benefit expense	697,851	422,142	422,142	422,142
Total remuneration	**2,069,773**	**1,791,608**	**1,151,608**	**2,111,608**

[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	Thomas Ortmanns			
	2017	2018	2018 (min)[1]	2018 (max)[2]
€				
Fixed remuneration	880,000	880,000	880,000	880,000
Ancillary benefits	55,260	18,504	18,504	18,504
Total	**935,260**	**898,504**	**898,504**	**898,504**
Variable remuneration based on a single-year assessment	160,000	160,000	–	240,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2018 (March 2024)	–	240,000	–	360,000
Share bonus 2018 (March 2019)	–	160,000	–	240,000
Share deferral 2018 (March 2024)	–	240,000	–	360,000
Cash deferral 2017 (March 2021)	240,000	–	–	–
Share bonus 2017 (March 2018)	160,000	–	–	–
Share deferral 2017 (March 2021)	240,000	–	–	–
Total	**800,000**	**800,000**	**–**	**1,200,000**
Benefit expense	544,137	621,605	621,605	621,605
Total remuneration	**2,279,397**	**2,320,109**	**1,520,109**	**2,720,109**

Remuneration granted	Christof Winkelmann			
	2017	2018	2018 (min)[1]	2018 (max)[2]
€				
Fixed remuneration	704,000	704,000	704,000	704,000
Ancillary benefits	24,062	70,329	70,329	70,329
Total	**728,062**	**774,329**	**774,329**	**774,329**
Variable remuneration based on a single-year assessment	128,000	128,000	–	192,000
Variable remuneration based on a multiple-year assessment				
Cash deferral 2018 (March 2024)	–	192,000	–	288,000
Share bonus 2018 (March 2019)	–	128,000	–	192,000
Share deferral 2018 (March 2024)	–	192,000	–	288,000
Cash deferral 2017 (March 2021)	192,000	–	–	–
Share bonus 2017 (March 2018)	128,000	–	–	–
Share deferral 2017 (March 2021)	192,000	–	–	–
Total	**640,000**	**640,000**	**–**	**960,000**
Benefit expense	663,349	498,191	498,191	498,191
Total remuneration	**2,031,411**	**1,912,520**	**1,272,520**	**2,232,520**

[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	
	2018	2017	2018	2017	2018	2017	2018	2017
€								
Fixed remuneration	1,300,000	1,300,000	220,000	–	880,000	880,000	704,000	704,000
Ancillary benefits	34,024	39,557	3,244	–	19,598	32,605	25,466	27,922
Total	**1,334,024**	**1,339,557**	**223,244**	**–**	**899,598**	**912,605**	**729,466**	**731,922**
Variable remuneration based on a single-year assessment	343,994	377,720	–	–	196,568	212,320	157,254	135,309
Variable remuneration based on a multiple-year assessment								
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 2013 (April 2017)	–	112,727	–	–	–	65,757	–	–
Cash deferral 2014 (April 2017)	–	103,030	–	–	–	102,785	–	–
Cash deferral 2015 (April 2017)	–	150,686	–	–	–	106,969	–	–
Share bonus 2013 (April 2017)	–	239,867	–	–	–	139,922	–	–
Share deferral 2012 (April 2017)	–	222,358	–	–	–	–	–	–
Share deferral 2013 (April 2017)	–	121,816	–	–	–	71,060	–	–
Dividends	138,349	101,276	–	–	91,929	63,848	24,316	7,595
Total	**1,613,853**	**1,429,480**	**–**	**–**	**985,743**	**762,661**	**249,509**	**142,904**
Benefit expense	847,178	726,347	148,056	–	488,691	399,791	422,142	697,851
Total remuneration	**3,795,055**	**3,495,384**	**371,300**	**–**	**2,374,032**	**2,075,057**	**1,401,117**	**1,572,677**

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

Remuneration paid	Thomas Ortmanns		Christof Winkelmann		Dr Wolf Schumacher[2]		Dirk Große Wördemann[3]	
	2018	2017	2018	2017	2018	2017	2018	2017
€								
Fixed remuneration	880,000	880,000	704,000	704,000	–	–	–	–
Ancillary benefits	18,504	55,260	70,329	24,062	–	–	–	–
Total	**898,504**	**935,260**	**774,329**	**728,062**	**–**	**–**	**–**	**–**
Variable remuneration based on a single-year assessment	194,168	213,600	159,174	85,120	–	–	–	–
Variable remuneration based on a multiple-year assessment								
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 2013 (April 2017)	–	112,727	–	–	–	190,184	–	–
Cash deferral 2014 (April 2017)	–	102,215	–	–	–	179,875	–	–
Cash deferral 2015 (April 2017)	–	106,325	–	–	–	138,812	–	–
Share bonus 2013 (April 2017)	–	239,867	–	–	–	404,684	–	–
Share deferral 2011 (April 2017)	–	–	–	–	–	–	–	238,390
Share deferral 2012 (April 2017)	–	222,358	–	–	–	375,143	–	180,523
Share deferral 2013 (April 2017)	–	121,816	–	–	–	205,519	–	–
Dividends	95,279	82,271	19,149	4,778	88,048	111,251	–	10,369
Total	**1,290,722**	**1,201,179**	**221,062**	**89,898**	**1,584,728**	**1,605,468**	**202,720**	**429,282**
Benefit expense	621,605	544,137	498,191	663,349	–	–	–	–
Total remuneration	**2,810,831**	**2,680,576**	**1,493,582**	**1,481,309**	**1,584,728**	**1,605,468**	**202,720**	**429,282**

1) Dr Wolf Schumacher resigned with effect from 30 September 2015. 2) Dirk Große Wördemann resigned with effect from 31 May 2013.

Pensions

	2018			2017		
	Pension claims p.a.[1]	Balance of pension obligations (IFRS) as at 31 Dec 2018	Increase of pension obligations (IFRS) in 2018	Pension claims p.a.[1]	Balance of pension obligations (IFRS) as at 31 Dec 2017	Increase of pension obligations (IFRS) in 2017
€ 000's						
Hermann J. Merkens	307	7,270	847	285	6,422	726
Marc Hess[2]	37	148	148	–	–	–
Dagmar Knopek	134	2,510	489	113	2,021	400
Christiane Kunisch-Wolff	118	1,172	422	116	750	698
Thomas Ortmanns	280	6,357	622	267	5,735	544
Christof Winkelmann	115	1,228	498	113	730	663
Total	**991**	**18,685**	**3,026**	**894**	**15,658**	**3,031**

1) Pension claims are calculated based on the earliest possible pension payment.
2) Marc Hess was appointed to the Management Board on 1 October 2018.

Service cost (in accordance with IFRSs) incurred in the 2018 financial year in connection with the pension claims of members of the Management Board totalled € 2.7 million (2017: € 2.8 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 € 2.8 million in the year under review (2017: € 2.4 million). The total amount of pension obligations was € 51.5 million (2017: € 48.7 million). Of that amount, € 32.8 million related to former members of the Management Board and their surviving dependants (2017: € 33.1 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. The remuneration system for the Supervisory Board only comprises a fixed remuneration, supplemented by a compensation for attending meetings. 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.

The fixed remuneration is € 50,000 p.a. for each Supervisory Board member. The Chairman of the Supervisory Board shall receive three times this amount, while the deputies shall receive one and a half times as much as a normal member. The fixed remuneration is increased for each membership in a committee (with the exception of the Committee for Urgent Decisions, which is part of the Risk Committee).

This additional fixed remuneration amounts to € 20,000 p.a. for membership of the Risk Committee and the Audit Committee; fixed remuneration is increased by € 40,000 p.a. for the chairmanship of one of these committees.

The additional fixed remuneration amounts to € 15,000 p.a. for membership of the other Supervisory Board committees; fixed remuneration is increased by € 30,000 p.a. for the chairmanship of one of these committees.

The meeting attendance compensation amounts to € 1,000 for each meeting attended (except for the Committee for Urgent Decisions).

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

Supervisory Board remuneration

€	Year	Fixed remuneration	Attendance fees	Total remuneration
Marija Korsch	2018	265,000	36,000	301,000
Chairman	2017	265,000	33,000	298,000
Prof. Dr Stephan Schüller	2018	125,000	27,000	152,000
Deputy Chairman	2017	125,000	25,000	150,000
Dieter Kirsch, Deputy Chairman	2018	100,000	20,000	120,000
(31 March to 31 December 2018)	2017	85,000	17,000	102,000
York-Detlef Bülow	2018	31,250	9,000	40,250
Deputy Chairman (until 31 March 2018)	2017	125,000	24,000	149,000

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€	Year	Fixed remuneration	Attendance fees	Total remuneration
Thomas Hawel	2018	65,000	12,000	77,000
	2017	65,000	10,000	75,000
Petra Heinemann-Specht (from 1 April 2018)	2018	52,500	10,000	62,500
	2017	–	–	–
Richard Peters	2018	100,000	23,000	123,000
	2017	100,000	21,000	121,000
Dr Hans-Werner Rhein	2018	85,000	16,000	101,000
	2017	85,000	15,000	100,000
Sylvia Seignette	2018	90,000	13,000	103,000
	2017	90,000	10,000	100,000
Elisabeth Stheeman [1)]	2018	85,000	17,000	102,000
	2017	85,000	14,000	99,000
Hans-Dietrich Voigtländer	2018	115,000	26,000	141,000
	2017	115,000	24,000	139,000
Prof. Dr Hermann Wagner	2018	110,000	19,000	129,000
	2017	110,000	16,000	126,000
Beate Wollmann	2018	65,000	12,000	77,000
	2017	50,000	6,000	56,000
Total	**2018**	**1,288,750**	**240,000**	**1,528,750**
	2017	**1,300,000**	**215,000**	**1,515,000**

[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).

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.

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 profit, as well as in terms of risk weighted assets. The performance of the Housing Industry division is measured by reference to the segment operating profit 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 weightings attached to the three additive components depending on an individual's responsibility within the Company. The weighting assigned to the Group and organisational unit components, for example, gradually increases from 15 % and 25 % to 25 % and 35 % respectively, while the weighting assigned to the individual component can be reduced from 60 % to 40 % at the same time. For further information on the individual targets and possible resulting KPIs, please 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 assigned to the management level below the Management Board 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, 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 covered by, and exempt from, collective agreements who are not classed as risk takers

Employees who are not risk takers also receive variable remuneration. The variable remuneration 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 variable remuneration 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

For risk takers, the target achievement level for the Group component and the organisational component is capped at 150 %. 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 %. For non-risk takers whose variable remuneration is determined based on an appraisal and, where appropriate, individual targets, the variable compensation is also limited to 200 % in relation to the target achievement level.

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 € 100,000, for example, the reference value for the variable remuneration paid out if that employee achieves 100 % target achievement is limited to a maximum of € 50,000. It is very common, however, for variable remuneration to account for a smaller proportion of an employee's 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.

Consideration of corporate performance and risk-bearing capacity

Both the variable remuneration paid to risk-takers and the variable remuneration paid to non-risk takers take account of the Company's performance.

The variable remuneration paid to non-risk takers is initially calculated, for the assessment year in question, as the total of all variable remuneration paid to non-risk takers in the event of a target achievement level of 105 % (hereinafter referred to as the "bonus pool") as part of a two-step procedure, with the first step (30 %) also taking the operating profit and RWA into account. The variable remuneration to be paid out to non-risk takers cannot exceed the bonus pool, which is to be calculated on an annual basis. If the relevant lower thresholds for RWA and operating profit set out in the recovery plan for the corresponding assessment year are reached or undercut, then the first step is dispensed with entirely and the bonus pool volume corresponds to a maximum of 70 % from the second step. In such cases, due to the structure of the model, the variable remuneration paid to risk-takers results in a reduction in the Group component, or in the Group component ceasing to apply, anyway.

The bonus pool volume referred to above for non-risk takers can be restricted further or reduced to zero if the corresponding thresholds set out in the recovery plan are undercut further, or if the corresponding lower thresholds are met. If a threshold is only undercut for a brief period, the Management Board can opt not to reduce the bonus pool. The Management Board can make the same decision for the variable remuneration paid to risk-takers or can also opt to reduce the variable remuneration to be distributed.

If the total amount of variable remuneration available for distribution is to be reduced, the variable remuneration to be paid out to the employees is reduced by the same proportion.

In all other respects, the provisions on risk-bearing capacity explained in the section on the Management Board system (see risk-bearing capacity, and parallel interest with shareholders) apply accordingly.

Amendments to the remuneration systems last year

In order to implement the new requirements set out in the German Regulation on Remuneration in Financial Institutions, the deferral period for the variable remuneration payable to risk takers assigned to the management level below the Management Board was increased from three to five years and a clawback rule was agreed. Provisions were also developed stating that no interest or dividends can be paid on deferred remuneration components.

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 InstitutsVergV. 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 is made available within six months of the end of the financial year. www.aareal-bank.com/en/investors-portal/finance-information/regulatory-disclosures/archive/2018/

Remuneration governance

Governance of Supervisory Board remuneration

The role of the Annual General Meeting

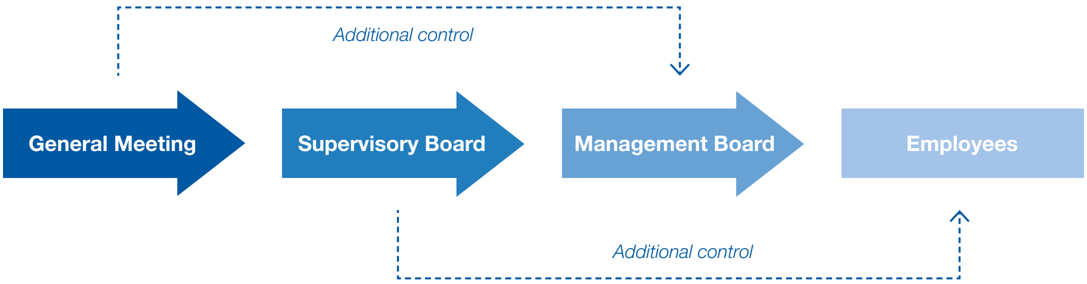
Given the Supervisory Board's role as a supervisory body, remuneration for its members must not provide any incentives which would counter this surveillance function. The Annual General Meeting (AGM) determines the remuneration of the Supervisory Board, in Aareal Bank AG's Memorandum and Articles of 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).

Implementing the Second Shareholder Rights Directive, from the financial year 2020 onwards, 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.

Determination and control of remuneration systems



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 seven 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.

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. In line with its own understanding of good corporate governance, Aareal Bank makes such submission in the event of any material changes to the remuneration system for the Management Board. Implementation of the Second EU Shareholder Rights Directive (2017/828 (EU)) will require a mandatory submission at least every four years, from 2020 onwards. The Supervisory Board of Aareal Bank will give due consideration to the vote of the AGM.

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 to the consolidated financial statements.

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 attendance of the members of the Supervisory Board and its committees.

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 InstitutsVergV. 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 InstitutsVergV 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 such as hkp Deutschland GmbH.

Explanatory Report of the Management Board on Takeover Disclosures in Accordance with Section 315a (1) of the German Commercial Code (Handelsgesetzbuch – "HGB")

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

The composition of Aareal Bank AG's subscribed capital is shown in Note 60 ("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 Note 82 to the consolidated financial statements.

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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 General Meeting on 21 May 2014, the Management Board was authorised to issue, on one or more occasions until 20 May 2019, profit-participation rights with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of € 1,000,000,000. Holder or creditor conversion rights may be attached to such profit-participation rights, provided they are not issued against contribution in kind. Conversion rights may be attached exclusively to no-par value bearer shares and are limited to a maximum amount of € 89,785,830 of the Company's share capital. Issuance of profit-participation rights may also be effected by domestic or foreign enterprises in which the Company either directly or indirectly holds a majority interest. In such cases, the Company may itself assume guarantees and offer shares of Aareal Bank AG, subject to the approval of the Supervisory Board, in order to meet the resulting conversion rights. 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.

The issued share capital is subject to a conditional capital increase not exceeding € 89,785,830 by issuance of up to 29,928,610 new no-par value bearer shares ("Conditional Capital 2014"). The conditional capital increase shall be implemented only insofar as (i) the holders or creditors of conversion rights from convertible profit-participation rights issued by the Company (or by an enterprise in which the Company either directly or indirectly holds a majority interest) until 20 May 2019 on the basis of the Annual General Meeting's authorisation resolution of 21 May 2014 exercise their conversion rights or (ii) the holders or creditors of convertible profit-participation rights issued by the Company (or by an enterprise in which the Company either directly or indirectly holds a majority interest) until 20 May 2019 on the basis of the Annual General Meeting's authorisation resolution of 21 May 2014 and who are obliged to exercise those rights fulfil their obligation or (iii) the Company makes use of alternative performance; insofar as treasury shares are not used to service the rights or, in the aforementioned cases (i) and (ii), no cash compensation is granted. 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.

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 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.

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, which forms part of the Group Management Report.

Consolidated Non-financial Statement

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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Consolidated Financial Statements
Statement of Comprehensive Income

Income Statement

€ mn	Note	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1]
Interest income from financial instruments (ac and fvoci)		847	835
Interest income from financial instruments (fvpl)		38	8
Market-driven modification gains		2	n/a
Interest expenses for financial instruments (ac)		113	110
Interest expenses for financial instruments (fvpl)		236	149
Market-driven modification losses		3	n/a
Net interest income	28	**535**	**584**
Loss allowance excluding credit-driven net modification gain or loss		72	82
Credit-driven net modification gain or loss		0	n/a
Loss allowance	29	**72**	**82**
Commission income		259	243
Commission expenses		44	37
Net commission income	30	**215**	**206**
Net gain or loss on the derecognition of financial assets (ac)		24	50
Net gain or loss on the derecognition of financial liabilities (ac)		0	0
Net gain or loss on the derecognition of financial assets (fvoci)		–	0
Net derecognition gain or loss	31	**24**	**50**
Net gain or loss from financial instruments (fvpl)	32	-2	14
Net gain or loss from hedge accounting	33	-2	-7
Net gain or loss from investments accounted for using the equity method	34	0	–
Administrative expenses	35	462	511
Net other operating income/expenses	36	25	74
Negative goodwill from acquisitions	37	55	–
Operating profit		**316**	**328**
Income taxes	38	90	115
Consolidated net income		**226**	**213**
Consolidated net income attributable to non-controlling interests		2	6
Consolidated net income attributable to shareholders of Aareal Bank AG		224	207
Earnings per share (EpS)			
Consolidated net income attributable to shareholders of Aareal Bank AG[2]		224	207
of which: allocated to ordinary shareholders		208	191
of which: allocated to AT1 investors		16	16
Earnings per ordinary share (in €)[3]		3.48	3.20
Earnings per AT1 unit (in €)[4]		0.16	0.16

[1] Comparative amounts reclassified according to the new classification format

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

[3] 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.

[4] Earnings per AT1 unit (based on 100,000,000 AT1 units with a notional amount of € 3 each) are determined by dividing the earnings allocated 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 2018	1 Jan - 31 Dec 2017[1)]
Consolidated net income	**226**	**213**
Items that will not be reclassified subsequently to profit or loss		
Changes in the reserve from remeasurements of defined benefit plans	**-7**	**9**
Remeasurements	-10	13
Taxes	3	-4
Changes in the reserve from the measurement of equity instruments (fvoci)	**0**	**–**
Gains and losses from equity instruments (fvoci)	0	–
Transfers to retained earnings	–	–
Taxes	0	–
Items that are reclassified subsequently to profit or loss		
Changes in the reserve from the measurement of debt instruments (fvoci)	**-14**	**-5**
Gains and losses from debt instruments (fvoci)	-20	-7
Reclassifications to the income statement	–	0
Taxes	6	2
Changes in hedging reserves	**–**	**-18**
Profit/loss from derivatives used to hedge future cash flows	–	-27
Reclassifications to the income statement	–	0
Taxes	–	9
Changes in the reserve from foreign currency basis spreads	**-12**	**n/a**
Gains and losses from foreign currency basis spreads	-17	n/a
Reclassifications to the income statement	–	n/a
Taxes	5	n/a
Changes in currency translation reserves	**5**	**-15**
Gains and losses from translating foreign operations' financial statements	1	-15
Reclassifications to the income statement	–	–
Taxes	4	–
Other comprehensive income	**-28**	**-29**
Total comprehensive income	**198**	**184**
Total comprehensive income attributable to non-controlling interests	2	6
Total comprehensive income attributable to shareholders of Aareal Bank AG	196	178

[1)] Comparative amounts reclassified according to the new classification format

Statement of Financial Position

€ mn	Note	31 Dec 2018	31 Dec 2017[1]	31 Dec 2016[1]
Assets				
Financial assets (ac)	39	**34,702**	**33,696**	**38,421**
Cash funds	8	1,265	2,081	1,786
Loan receivables	9	26,795	26,316	29,767
Money market and capital market receivables	10	6,578	5,225	6,800
Receivables from other transactions	12	64	74	68
Loss allowance (ac)	40	-577	-540	-554
Financial assets (fvoci)	41	**4,450**	**5,424**	**5,949**
Money market and capital market receivables	10	4,443	5,422	5,947
Equity instruments	11	7	2	2
Financial assets (fvpl)	42	**3,183**	**2,449**	**2,983**
Loan receivables	9	711	196	–
Money market and capital market receivables	10	538	–	–
Positive market value of designated hedging derivatives	13	1,277	1,926	2,481
Positive market value of other derivatives	14	657	327	502
Investments accounted for using the equity method	15, 43	7	7	0
Intangible assets	16, 44	158	153	126
Property and equipment	17, 45	260	253	252
Income tax assets	46	30	52	68
Deferred tax assets	18, 47	141	99	134
Other assets	19, 48	333	315	329
Total		**42,687**	**41,908**	**47,708**
Equity and liabilities				
Financial liabilities (ac)	49	**37,215**	**36,630**	**40,587**
Money market and capital market liabilities	20	26,371	26,109	29,935
Deposits from the housing industry	21	9,679	9,164	9,191
Liabilities from other transactions	22	121	92	95
Subordinated capital	23	1,044	1,265	1,366
Financial liabilities (fvpl)	50	**1,934**	**1,703**	**3,181**
Negative market value of designated hedging derivatives	13	1,461	1,479	2,529
Negative market value of other derivatives	14	473	224	652
Provisions	24, 51	519	570	680
Income tax liabilities	52	40	29	71
Deferred tax liabilities	18, 53	18	19	28
Other liabilities	25, 54	33	33	32
Equity	26, 55	**2,928**	**2,924**	**3,129**
Subscribed capital		180	180	180
Capital reserves		721	721	721
Retained earnings		1,797	1,798	1,734
AT1 bond		300	300	300
Other reserves		-72	-77	-48
Non-controlling interests		2	2	242
Total		**42,687**	**41,908**	**47,708**

[1] Comparative amounts reclassified according to the new classification format; recognised amounts of the previous period as at 1 January 2017 correspond to the recognised amounts as at 31 December 2016

Statement of Changes in Equity

€ mn	Equity as at 1 Jan 2018[1]	Adjustment due to first-time application of IFRS 9	Adjusted equity as at 1 Jan 2018	Total comprehensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 31 Dec 2018
Subscribed capital	**180**		**180**						**180**
Capital reserves	**721**		**721**						**721**
Retained earnings	**1,798**	-60	**1,738**	224		-150	-16	1	**1,797**
AT1 bond	**300**		**300**						**300**
Other reserves	**-77**	**33**	**-44**	**-28**					**-72**
Reserve from remeasurements of defined benefit plans	-91		-91	-7					-98
Reserve from the measurement of equity instruments (fvoci)	0		0	0					0
Reserve from the measurement of debt instruments (fvoci)	24	29	53	-14					39
Hedging reserve	-1	1							
Reserve from changes in the value of foreign currency basis spreads		3	3	-12					-9
Currency translation reserves	-9		-9	5					-4
Total	**2,922**	**-27**	**2,895**	**196**		**-150**	**-16**	**1**	**2,926**
Non-controlling interests	**2**		**2**	2	-2				**2**
Equity	**2,924**	**-27**	**2,897**	**198**	**-2**	**-150**	**-16**	**1**	**2,928**

€ mn	Equity as at 1 Jan 2017[1]	Total comprehensive income for the period	Payments to non-controlling interests	Dividends	AT1 coupon	Other changes	Equity as at 31 Dec 2017[1]
Subscribed capital	**180**						**180**
Capital reserves	**721**						**721**
Retained earnings	**1,734**	207		-120	-16	-7	**1,798**
AT1 bond	**300**						**300**
Other reserves	**-48**	**-29**					**-77**
Reserve from remeasurements of defined benefit plans	-100	9					-91
Reserve from the measurement of equity instruments (fvoci)	0						0
Reserve from the measurement of debt instruments (fvoci)	29	-5					24
Hedging reserves	17	-18					-1
Reserve from changes in the value of foreign currency basis spreads							
Currency translation reserves	6	-15					-9
Total	**2,887**	**178**		**-120**	**-16**	**-7**	**2,922**
Non-controlling interests	**242**	6	-6			-240	**2**
Equity	**3,129**	**184**	**-6**	**-120**	**-16**	**-247**	**2,924**

[1] Comparative amounts reclassified according to the new classification format

Statement of Cash Flows

€ mn	Cash flow 1 Jan - 31 Dec 2018	Cash flow 1 Jan - 31 Dec 2017[1]
Consolidated net income	**226**	**213**
Additions to and reversals of loss allowances	76	118
Amortisation, depreciation, impairment and write-ups of non-current assets	16	27
Other non-cash changes	164	-1,070
Gains/losses on the disposal of non-current assets	-55	-7
Other adjustments	-548	130
Subtotal	**-121**	**-589**
Changes in financial assets (ac) (excluding cash funds)	42	3,756
Changes in financial assets (fvoci)	245	577
Changes in financial assets (fvpl)	259	373
Changes in other assets	-50	-2
Changes in financial assets (ac) (excluding subordinated capital)	-1,060	-2,977
Changes in financial liabilities (fvpl)	-90	-259
Changes in provisions	-58	-101
Changes in other liabilities	10	-6
Income taxes paid	-22	-107
Interest received	868	346
Dividends received	0	–
Interest paid	-317	-182
Cash flow from operating activities	**-294**	**829**
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	-6	-7
Proceeds from the disposal of property and equipment and intangible assets	2	13
Payments for the acquisition of property and equipment and intangible assets	-31	-43
Effect of changes in reporting entity structure	-44	-21
Cash flow from investing activities	**-79**	**-58**
Dividends paid and AT1 coupon payments	-165	-135
Changes in subordinated capital[2]	-276	-87
Changes due to other funding activities	-2	-254
Cash flow from financing activities	**-443**	**-476**
Cash and cash equivalents as at 1 January	**2,081**	**1,786**
Cash flow from operating activities	-294	829
Cash flow from investing activities	-79	-58
Cash flow from financing activities	-443	-476
Cash and cash equivalents as at 31 December	**1,265**	**2,081**

[1] Within the scope of the changeover to IFRS 9 and the business model allocation, cash flows from securities were re-allocated from investment activities to operating activities.

[2] The changes in subordinated capital in the amount of € -221 million (2017: € -101 million) consists of € -215 million (2017: € -116 million) related to cash flow relevant payments of principal and interest as well as an amount of € -6 million (2017: € 15 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 2018 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 5 March 2019; 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 generally apply accounting policies – and the presentation of financial statements – consistently, in order to ensure the comparability of financial statements over time. The classification format was adjusted within the framework of the first-time application of IFRS 9.

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 revenue is recognised based on 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). Based on the IFRIC decision ”Presentation of interest revenue for particular financial instruments“, we report interest from economic hedging relationships under interest from financial instruments (fvpl). The previous year‘s figures were adjusted accordingly. 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 agreement 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 and tax assets and liabilities. 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 9 Financial Instruments**
  IFRS 9 Financial Instruments introduces new rules for the accounting of financial instruments, and generally replaced IAS 39 Financial Instruments: Recognition and Measurement as at 1 January 2018. We present the changes in the chapter "First-time application of IFRS 9 Financial Instruments" in this section.

- **IFRIC 22 Foreign Currency Transactions and Advance Consideration**
  The objective of this interpretation is to clarify the accounting treatment of transactions that include the receipt or payment of consideration in a foreign currency.

- **IFRS 15 Revenue from Contracts with Customers**
  IFRS 15 governs the recognition of revenue from contracts with customers based on a uniform model. The standard supersedes the current revenue recognition provisions set out in IAS 11 and IAS 18 as well as the related interpretations. IFRS 15 has to be applied by all companies that enter into contracts with customers for the delivery of goods or the provision of services unless these contracts are within the scope of other standards. Accordingly, amongst other things, financial instruments and other contractual rights or obligations within the scope of IFRS 9 are excluded from the scope of IFRS 15. The core principle of IFRS 15 for revenue recognition is that an entity has to recognise revenue when the performance obligations assumed are satisfied, i.e. when control over the goods and services has been transferred. Revenue has to be recognised in an amount that reflects the consideration that the entity expects to receive in exchange for those goods or services. IFRS 15 introduces a 5-step model based on which the amount and the timing of revenue recognition are determined. In addition, the standard requires additional disclosures, including, amongst other things, a disaggregation of total revenue, performance obligations, a reconciliation of opening and closing balances of contractual net assets and liabilities as well as significant judgements and estimates. Aareal Bank Group has reviewed the effects of the new standard on the consolidated financial statements by analysing the relevant standard contracts on the basis of the 5-step model. Within the Group, these changes mainly affect Aareon. Aareon has adjusted its processes. Within the scope of this adjustment, we have changed the breakdown of net commission income to reflect the product view which is relevant for management purposes. Com-

mission income from advisory and other services is broken down into ERP products, digital solutions, and add-on products. Commission expenses from advisory and other services have been renamed as purchased services. Net commission income from trustee and administered loans, securities business, and other lending and money market transactions as well as net other commission income have been summarised as net commission income from banking business and other activities. Moreover, commission income is also shown in segment reporting. The modified retrospective approach did not have any material consequences for Aareal Bank Group.

- **Annual Improvements Cycle 2014 – 2016**
  Within the scope of the Annual Improvements Cycle, the IASB publishes clarifications and minor changes to the existing standards IFRS 1, IFRS 12 and IAS 28.

- **Amendments to IAS 40: Transfers of Investment Property**
  The amendments clarify the provisions regarding transfers to or from investment property. The amendments mainly refer to the question whether property under construction or in development that was previously classified as inventory can be reclassified to the investment property category when there is evidence of a change in use.

- **Clarifications to IFRS 15: Revenue from Contracts with Customers**
  In April 2016, the IASB issued the final version of the amendment standard IFRS 15. The amendment includes clarifications regarding various rules set out in IFRS 15, and also simplifications concerning the transition to the new standard. The clarifications refer to the identification of the service obligations from a contract, the assessment as to whether a company acts as principal or agent of a transaction, and the assessment as to whether revenue from a licence granted has to be recognised either as at a particular reporting date or during a specific period. The simplifications refer to options regarding the presentation of contracts that are either completed at the beginning of the earliest period presented, or which were modified prior to the beginning of the earliest period presented. This is to reduce the complexity and costs of the transition to the new standard.

- **Amendments to IFRS 2: Classification and Measurement of Share-based Payment Transactions**
  In June 2016, the IASB issued amendments to IFRS 2 that clarify classification and measurement of share-based payment transactions. The amendments relate to the following areas: (i) accounting for cash-settled share-based payment transactions that include a performance condition, (ii) the classification of share-based payment transactions with a settlement feature for withholding tax obligations and (iii) accounting for modifications of share-based payment transactions that change the classification from "cash-settled" to "equity-settled".

- **Amendments to IFRS 4: Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts**
  In September 2016, the IASB issued amendments to IFRS 4. The amendments refer to the first-time application of IFRS 9 by insurers. Due to different effective dates for IFRS 9 and the new standard for insurance contracts, without these amendments, results will be more volatile for a transitional period; in addition, conversion efforts will be doubled.

Except for IFRS 9, the revised standards did not have any material consequences for the consolidated financial statements of Aareal Bank Group.

Until 31 December 2018, the following financial reporting standards (IASs/IFRSs) and interpretations (SICs and IFRICs) had been published by the International Accounting Standards Board (IASB) and adopted by the EU Commission:

New International Financial Reporting Standards / Interpretations		Issued	Endorsed	Effective Date
IFRS 16	Leases	January 2016	October 2017	Financial years beginning on or after 1 January 2019
IFRS 17	Insurance Contracts	May 2017		Financial years beginning on or after 1 January 2022
IFRIC 23	Uncertainty over Income Tax Treatments	June 2017	October 2018	Financial years beginning on or after 1 January 2019

Revised International Financial Reporting Standards		Issued	Endorsed	Effective Date
IAS 1	Definition of Material	October 2018		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
IAS 19	Plan Amendment, Curtailment or Settlement	February 2018		Financial years beginning on or after 1 January 2019
IAS 28	Long-term Interests in Associates and Joint Ventures	October 2017	February 2019	Financial years beginning on or after 1 January 2019
IFRS 9	Prepayment Features with Negative Compensation	October 2017	March 2018	Financial years beginning on or after 1 January 2019
	Annual Improvements Cycle 2015-2017	December 2017		Financial years beginning on or after 1 January 2019

- **IFRS 16: Leases**
  The new financial reporting standard IFRS 16, regarding lease accounting, will replace 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 previous 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 outs a number of further rules for presentation, disclosures in the Notes and sale-and-lease-back transactions. Overall, we do not expect any material impact on the consolidated financial statements. The adoption of IFRS 16 is based on the modified retrospective approach, i.e. the expected transition effect from the retrospective application (€ -6 million) is recorded in equity, in retained earnings. We anticipate the amount of right-of-use assets and the corresponding lease liabilities to be € 71 million. The practical relief provided for by the IFRS 16 as regards short-term lease agreements and low-value leased assets are made use of.

- **IFRIC 23: Uncertainty over Income Tax Treatments**
  The objective of this interpretation is to clarify the accounting for uncertainty in relation to income taxes.

- **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 the problems 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.

- **IAS 19 Plan Amendment Curtailment or Settlement**
  As a result of the amendments, entities will be required in future 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, the IASB publishes clarifications and minor changes to the existing standards IFRS 3, IFRS 11, IAS 12 and IAS 23.

Aareal Bank Group did not opt for early application of these standards in 2018, 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.

First-time application of IFRS 9 Financial Instruments

IFRS 9 Financial Instruments introduces new rules for the accounting of financial instruments, and generally replaced IAS 39 Financial Instruments: Recognition and Measurement from 1 January 2018. The first-time application had an effect of € -27 million (after taxes) on equity carried on the statement of financial position, and of € -17 million on regulatory equity (full Basel III implementation pursuant to Directive 2013/36/EU and Regulation (EU) No 575/2013 of the European Parliament and the Council). The effect of first-time application comprises various individual effects.

Under the new model for classification and measurement of financial assets, the subsequent measurement of financial assets is based on three categories with different measurement methods and different recognition methods related to changes in value:

- ”Financial assets measured at amortised cost (ac) using the effective interest method”;
- ”Financial assets at fair value through other comprehensive income (fvoci)”; and
- ”Financial assets at fair value through profit or loss (fvpl)”.

The classification to the measurement categories is based on the criteria of business model and contractual characteristics of the financial assets (the so-called ”SPPI criterion” = solely payments of principal and interest). The allocation of financial instruments to the business models was made as at 1 January 2018. The major portion of the financial instruments was allocated to the “amortised cost” measurement category. We recorded a positive overall effect of € 28 million (after taxes) from the transition on the revaluation surplus, due to the reversal of the revaluation surplus from securities reclassified in accordance with IAS 39, and from changes in the measurement category of individual securities (to fvpl, because the SPPI criterion is not met, or due to an assignment to the residual business model). In addition, adjustments during the contract term that lead to a change in the contractual cash flows, but that are not of an extent that the previous financial asset is derecognised and a new financial asset is recognised, will result in non-substantial modifications. In this case, the carrying amount of a financial asset is adjusted and a modification gain or loss is determined. The transition effect from market-driven modifications amounted to € -6 million (after taxes). Credit-driven modification effects are included in the effects resulting from the allocation of items into the Stage 3 category of loss allowances.

There are special rules for equity instruments as there is an option to measure these either through other comprehensive income or through profit or loss. The option was exercised. This did not have any transition effect.

The accounting rules for financial liabilities do not result in any material changes. An exception to this is the inclusion of changes from own credit risk in case of non-derivative financial liabilities measured at fair value through profit or loss. These changes may not be recognised through profit or loss, but through other comprehensive income. The Group currently does not have any non-derivative financial liabilities measured at fair value.

The new rules for impairment (expected credit loss model) replaced the previous incurred credit loss model. The objective of this is an earlier measurement and recognition of allowances for credit losses. IFRS 9 prescribes three stages which are used to determine the amount of the loss allowances to be recognised and the recognition of interest. Financial assets are allocated to Stage 1. Twelve-month expected credit losses are recognised for these assets. If the credit risk increases significantly, the loss allowance is increased to the total amount of lifetime expected credit losses (Stage 2). If there is objective evidence of impairment in relation to a financial asset, a loss allowance at an amount equal to the expected credit losses over the entire remaining term also has to be recognised and, in addition, interest revenue has to be recognised based on the net carrying amount (Stage 3). The impairment model set out in IFRS 9 has to be applied to financial assets of the categories ”Measured at amortised cost“ and ”Measured at fair value through other comprehensive income“ as well as to loan commitments and financial guarantees. In addition, lease receivables and trade receivables are covered by the new impairment rules. To the extent that financial instruments are measured at fair value through profit or loss, no allowance for credit losses is recognised for such financial instruments; instead, they are reported at their net carrying amount.

Portfolio-based allowances for credit losses were already recognised within the Group under IAS 39. Calculation under Stage 1 in accordance with IFRS 9 continues to be on the basis of a twelve-month loss. In Stage 2, additions to loss allowances were recognised due to the recognition of a loss allowance at an amount equal to the expected credit losses over the entire remaining term. The transition effect for Stage 1 and Stage 2 amounted to approximately € -27 million (after taxes).

Specific allowances for credit losses pursuant to IAS 39 were recognised where estimated future cash flows fall below the carrying amount of a loan receivable. This methodology was developed further into a probability-weighted multi-scenario analysis. The transition effect amounted to € -22 million (after taxes) for Stage 3.

Hedge accounting rules were changed by establishing a closer relationship between the entity's risk management strategy, the reasons for entering into hedging instrument and the recognition of hedging relationships in the entity's financial statements. Non-derivative items may also be included in hedge accounting; net positions are now also eligible for designation as hedges. A voluntary discontinuation of hedge accounting – so-called de-designation – is no longer permitted under the new regulations. Hedging relationships may only be discontinued when the objective of risk management has been changed. In contrast, the new IFRS 9 allows for an adjustment of hedging relationships if this is necessary (rebalancing). The requirements regarding effectiveness have also been simplified: only qualitative assessments of effectiveness and prospective effectiveness tests have to be performed. In addition, foreign currency basis spreads may be recognised as part of the costs of the hedge. Changes in the fair value due to this component are recognised directly in equity in the reserve from foreign currency basis spreads. Due to the separation of the macro hedge accounting project from IFRS 9 and its postponement, the application of the new hedge accounting rules in IFRS 9, for the time being, allows for the continued application of special rules for fair value hedge accounting for portfolio hedges of interest rate risks in IAS 39. The Group does not currently use this option. The Group uses the simplifications under micro-hedge accounting and for foreign currency basis spreads. This did not have any transition effect on equity.

IFRS 9 comprises comprehensive disclosure requirements, above all in the area of impairments, leading to numerous new requirements. The disclosures on financial instruments continue to be based on IFRS 7, which was amended and significantly extended in the context of the publication of IFRS 9.

Due to the introduction of IFRS 9 and in order to increase the transparency of the financial statements, the classification format was adjusted. The comparative figures were reclassified, but are still based on the IAS 39 rules. The following table shows a reconciliation of the financial instruments by measurement categories under IAS 39 to IFRS 9 (before taxes).

€ mn	IAS 39 31 Dec 2017	IAS 39 reclassified 31 Dec 2017	Reclassification	Revaluation OCI	Revaluation Retained earnings	IFRS 9 1 Jan 2018
Financial assets (ac)						
Cash funds (ac)		**2,081**				**2,081**
from cash funds (lar)	2,081					
Loan receivables (ac)		**26,316**				**25,885**
from loans and advances to banks (lar)	5					
from loans and advances to customers (lar)	26,311				27	
less loan receivables (fvpl)			-458			
Money market and capital market receivables (ac)		**5,225**				**6,087**
from loans and advances to banks (lar)	774					
from loans and advances to customers (lar)	1,338					
from non-trading assets (lar, htm)	3,113			63		
plus money market and capital market receivables (fvoci)			1,594	-41		
less money market and capital market receivables (fvoci)			-505			
less money market and capital market receivables (fvpl)			-249			
Receivables from other transactions (ac)		**74**	2			**76**
from other (financial) assets (lar)	74					
Financial assets (fvoci)						
Money market and capital market receivables (fvoci)		**5,422**				**4,343**
from non-trading assets (afs)	5,422					
plus money market and capital market receivables (ac)			505	10		
less money market and capital market receivables (ac)			-1,594			
Equity instruments (fvoci)		**2**				**2**
from non-trading assets (afs)	2					
Financial assets (fvpl)						
Loan receivables (fvpl)		**196**				**604**
from loans and advances to customers (hft)	196					
plus (net) loan receivables (ac)			408			
Money market and capital market receivables (fvpl)		**–**			2	**251**
plus money market and capital market receivables (ac)			249			
Positive market value of designated hedging derivatives (fvpl)		**1,926**				**1,387**
from positive market value of derivative hedging instruments (hft)	1,926					
less positive market value of other derivatives (fvpl)			-539			
Positive market value of other derivatives (fvpl)		**327**				**866**
from trading assets (hft)	327					
plus positive market value of designated hedging derivatives (fvpl)			539	-1	1	
Total		**41,569**	**-48**	**31**	**30**	**41,582**

€ mn	IAS 39 31 Dec 2017	IAS 39 reclassified 31 Dec 2017	Reclassi-fication	Revaluation OCI	Revaluation Retained earnings	IFRS 9 1 Jan 2018
Financial liabilities (ac)						
Money market and capital market liabilities (ac)		**26,109**				**26,109**
from liabilities to banks (lac)	1,914					
from liabilities to customers (lac)	16,601					
from certificated liabilities (lac)	7,594					
Deposits from the housing industry (ac)		**9,164**				**9,164**
from liabilities to customers (lac)	9,164					
Liabilities from other transactions (ac)		**92**				**92**
from other (financial) liabilities (lac)	92					
Subordinated capital (ac)		**1,265**				**1,265**
Subordinated capital (lac)	1,265					
Financial liabilities (fvpl)						
Negative market value of designated hedging derivatives (fvpl)		**1,479**				**1,318**
from negative market value of derivative hedging instruments (hft)	1,479					
less negative market value of other derivatives (fvpl)			-161	1	-1	
Negative market value of other derivatives (fvpl)		**224**				**385**
from trading liabilities (hft)	224			6	-6	
plus negative market value of other derivatives (fvpl)			161			
Total		**38,333**	**–**	**7**	**-7**	**38,333**

€ mn	IAS 39 31 Dec 2017	IAS 39 reclassified 31 Dec 2017	Reclassi-fication	Revaluation OCI	Revaluation Retained earnings	IFRS 9 1 Jan 2018
Loss allowance on financial assets (ac)						
Loan receivables (ac)		**-540**				**-571**
from loans and advances to customers (lar)	-540				-81	
less loan receivables (fvpl)			50			
Money market and capital market receivables (ac)		**–**				**-20**
from non-trading assets (lar, htm)	–				-15	
plus money market and capital market receivables (fvoci)					-5	
Receivables from other transactions (ac)		**–**				**-2**
from other (financial) assets (lar)	–		-2			
Provisions for unrecognised lending business		**-4**				**-6**
from provisions in the lending business for unrecognised items	-4				-2	
Loss allowance in reserves from debt instruments (fvoci)						
Money market and capital market receivables (fvoci)		**–**				**0**
from non-trading assets (afs)	–				0	
Total	**-544**	**-544**	**48**	**–**	**-103**	**-599**

The total transition effect of € -27 million (after taxes) recognised under equity comprises the revaluation effects disclosed in other comprehensive income and retained earnings of € -42 million, less tax effects of € 15 million.

Within the scope of the first-time application, non-trading assets (afs) (money market and capital market receivables (fcovi)) in the amount of € 1,594 million were allocated to the "hold" business model and since then have been measured at amortised cost. Debt securities held on the reporting date were carried at € 1,461 million, reflecting their fair value. Therefore, there was no material difference required to be reported in the revaluation surplus in accordance with IAS 39.

(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. Currently, all subsidiaries included in the reporting entity structure of Aareal Bank are controlled through a majority of voting rights.

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 entities is based on the purchase method, in accordance with IFRS 3, whereby emeasured 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 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 from 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 (44).

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 2018, the reporting entity structure comprised 67 companies (2017: 73), including Aareal Bank AG as well as 59 (2017: 65) subsidiaries, two joint arrangements (2017: two) as well as five associates (2017: five).

Aareal Bank Group successfully closed the acquisition of all shares of Düsseldorfer Hypothekenbank AG (Düsselhyp), announced on 10 September 2018. The acquisition was completed with effect from 31 December 2018 (the closing date). Düsselhyp is therefore now a legally independent subsidiary of Aareal Bank Group. The purchase price paid amounted to € 149 million. Aareal Bank will not pursue any further strategic objectives with this acquisition. Aareal Bank will consistently pursue this orderly run-down. The acquisition resulted in a negative goodwill of € 55 million, which was recognised in income. Administrative expenses for the 2019 financial year will presumably be burdened by the transaction, in a very low double-digit million amount. These costs have reduced the purchase price and increased negative goodwill accordingly. As part of the integration of Düsselhyp into Aareal Bank Group, a control and profit transfer agreement was concluded.

In accordance with IFRS 3, all identifiable assets and liabilities of the acquired entity have to be measured at their fair value at the time of acquisition (closing). These fair values also represent the amounts recognised upon initial consolidation. The difference between the purchase price and the higher net balance of assets and liabilities acquired and measured at fair value is recognised as negative goodwill in the income statement, and directly increases the equity of Aareal Bank Group. This income currently amounts to € 55 million and is reported in the statement of comprehensive income in a separate item. It primarily results from the utilisation of a favourable market environment for such transactions. Apart from favourable price-to-book valuations and attractive asset and liability spreads, limited investor interest in the European corporate property banking sector contributed to this favourable environment.

The determination of the fair value for the assets acquired and liabilities assumed, which is required for the purchase price allocation in accordance with IFRS 3, is subject to judgements, in particular with regard to cash flows and discount rates. The purchase price allocation has been completed.

The following overview shows the purchase price allocation in accordance with IFRS 3 as at the acquisition date:

€ mn	Fair value as at 31 December 2018
Financial assets (ac)	**1,663**
Cash funds	105
Loan receivables	312
Money market and capital market receivables	1,244
Receivables from other transactions	2
Financial assets (fvoci)	**412**
Money market and capital market receivables	412
Financial assets (fvpl)	**398**
Money market and capital market receivables	308
Positive market value of designated hedging derivatives	76
Positive market value of other derivatives	14
Intangible assets	0
Property and equipment	0
Income tax assets	0
Net deferred tax assets	45
Other assets	1
Total assets acquired	**2,519**
Financial liabilities (ac)	**1,975**
Money market and capital market liabilities	1,972
Liabilities from other transactions	3
Financial liabilities (fvpl)	**324**
Negative market value of designated hedging derivatives	214
Negative market value of other derivatives	110
Provisions	16
Other liabilities	0
Total liabilities assumed	**2,315**
Total net assets acquired	**204**
Purchase price	149
Negative goodwill	**55**

The nominal amount of loan receivables ac is € 299 million; it does not include any impaired loans. Within the scope of the acquisition of Düsselhyp, Aareal Bank also assumed credit and legal risks. The risks were taken into account within the context of the purchase price allocation.

The business combination resulted in costs of € 2 million.

There were no other material changes to the scope of consolidation during the period under review.

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) or at average rates (income statement). Translation differences are recognised in equity, in the currency translation reserves.

(5) Revenue recognition

Revenue recognition is assessed on the basis of the five-step model in accordance with IFRS 15. Aareal Bank Group recognised 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 is 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) Determination of fair value

The determination of fair value is governed by IFRS 13 and applies to 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 between market participants 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. In the absence of a principal market for the financial instrument, the most advantageous market is used to determine the fair value. 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.

Debt securities and promissory note loans for which no current market price is available are measured through an analysis of future payments using the fully-capitalised earnings value approach, where the inputs are based on observable market data. 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 appropriate 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 as well as of OTC hedging 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. Adjustments for specific counterparty risks (CVA and DVA) are not taken into account for the determination of the present value of derivatives at Aareal Bank, as they are deemed immaterial. 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 are not required. The Bank uses the overnight interest rate swap curve (OIS curve) for the measurement of derivatives secured by cash collateral. In the year under review, callable derivatives were switched to this measurement method. The impact of this change in estimates, which was applied prospectively, on income was immaterial.

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.

(7) 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 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 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 or if the absolute credit risk can be classified as low, the financial instrument has to remain in Stage 1 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 1. 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), the expected contractual term and the current and expected country-specific economic environment such as the GDP, long-term interest and unemployment rate. A period of not more than twelve months is assessed for Stage 1, 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).

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 are 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 or from changed cash flows 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 or the changes in the cash flows 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.

Derivatives used as hedging instruments for the purposes of a cash flow hedge serve to hedge future cash flows against changes in interest rates or interest and exchange rates resulting from variable-rate financial assets and liabilities. The effective portion of measurement gains or losses from the derivative is recorded in equity, in the revaluation surplus. The ineffective portion of these measurement gains or losses is recorded directly in income. When the hedging relationship ceases to exist, the amounts recorded in the other reserves are transferred to the income statement at the same time as profits or losses on the former underlying transaction are recognised in income. The underlying transaction is recognised in line with the rules for the measurement category to which the underlying transaction has been allocated.

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.

(8) Cash funds

Cash funds include cash on hand and balances with central banks. Cash funds are exclusively allocated to the measurement category "ac".

(9) 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.

(10) Money market and capital market receivables

Money market and capital market receivables consist of 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.

(11) Equity instruments

This item includes unconsolidated equity instruments. They are allocated to the measurement category ”fvoci”.

(12) 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”.

(13) 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.

(14) 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 assets (fvpl)”. Interest received or paid in connection with these derivatives is also recorded generally in the item ”Net gain or loss from financial assets (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 assets (fvpl)", together with the effects from the measurement of the transactions.

(15) Investments accounted for using the equity method

Investments accounted for using the equity method include 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 prepared under local GAAP.

(16) 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 estimated 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.

(17) Property and equipment

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.

(18) Deferred tax assets / deferred tax liabilities

Deferred taxes are reported in the items "Deferred tax assets" and "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.

(19) 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, though the IFRS 5 criteria are not met. They are measured at the lower of cost or net realisable value, in accordance with IAS 2, and therefore are subject to estimation uncertainties.

(20) 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 "ac".

(21) 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".

(22) 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".

(23) Subordinated capital

The item "Subordinated capital" consists of subordinated liabilities, profit-participation certificates and silent participations. 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. Pursuant to the terms and conditions of issue, holders of profit-participation certificates have a claim on interest payments which takes precedence over the profit entitlements of shareholders. To the extent that a distribution would cause a net loss in the annual financial statements, said interest claim would be reduced, possibly down to zero, creating a claim for backpayment during the term of the certificates at the same time. Repayment takes place at the nominal amount (subject to any loss sharing), on the day after the Annual General Meeting passing resolutions regarding the relevant financial year. The profit-participation certificates evidence creditors' rights; they do not grant any share in the liquidation proceeds.

Subordinated capital is allocated to the measurement category "ac".

(24) 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. Provisions, including uncertain tax positions, are measured on the basis of the best estimate of expenditure required to settle the obligation (most likely value) required as at the reporting date.
In the context of acquisitions in accordance with IFRS 3, contingent liabilities, including uncertain tax obligations, were also recognised at their 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 Global-Rate: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, 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. Accordingly, the recognition of pension obligations is also subject to estimation uncertainties.

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 (77) 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.

(25) Other liabilities

Other liabilities include, among other items, contract liabilities, deferred income and liabilities from other taxes.

(26) Equity

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 hedging reserves, 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.

(27) 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

(28) Net interest income

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1)]
Interest income from financial assets (ac)	838	828
Loan receivables	820	810
Money market and capital market receivables	18	18
Interest income from financial liabilities (ac)	9	7
Money market and capital market liabilities	5	4
Deposits from the housing industry	4	3
Interest income from financial assets (fvoci)	0	0
Money market and capital market receivables	0	0
Current dividend income	0	0
Interest income from financial instruments (fvpl)	38	8
Loan receivables	22	1
Money market and capital market receivables	7	–
Other derivatives	9	7
Market-driven modification gains	2	n/a
Total interest and similar income	**887**	**843**
Interest expenses from financial liabilities (ac)	104	98
Money market and capital market liabilities	77	69
Deposits from the housing industry	2	0
Liabilities from other transactions	0	1
Subordinated capital	25	28
Interest expenses from financial assets (ac)	9	12
Cash funds	8	10
Money market and capital market receivables	1	2
Interest expenses for financial instruments (fvpl)	236	149
Other derivatives	236	149
Market-driven modification losses	3	n/a
Total interest and similar expenses	**352**	**259**
Total	**535**	**584**

[1)] Comparative amounts reclassified according to the new classification format

Net interest income totalled € 535 million, an expected reduction from the previous year (2017: € 584 million), which was largely due to the portfolio decline seen in the previous year, reflecting – amongst other factors – the scheduled reduction of the former WestImmo and Corealcredit portfolios.

(29) Loss allowance

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1)]
Additions	137	131
Reversals	61	53
Direct write-offs	–	43
Recoveries on loans and advances previously written off	4	39
Loss allowance – other items	0	n/a
Credit-driven net modification gain or loss	0	n/a
Total	**72**	**82**

[1)] Comparative amounts reclassified according to the new classification format

Loss allowance amounted to € 72 million (2017: € 82 million) and was thus in line with our expectations. Please also refer to our explanations in Note (59).

(30) Net commission income

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1)]
Commission income from		
ERP products	167	160
Digital solutions	42	37
Additional products	11	11
Banking business and other activities	39	35
Total commission income	**259**	**243**
Commission expenses for		
Purchased services	40	32
Banking business and other activities	4	5
Total commission expenses	**44**	**37**
Total	**215**	**206**

[1)] Comparative amounts reclassified according to the new classification format

Net commission income increased to € 215 million (2017: € 206 million), as expected, which was mainly due to higher commission income at Aareon. Commission income from ERP products, digital solutions and additional products includes € 26 million of licence revenue (2017: € 20 million) that are recognised at a point in time. In the reporting period, revenue of € 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 € 11 million (2017: € 8 million).

(31) Net derecognition gain or loss

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1)]
Net gain or loss on the derecognition of financial assets (ac)		
Loan receivables	24	50
Net gain or loss on the derecognition of financial liabilities (ac)		
Money market and capital market liabilities	0	0
Net gain or loss on the derecognition of financial assets (fvoci)		
Money market and capital market receivables	–	0
Total	**24**	**50**

[1)] Comparative amounts reclassified according to the new classification format

The € 24 million net gain on derecognition (2017: € 50 million) – a market-driven figure which is usually volatile – mainly resulted from gains on derecognition of loan receivables and declined due to lower effects from early repayments.

(32) Net gain or loss from financial instruments (fvpl)

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017[1)]
Net gain or loss from loan receivables	-6	–
Net gain or loss from money market and capital market receivables	-2	0
Net gain or loss from other derivatives	8	7
Currency translation	-2	7
Total	**-2**	**14**

[1)] Comparative amounts reclassified according to the new classification format

(33) Net gain or loss from hedge accounting

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Ineffective portion of fair value hedges	-2	-2
Ineffective portion of cash flow hedges	–	-5
Ineffective portion of net investment hedges	0	0
Total	**-2**	**-7**

(34) Net gain or loss from investments accounted for using the equity method

In the past financial year, there were € 0 million from investments accounted for using the equity method (2017: € –); this was also in line with the pro-rata results from joint ventures and associates.

(35) Administrative expenses

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Staff expenses	261	313
Wages and salaries	206	257
Social security contributions	33	33
Pensions	22	23
Other administrative expenses	177	176
Depreciation, amortisation and impairment of property and equipment and intangible assets	24	22
Total	**462**	**511**

At € 462 million (2017: € 511 million), administrative expenses were reduced, reflecting the impact of transformation costs and running costs.

Staff expenses include contributions to defined contribution plans in the amount of € 14 million (2017: € 14 million).

Other administrative expenses include administrative costs for research and development not eligible for capitalisation in the amount of € 7 million (2017: € 5 million).

This item also includes the total fees charged by the auditor of the consolidated financial statements in the financial year 2018, which consists of the following sub-items:

€ 000's	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Auditing fees	4,616	5,271
Other assurance services	218	411
Tax advisory services	7	7
Other services	308	587
Total	**5,149**	**6,276**

Other assurance services include the review in accordance with the German Securities Trading Act (WpHG), deposit protection, the bank levy, software confirmations, comfort letters and the Combined Separate Non-financial Report. Tax advisory services relate to general tax advice rendered. Other services include, in particular, due diligence services and regulatory advice.

(36) Net other operating income/expenses

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Income from properties	57	62
Income from the reversal of provisions	5	83
Income from goods and services	1	0
Miscellaneous other operating income	31	23
Total other operating income	**94**	**168**
Expenses for properties	57	54
Expenses for other taxes	4	5
Miscellaneous other operating expenses	8	35
Total other operating expenses	**69**	**94**
Total	**25**	**74**

Income from properties comprises a reversal of an impairment loss of € 13 million, reflecting changed expectations of income, in relation to the owner-operated hotel that is allocated to the Structured Property Financing segment. This reversal referred to an impairment loss recognised in 2016. Expenses for properties include a loss on disposal in the amount of € 10 million that arose on the sale of a commercial property in the US.

The comparative figure for the previous year's period included € 50 million in net reversals of provisions in connection with the final agreement on contractual issues with a third party, which were still pending when Aareal Bank Group acquired former Corealcredit, and the release of tax assessment notes. This was offset by corresponding income tax expense of € 26 million.

(37) Negative goodwill from acquisitions

Further information is included in the section "Consolidation".

(38) Income taxes

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Current income taxes	55	82
Deferred taxes	35	33
Total	**90**	**115**

The differences between calculated and reported income taxes are presented in the following reconciliation:

€ mn	1 Jan-31 Dec 2018	1 Jan-31 Dec 2017
Operating profit (before income taxes)	316	328
Expected tax rate	31.7%	31.7%
Calculated income taxes	**100**	**104**
Reconciliation to reported income taxes		
Different foreign tax burden	10	9
Tax attributable to tax-exempt income	-25	-24
Tax attributable to non-deductible expenses	5	10
Taxes for previous years	–	17
Other tax effects	–	-1
Reported income taxes	**90**	**115**
Effective tax rate	29%	35%

The expected tax rate of 31.7% (2017: 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

(39) Financial assets (ac)

€ mn	31 Dec 2018	31 Dec 2017[1]
Cash funds (ac)	**1,265**	**2,081**
Cash on hand	0	0
Balances with central banks	1,265	2,081
Loan receivables (ac)	**26,795**	**26,316**
Property loans	26,309	25,701
Public-sector loans	448	537
Other loan receivables	38	78
Money market and capital market receivables (ac)	**6,578**	**5,225**
Money market receivables	1,000	713
Promissory note loans	1,751	1,399
Bonds	3,827	3,113
Receivables from other transactions (ac)	**64**	**74**
Trade receivables	35	37
Other financial receivables	29	37
Total	**34,702**	**33,696**

[1] Comparative amounts reclassified according to the new classification format

(40) Loss allowance (ac)

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	0	–	**–**
Transfer to Stage 2	-1	1	0	–	**–**
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**

The loss allowances 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 (59) in the chapter ”Notes related to financial instruments”.

31 December 2017 [1)]

€ mn	Specific valuation allowance	Portfolio impairment allowance	Total loss allowance for recognised items	Provisions in the lending business for unrecog-nised items	Total loss allowance for provisions in the lending business
Loss allowance as at 1 January	**435**	**119**	**554**	**5**	**559**
Additions	131	–	**131**	–	**131**
Utilisations	57	–	**57**	0	**57**
Reversals	15	37	**52**	1	**53**
Unwinding	30	–	**30**	–	**30**
Changes in the basis of consolidation	–	–	**–**	–	**–**
Currency adjustments	-5	-1	**-6**	0	**-6**
Balance as at 31 December	**459**	**81**	**540**	**4**	**544**

[1)] Comparative values determined in accordance with IAS 39

(41) Financial assets (fvoci)

€ mn	31 Dec 2018	31 Dec 2017 [1)]
Money market and capital market receivables (fvoci)	**4,443**	**5,422**
Bonds	4,443	5,422
Equity instruments (fvoci)	**7**	**2**
Equities and other non-fixed income securities	0	–
Other investments	7	2
Total	**4,450**	**5,424**

[1)] Comparative amounts reclassified according to the new classification format

(42) Financial assets (fvpl)

€ mn	31 Dec 2018	31 Dec 2017[1]
Loan receivables (fvpl)	**711**	**196**
Property loans	711	196
Money market and capital market receivables (fvpl)	**538**	**–**
Promissory note loans	90	–
Bonds	448	–
Positive market value of designated hedging derivatives (fvpl)	**1,277**	**1,926**
Positive market value of fair value hedges	1,277	1,915
Positive market value of cash flow hedges	–	8
Positive market value of net investment hedges	–	3
Positive market value of other derivatives (fvpl)	**657**	**327**
Positive market value of economic hedging derivatives	466	80
Positive market value of miscellaneous other derivatives	191	247
Total	**3,183**	**2,449**

[1] Comparative amounts reclassified according to the new classification format

(43) Investments accounted for using the equity method

Aareal Bank holds interests in five associates (2017: five) and one joint arrangement (2017: one) that are accounted for using the equity method. The sum total of the carrying amounts of the equity investments amounted to € 7 million (31 December 2017: € 7 million). The joint venture had a carrying amount of € 0 million (2017: € 0 million), meaning that pro-rata losses of € 2 million did not need to be recognised.

(44) Intangible assets

€ mn	31 Dec 2018	31 Dec 2017
Goodwill	85	85
Proprietary software	32	24
Other intangible assets	41	44
Total	**158**	**153**

Goodwill is entirely attributable to the Aareon sub-group (Consulting/Services segment) and can be allocated to the following business divisions defined as cash-generating units:

€ mn	31 Dec 2018 Goodwill	31 Dec 2017 Goodwill
Business divisions		
Germany	35	35
International Business	50	50
Total	**85**	**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 adopted by Aareon AG's Management Board and approved by the Supervisory Board – 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 consistently throughout the Aareon sub-group on the basis of a risk-adequate discount factor of 6.2 % before taxes. The discount factor is calculated based on a risk-free basic interest rate of 1.0 % plus a company-specific risk premium of 6.5 %, multiplied with a beta factor of 0.8. Due to the uncertainty surrounding the planning beyond the four-year horizon, we assume a 2 % growth rate, which reflects expected inflation developments and our cautious view of the market environment. The recoverable amounts show a significant excess compared to the carrying amounts: even if the above-mentioned material assumptions were to change significantly (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:

	2018				2017			
	Goodwill	Proprietary software	Other intangible assets	Total	Goodwill	Proprietary software	Other intangible assets	Total
€ mn								
Cost								
Balance as at 1 January	**138**	**93**	**124**	**355**	**133**	**87**	**78**	**298**
Additions	0	13	5	**18**	10	5	11	**26**
Transfers	–	0	1	**1**	-4	0	26	**22**
Disposals	–	–	26	**26**	0	–	7	**7**
Changes in the basis of consolidation	–	–	0	**0**	–	1	16	**17**
Currency translation differences	0	0	-1	**-1**	-1	0	0	**-1**
Balance as at 31 December	**138**	**106**	**103**	**347**	**138**	**93**	**124**	**355**
Amortisation and impairment losses								
Balance as at 1 January	**53**	**69**	**80**	**202**	**57**	**65**	**50**	**172**
Amortisation and impairment losses	–	4	8	**12**	–	4	7	**11**
of which: impairment losses	–	–	–	**–**	–	–	–	**–**
Write-ups	–	–	–	**–**	–	–	–	**–**
Transfers	–	–	–	**–**	-4	–	26	**22**
Disposals	–	–	26	**26**	–	–	3	**3**
Changes in the basis of consolidation	–	–	–	**–**	–	–	–	**–**
Currency translation differences	–	1	0	**1**	–	0	0	**0**
Balance as at 31 December	**53**	**74**	**62**	**189**	**53**	**69**	**80**	**202**
Carrying amount as at 1 January	**85**	**24**	**44**	**153**	**76**	**22**	**28**	**126**
Carrying amount as at 31 December	**85**	**32**	**41**	**158**	**85**	**24**	**44**	**153**

(45) Property and equipment

	31 Dec 2018	31 Dec 2017
€ mn		
Land and buildings and construction in progress	230	221
Office furniture and equipment	30	32
Total	**260**	**253**

Property and equipment developed as follows:

	2018			2017		
€ mn	Land and buildings and construction in progress	Office furniture and equipment	Total	Land and buildings and construction in progress	Office furniture and equipment	Total
Cost						
Balance as at 1 January	**299**	**86**	**385**	**288**	**81**	**369**
Additions	6	7	**13**	19	8	**27**
Transfers	–	0	**0**	1	9	**10**
Disposals	2	19	**21**	9	12	**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	**303**	**74**	**377**	**299**	**86**	**385**
Depreciation and impairment losses						
Balance as at 1 January	**78**	**54**	**132**	**68**	**49**	**117**
Depreciation and impairment losses	9	8	**17**	9	7	**16**
of which: impairment losses	–	–	**–**	–	0	**0**
Write-ups	13	–	**13**	–	0	**0**
Transfers	–	–	**–**	1	9	**10**
Disposals	1	18	**19**	0	11	**11**
Changes in the basis of consolidation	–	–	**–**	–	–	**–**
Currency translation differences	0	0	**0**	0	0	**0**
Balance as at 31 December	**73**	**44**	**117**	**78**	**54**	**132**
Carrying amount as at 1 January	**221**	**32**	**253**	**220**	**32**	**252**
Carrying amount as at 31 December	**230**	**30**	**260**	**221**	**32**	**253**

(46) Income tax assets

Income tax assets in a total amount of € 30 million as at 31 December 2018 (2017: € 52 million) include € 1 million (2017: € 2 million) expected to be realised after a period of more than twelve months.

(47) Net 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 € 572 million (2017: € 546 million).

Deferred tax assets were recognised in relation to the following items of the statement of financial position:

€ mn	31 Dec 2018	31 Dec 2017[1]
Financial assets (ac)	34	–
Financial assets (fvpl)	1	–
Intangible assets	–	0
Property and equipment	0	0
Other assets	0	0
Financial liabilities (ac)	455	482
Financial liabilities (fvpl)	123	47
Provisions	90	85
Other liabilities	0	26
Tax loss carryforwards	10	5
Net deferred tax assets	**713**	**645**

[1] Comparative amounts reclassified according to the new classification format

Of the deferred taxes on loss carryforwards, an amount of € 3 million (2017: € 1 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 € 62 million (2017: € 43 million).

Deferred tax assets in the amount of € 32 million (2017: € 25 million) were reported under other reserves.

(48) Other assets

€ mn	31 Dec 2018	31 Dec 2017[1]
Properties	209	203
Contract assets	24	19
Miscellaneous	100	93
Total	**333**	**315**

[1] Comparative amounts reclassified according to the new classification format

The portion of the unsatisfied performance obligation from IT consulting projects in the amount of € 10 million is expected to be realised in the amount of € 9 million in 2019 as well as € 1 million in 2020 and thereafter. We do not disclose the portion of unsatisfied performance obligations from other contracts since the consideration from the customer equals the services provided.

(49) Financial liabilities (ac)

€ mn	31 Dec 2018	31 Dec 2017[1)]
Money market and capital market liabilities (ac)	**26,371**	**26,109**
Money market liabilities	4,600	4,821
Promissory note loans	5,200	5,421
Mortgage Pfandbriefe	10,934	11,036
Public-sector Pfandbriefe	2,989	2,578
Other debt securities	2,648	2,230
Other financial liabilities	0	23
Deposits from the housing industry (ac)	**9,679**	**9,164**
Payable on demand	7,719	7,314
Term deposits	1,960	1,850
Liabilities from other transactions (ac)	**121**	**92**
Trade payables	24	18
Other liabilities	97	74
Subordinated capital (ac)	**1,044**	**1,265**
Subordinated liabilities	1,044	1,060
Profit-participation certificates	–	12
Silent participations	–	193
Total	**37,215**	**36,630**

1) Comparative amounts reclassified according to the new classification format

(50) Financial liabilities (fvpl)

€ mn	31 Dec 2018	31 Dec 2017[1)]
Negative market value of designated hedging derivatives (fvpl)	**1,461**	**1,479**
Negative market value of fair value hedges	1,443	1,464
Negative market value of cash flow hedges	–	15
Negative market value of net investment hedges	18	–
Negative market value of other derivatives (fvpl)	**473**	**224**
Negative market value of economic hedging derivatives	322	34
Negative market value of miscellaneous other derivatives	151	190
Total	**1,934**	**1,703**

1) Comparative amounts reclassified according to the new classification format

(51) Provisions

€ mn	31 Dec 2018	31 Dec 2017[1)]
Provisions for pensions and similar obligations	362	351
Provisions for unrecognised lending business	5	4
Other provisions and contingent liabilities	152	215
Total	**519**	**570**

[1)] Comparative amounts reclassified according to the new classification format

A detailed breakdown of the provisions for unrecognised lending business by classes of financial assets is disclosed in Note (59) 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 the Bank's 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 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 the 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).

Six individual benefit commitments are fixed amount commitments related to monthly benefit payments upon retirement and disability, including a widow(er)'s pension of 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.

Two 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 %. 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 this commitment 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 w% 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 2018	31 Dec 2017
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 2005
Actuarial assumptions (in %)		
Interest rate used for valuation	1.80	1.84
Development of salaries	2.00	2.00
Pension increase	1.57	1.59
Rate of inflation	1.75	1.75
Staff turnover rate	3.00	3.00

As at year-end, the calculation principles were changed to the 2018 G actuarial tables. The actuarial loss resulting from the remeasurement is reported under changes in demographic assumptions.

Development of net pension liabilities:

€ 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
Changes in basis of consolidation	**–**	**–**	**–**
Balance as at 31 December 2018	**448**	**-86**	**362**

€ mn	Present value of pension obligations	Fair value of plan assets	Net pension liability
Balance as at 1 January 2017	**432**	**-73**	**359**
Pension expense	**19**	**-1**	**18**
Current service cost	11	–	11
Net interest cost	8	-1	7
Payments	**-9**	**-5**	**-14**
Pension benefits paid	-12	0	-12
Employer's contributions	–	-2	-2
Contributions made by beneficiaries of defined benefit plans	3	-3	-
Remeasurements	**-12**	**-1**	**-13**
due to experience adjustments	-7	–	-7
due to changes in financial assumptions	-5	–	-5
due to changes in demographic assumptions	–	–	–
Difference between actual return and return calculated using an internal rate of interest (plan assets)	–	-1	-1
Changes in basis of consolidation	**1**	**–**	**1**
Balance as at 31 December 2017	**431**	**-80**	**351**

The weighted duration of pension liabilities is 18.1 years as at 31 December 2018 (2017: 18.7 years).

Expected maturities of the defined benefit obligation (DBO):

€ mn	31 Dec 2018	31 Dec 2017
Up to 1 year	13	13
Between 1 year and 5 years	57	55
More than 5 years and up to 10 years	80	78
Total	**150**	**146**

Contributions in the amount of € 11 million (2018: € 10 million) are expected to be paid in the financial year 2019.

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.
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.

		Defined benefit obligation 2018	Change	Defined benefit obligation 2017	Change
		€ mn	%	€ mn	%
Present value of obligations		**448**		**431**	
Interest rate used for valuation	Increase by 1.0 percentage points	375	-16	362	-16
	Decrease by 1.0 percentage points	542	21	523	21
Development of salaries	Increase by 0.5 percentage points	457	2	440	2
	Decrease by 0.5 percentage points	439	-2	422	-2
Pension increase	Increase by 0.25 percentage points	456	2	439	2
	Decrease by 0.25 percentage points	440	-2	423	-2
Life expectancy	Increase by 1 year	470	5	452	5
	Decrease by 1 year	425	-5	410	-5

Plan assets can be broken down as follows:

€ mn	31 Dec 2018	31 Dec 2017
Cash	0	0
Equities	–	–
Investment funds	58	53
Bonds	–	–
Reinsurance	28	27
Total	**86**	**80**

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	Miscellaneous 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 basis of consolidation	12	0	4	**16**
Currency translation differences	1	0	0	**1**
Carrying amount as at 31 Dec 2018	**128**	**10**	**14**	**152**

€ mn	Provisions for staff expenses and non-staff operating costs	Provisions for legal and tax risks	Miscellaneous other provisions	Total
Carrying amount as at 1 Jan 2017	**187**	**103**	**26**	**316**
Additions	89	1	7	**97**
Utilisation	71	2	8	**81**
Reversals	16	89	10	**115**
Interest	0	–	0	**0**
Reclassifications	0	–	0	**0**
Changes in basis of consolidation	–	–	0	**–**
Currency translation differences	-2	–	0	**-2**
Carrying amount as at 31 Dec 2017	**187**	**13**	**15**	**215**

Other provisions of € 152 million include € 37 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 € 105 million (2017: € 140 million) and provisions for non-staff operating costs in the amount of € 23 million (2017: € 47 million). Personnel provisions consist of, among other things, provisions for bonuses, partial retirement, severance pay and existing working hours accounts; they include € 32 million in provisions for severance pay and for partial retirement. Provisions for non-staff operating expenses mainly include provisions for professional and legal advice.

(52) Income tax liabilities

Income tax liabilities in a total amount of € 40 million as at 31 December 2018 (2017: € 29 million) include € 6 million (2017: € 7 million) expected to be realised after a period of more than twelve months.

(53) 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 € 572 million (2017: € 546 million).

Deferred tax liabilities were recognised in relation to the following items of the statement of financial position:

€ mn	31 Dec 2018	31 Dec 2017[1]
Financial assets (ac)	383	135
Financial assets (fvoci)	130	302
Financial assets (fvpl)	52	98
Intangible assets	11	12
Property and equipment	6	6
Other assets	8	12
Provisions	0	0
Other liabilities	–	0
Deferred tax liabilities	**590**	**565**

[1] Comparative amounts reclassified according to the new classification format

(54) Other liabilities

€ mn	31 Dec 2018	31 Dec 2017[1]
Deferred income	1	16
Liabilities from other taxes	17	17
Contract liabilities	14	–
Other	1	0
Total	**33**	**33**

[1] Comparative amounts reclassified according to the new classification format

An amount of € 14 million of the contract liabilities was recorded in profit or loss in the current reporting period.

(55) Total shareholders' equity

€ mn	31 Dec 2018	31 Dec 2017[1]
Subscribed capital	180	180
Capital reserves	721	721
Retained earnings	1,797	1,798
AT1 bond	300	300
Other reserves		
Reserve from remeasurements of defined benefit plans	-98	-91
Reserve from the measurement of equity instruments (fvoci)	0	0
Reserve from the measurement of debt instruments (fvoci)	39	24
Hedging reserves	–	-1
Reserve from foreign currency basis spreads	-9	–
Currency translation reserves	-4	-9
Non-controlling interests	2	2
Total	**2,928**	**2,924**

[1] Comparative amounts reclassified according to the new classification format

The item "Reserve from the measurement of debt instruments (fvoci)" includes loss allowance of € 0 million (2017: n/a).

Subscribed capital

Aareal Bank AG's subscribed capital amounted to € 180 million as at the reporting date (2017: € 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 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 General Meeting on 21 May 2014, the Management Board was authorised to issue, on one or more occasions until 20 May 2019, profit-participation rights with a limited or unlimited term for contribution in cash or in kind in a total nominal amount of € 1,000,000,000. If the profit-participation rights are not issued against contribution in kind, they may be linked to a conversion right for the holder or creditor. Conversion rights may only be issued for the Company's no-par value bearer shares with a proportionate share in the Company's share capital of € 89,785,830. The issue of profit-participation rights may also be effected by domestic or foreign companies in which the Company either directly or indirectly holds a majority interest. In this case, the Company, subject to Supervisory Board approval, may guarantee such issues as well as issue shares on its own to fulfil the conversion rights. 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.

The purpose of the authorisation passed by the Annual General Meeting on 21 May 2014 is to create Tier 1 capital that is eligible for regulatory purposes; it also provides for the issue of profit-participation rights with conversion obligations. It is in accordance with the various structuring alternatives for Additional Tier 1 capital instruments, pursuant to the Capital Requirements Regulation. For instance, a conversion obligation may be provided for if the Bank falls short of certain capital ratios (to be defined in the terms of convertible profit-participation certificates) or other financial indicators; conversion is required, in the opinion of the Company's Management Board and Supervisory Board, to safeguard the Company's continued existence; or if conversion is instructed by a supervisory authority within the scope of its powers.

Accordingly, the share capital is subject to a conditional capital increase not exceeding € 89,785,830 by issuance of up to 29,928,610 new no-par value bearer shares ("Conditional Capital 2014"). The conditional capital increase shall be implemented only insofar as (i) the holders or creditors of conversion rights from convertible profit-participation rights issued by the Company (or by an enterprise in which the Company either directly or indirectly holds a majority interest) until 20 May 2019 on the basis of the

Annual General Meeting's authorisation resolution of 21 May 2014 exercise their conversion rights or (ii) the holders or creditors of convertible profit-participation rights issued by the Company (or by an enterprise in which the Company either directly or indirectly holds a majority interest) until 20 May 2019 on the basis of the Annual General Meeting's authorisation resolution of 21 May 2014 and who are obliged to exercise those rights fulfil their obligation or (iii) the Company makes use of alternative performance; insofar as treasury shares are not used to service the rights or, in the aforementioned cases (i) and (ii), no cash compensation is granted. 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 new shares will be issued at the conversion price to be set as defined in the resolution passed by the General Meeting on 21 May 2014.

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 (2017: € 5 million) and of other retained earnings of € 1,792 million (2017: € 1,793 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 € 125,700,164.10 for the financial year 2018, as reported under the German Commercial Code (HGB), be used to distribute a dividend of € 2.10 per notional no-par value share. The dividend paid in 2018 amounted to € 2.50 per notional no-par value share.

In addition, on 30 April 2019, 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.

(56) 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 2018	1 Jan-31 Dec 2017[1]
Net gain or loss from financial assets (ac)	-49	-33
Net gain or loss from financial liabilities (ac)	0	0
Net gain or loss from financial assets (fvoci) recognised in other comprehensive income	-20	-7
Net gain or loss from financial assets (fvoci) transferred to the income statement	–	0
Net gain or loss from equity instruments (fvoci)	0	0
Net gain or loss from financial instruments (fvpl)	-2	14
Net gain or loss from financial guarantee contracts and loan commitments	1	1

[1] Comparative amounts reclassified according to the new classification format

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 includes 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 € -2 million (2017: € -7 million) in the year under review. Moreover, the change in the reserve from foreign-currency basis spreads amounted to € -17 million. In the previous year, the hedging reserve changed by € -27 million.

(57) 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. 193) 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 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	–
Equity instruments	0	0	–	–
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	–

31 December 2017 [1)]

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (fvoci)	**5,424**	**5,422**	**–**	**2**
Money market and capital market receivables	5,422	5,422	–	–
Equity instruments	2	–	–	2
Financial assets (fvpl)	**2,449**	**–**	**2,253**	**196**
Loan receivables	196	–	–	196
Money market and capital market receivables	–	–	–	–
Positive market value of designated hedging derivatives	1,926	–	1,926	–
Positive market value of other derivatives	327	–	327	–
Financial liabilities (fvpl)	**1,703**	**–**	**1,703**	**–**
Negative market value of designated hedging derivatives	1,479	–	1,479	–
Negative market value of other derivatives	224	–	224	–

1) Comparative amounts reclassified according to the new classification format

In the financial year 2018, there were no material transfers between the hierarchy levels for the various financial instruments.

The fair values of financial instruments 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:

€ mn	Loan receivables (fvpl)
Fair value as at 1 January 2018 [1]	**604**
Change in measurement	**-2**
Portfolio changes	
Additions	690
Derecognition	582
Deferred interest	1
Fair value as at 31 December 2018	**711**

[1] Fair value in accordance with IAS 39, as at 31 December 2017: € 196 million (recognised in 2017)

Financial instruments held in the Bank's portfolio contributed € -1 million to the net gain or loss from financial instruments (fvpl) (2017: € 0 million).

Regarding loan receivables (ac), 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 € 12 million (2017: approximately € 2 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 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 capital	1,090	321	769	–

31 December 2017[1)]

€ mn	Total fair value	Fair value level 1	Fair value level 2	Fair value level 3
Financial assets (ac)	**33,679**	**2,304**	**4,994**	**26,381**
Cash funds	2,081	–	2,081	–
Loan receivables	26,308	–	3	26,305
Money market and capital market receivables	5,218	2,304	2,910	4
Receivables from other transactions	72	–	–	72
Financial liabilities (ac)	**36,961**	**853**	**26,593**	**9,515**
Money market and capital market liabilities	26,349	513	25,778	58
Deposits from the housing industry	9,164	–	–	9,164
Liabilities from other transactions	90	–	–	90
Subordinated capital	1,358	340	815	203

[1)] Comparative amounts reclassified according to the new classification format

(58) 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 2018 Carrying amount	31 Dec 2018 Fair value	31 Dec 2017 Carrying amount[1)]	31 Dec 2017 Fair value[1)]
Financial assets (ac)	**34,125**	**34,556**	**33,156**	**33,679**
Cash funds	1,265	1,265	2,081	2,081
Loan receivables	26,232	26,858	25,776	26,308
Money market and capital market receivables	6,567	6,372	5,225	5,218
Receivables from other transactions	61	61	74	72
Financial assets (fvoci)	**4,450**	**4,450**	**5,424**	**5,424**
Money market and capital market receivables	4,443	4,443	5,422	5,422
Equity instruments	7	7	2	2
Financial assets (fvpl)	**3,183**	**3,183**	**2,449**	**2,449**
Loan receivables	711	711	196	196
Money market and capital market receivables	538	538	–	–
Equity instruments	0	0	–	–
Positive market value of designated hedging derivatives	1,277	1,277	1,926	1,926
Positive market value of other derivatives	657	657	327	327

[1)] Comparative amounts reclassified according to the new classification format

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€ mn	31 Dec 2018 Carrying amount	31 Dec 2018 Fair value	31 Dec 2017 Carrying amount[1]	31 Dec 2017 Fair value[1]
Financial liabilities (ac)	**37,215**	**37,168**	**36,630**	**36,961**
Money market and capital market liabilities	26,371	26,278	26,109	26,349
Deposits from the housing industry	9,679	9,679	9,164	9,164
Liabilities from other transactions	121	121	92	90
Subordinated capital	1,044	1,090	1,265	1,358
Financial liabilities (fvpl)	**1,934**	**1,934**	**1,703**	**1,703**
Negative market value of designated hedging derivatives	1,461	1,461	1,479	1,479
Negative market value of other derivatives	473	473	224	224

[1] Comparative amounts reclassified according to the new classification format

(59) 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)

€ 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	Transfers	Balance as at 31 December
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 (2017: n/a) and is reported on the equity and liabilities side of the statement of financial position under other reserves.

Provisions for unrecognised lending business

€ 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	Balance 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 subject to credit risk. Of the receivables from other transactions in the amount of € 64 million, € 58 million were neither overdue nor impaired, € 4 million were overdue but not impaired and € 2 million were impaired.

(60) 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) 2018

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Impairment and reversal 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	0	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) 2018

€ mn	Gross carrying amount as at 1 January	Additions	Disposals	Transfer to Stage 1	Transfer to Stage 2	Transfer to Stage 3	Impairment and reversal 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 Economic and Risk 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.

(61) 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.

Modifications in the case of loan receivables (ac)

€ mn	Stage 1	Stage 2	Stage 3
Amortised cost before modification	248	45	484
Net gain or loss on modification	-1	0	0
Amortised cost after modification	**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.

(62) 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 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**

31 December 2017

€ 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	2,212	–	2,212	1,094	983	135
Reverse repos	–	–	–	–	–	–
Total	**2,212**	**–**	**2,212**	**1,094**	**983**	**135**

Financial liabilities

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**

31 December 2017

€ 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	1,645	–	1,645	1,094	551	–
Repos	–	–	–	–	–	–
Total	**1,645**	**–**	**1,645**	**1,094**	**551**	**–**

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. Aareal Bank settles on a net basis in the case of transactions within the framework of GC pooling, which means that these transactions are offset in the statement of financial position.

(63) 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 2018	31 Dec 2017[1]
Money market and capital market receivables (ac, fvoci and fvpl)	1,381	723
Receivables from other transactions (ac)	17	14
Total	**1,398**	**737**

[1] Comparative amounts reclassified according to the new classification format

The protection buyer has no right to sell or re-pledge any of financial assets pledged as collateral (2017: € –). There is a fully cash-collateralised and irrevocable payment obligation in the amount of € 17 million (2017: € 14 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 balance sheet date (2017: € –).

Collateral is provided and accepted predominantly on the basis of standardised agreements on securities repurchase transactions and on the collateralisation of forward transactions.

(64) 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 were 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 hedges during the transfer of securities are accounted for as liabilities to banks, or liabilities to customers. 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.

(65) Derivative financial instruments

Overview of market values of derivatives

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 2018		Fair value as at 31 Dec 2017	
€ mn	positive	negative	positive	negative
Fair value hedge derivatives	**1,277**	**1,443**	**1,915**	**1,464**
Interest rate risk	**1,277**	**1,422**	**1,385**	**1,312**
Interest rate swaps	1,277	1,422	1,385	1,312
Interest rate and currency risk	**–**	**21**	**530**	**152**
Cross-currency swaps	–	21	530	152
Derivatives from cash flow hedges	**–**	**–**	**8**	**15**
Interest rate and currency risk	**–**	**–**	**8**	**15**
Cross-currency swaps	–	–	8	15
Hedge of net investments	**–**	**18**	**3**	**–**
Currency risk	**–**	**18**	**3**	**–**
Cross-currency swaps	–	18	3	–
Other derivatives	**657**	**473**	**327**	**224**
Interest rate risk	**190**	**260**	**247**	**190**
Interest rate swaps	184	254	241	184
Swaptions	–	0	–	0
Caps, floors	6	6	6	6
Interest rate and currency risk	**467**	**213**	**80**	**34**
Spot and forward foreign exchange transactions	14	3	37	2
Cross-currency swaps	453	210	43	32
Total	**1,934**	**1,934**	**2,253**	**1,703**

Derivatives have been entered into with the following counterparties:

	Fair value as at 31 Dec 2018		Fair value as at 31 Dec 2017	
	positive	negative	positive	negative
€ mn				
OECD banks	1,820	1,888	2,087	1,693
Companies and private individuals	114	46	166	10
Total	**1,934**	**1,934**	**2,253**	**1,703**

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 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**

31 December 2017

€ 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	161	430	1,360	417	2,368
Cash outflows	144	279	981	358	1,762
Swaptions					
Cash inflows	–	–	–	–	–
Cash outflows	–	–	0	–	0
Caps, floors					
Cash inflows	0	0	5	1	6
Cash outflows	0	0	5	1	6
Interest rate and currency risk					
Spot and forward foreign exchange transactions					
Cash inflows	2,870	341	–	–	3,211
Cash outflows	2,843	337	–	–	3,180
Cross-currency swaps					
Cash inflows	186	1,923	5,133	1,147	8,389
Cash outflows	231	2,032	4,967	1,068	8,298
Total cash inflows	**3,217**	**2,694**	**6,498**	**1,565**	**13,974**
Total cash outflows	**3,218**	**2,648**	**5,953**	**1,427**	**13,246**

The procedure for measuring and monitoring liquidity risk is described in the Risk Report.

(66) 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 2018	Nominal amount 31 Dec 2018	Fair value change 1 Jan - 31 Dec 2018
Fair value hedges			
Interest rate risk			
Interest rate swaps	1,277	18,276	-87
Total	**1,277**	**18,276**	**-87**

Negative market value of designated hedging derivatives

€ mn	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	1,422	12,470	-56
Interest rate and currency risk			
Cross-currency swaps	21	112	-5
Hedge of net investments			
Currency risk			
Cross-currency swaps	18	599	17
Total	**1,461**	**13,181**	**-44**

The following overview presents the nominal amounts of the hedging derivatives by maturities:

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

The following table shows hedged items separately for each type of hedging relationship and risk category:

Hedged items of fair value hedges

€ mn	Active hedging relationships: Carrying amount 31 Dec 2018	Active hedging relationships: Accumulated hedge adjustment 31 Dec 2018	Active hedging relationships: Change in hedged fair values 1 Jan-31 Dec 2018	Discontinued hedging relationships: 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 € 22 million in the financial year. The balance of the hedge reserve stood at € -11 million at the 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 2018	1 Jan-31 Dec 2017
Interest rate risks	-2	-2
Interest rate and currency risks	0	0
Total	**-2**	**-2**

Hedge of net investments

The ineffective portion of currency-hedged net investments in foreign operations amounted to € 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.

(67) Maturities of financial liabilities

The following two overviews show the future undiscounted cash flows of non-derivative financial liabilities and of loan commitments.

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 capital (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**

Maturities as at 31 December 2017[1)]

€ 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)	1,148	2,324	5,054	10,488	10,457	**29,471**
Deposits from the housing industry (ac)	7,324	1,903	66	17	–	**9,310**
Subordinated capital (ac)	–	24	27	779	459	**1,289**
Financial liabilities from other transactions (ac)	92	–	–	–	–	**92**
Financial guarantees	122	–	–	–	2	**124**
Loan commitments	1,749	–	–	–	–	**1,749**

[1)] Comparative amounts reclassified according to the new classification format

The Risk Report includes a detailed description of the liquidity risk associated with financial liabilities.

Segment Reporting

(68) Operating segments of Aareal Bank

In the financial year 2018, segment reporting by Aareal Bank was prepared 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 are 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. Private placements are the focal point of the Bank's capital market activities. These are complemented by larger, public placements that are issued depending on market conditions. 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 AG 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 AG 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 process optimisation, electronic banking and asset management. 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. The interest rate contribution is reported in the segment's net commission income and then transferred to net interest 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.

(69) Segment results

€ mn	Structured Property Financing		Consulting/Services		Consolidation/ Reconciliation		Aareal Bank Group	
	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]
Net interest income	547	596	0	0	-12	-12	535	584
Loss allowance	73	82	-1				72	82
Net commission income	9	7	200	191	6	8	215	206
Net derecognition gain or loss	24	50					24	50
Net gain or loss from financial instruments (fvpl)	-2	14	0				-2	14
Net gain or loss from hedge accounting	-2	-7					-2	-7
Net gain or loss from investments accounted for using the equity method	0						0	
Administrative expenses	241	296	227	220	-6	-5	462	511
Net other operating income/expenses	21	69	4	6	0	-1	25	74
Negative goodwill from acquisitions	55						55	
Operating profit	**338**	**351**	**-22**	**-23**	**0**	**0**	**316**	**328**
Income taxes	99	123	-9	-8			90	115
Consolidated net income	**239**	**228**	**-13**	**-15**	**0**	**0**	**226**	**213**
Consolidated net income attributable to non-controlling interests	0	4	2	2			2	6
Consolidated net income attributable to shareholders of Aareal Bank AG	239	224	-15	-17	0	0	224	207
Allocated equity	2,058	1,724	189	165	268	627	2,515	2,516
Cost/income ratio (%)	40.4	40.5	111.6	111.9			58.2	55.5
RoE before taxes (in %)[2]	15.3	18.8	-12.7	-15.4			11.6	11.9
Employees (average)	**800**	**880**	**1,964**	**1,878**			**2,764**	**2,758**
Segment assets	**31,989**	**31,642**	**10,698**	**10,266**			**42,687**	**41,908**

[1] Comparative amounts reclassified according to the new classification format
[2] 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 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]	1 Jan - 31 Dec 2018	1 Jan - 31 Dec 2017[1]
€ mn								
ERP Products			168	160	-1		167	160
Digital solutions			42	37			42	37
Add-on products			23	21	-12	-10	11	11
Banking business and other activities	12	10	27	25			39	35
Total	**12**	**10**	**260**	**243**	**-13**	**-10**	**259**	**243**

[1] Comparative amounts reclassified according to the new classification format

(70) Income by geographical region

	2018	2017
€ mn		
Germany	522	621
Rest of Europe	172	161
North America	75	70
Asia/Pacific	3	2
Total	**772**	**854**

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). Since the 2018 financial year, subsidiaries or branches have been allocated to geographical markets based on their registered office or domicile. The previous year's figures were adjusted accordingly.

(71) Consulting/Services segment – reconciliation of the income statement

Reconciliation of the segment result from the income statement classification aligned to an industrial enterprise to a bank income statement classification (which is used for the purposes of segment reporting)

€ mn			Income statement classification – bank								
			Net interest income	Loss allowance	Net commission income	Net gain or loss from financial instruments (fvpl)	Administrative expenses	Net other operating income/expenses	**Operating profit**	Income taxes	**Segment result**
	2018		0	-1	200	0	227	4	**-22**	-9	**-13**
	2017		0		191		220	6	**-23**	-8	**-15**
Income statement classification – industrial enterprise											
Sales revenue	2018	242			242						
	2017	226			226						
Own work capitalised	2018	8					8				
	2017	4					4				
Other operating income	2018	7						7			
	2017	7						7			
Cost of materials purchased	2018	42			42						
	2017	35			35						
Staff expenses	2018	159					159				
	2017	151					151				
Depreciation, amortisation and impairment losses	2018	15					15				
	2017	12					12				
Other operating expenses	2018	63		-1		0	61	3			
	2017	62					61	1			
Interest and similar income/expenses	2018	0	0								
	2017	0	0								
Operating profit	**2018**	**-22**	**0**	**-1**	**200**	**0**	**227**	**4**			
	2017	**-23**	**0**		**191**		**220**	**6**			
Income taxes	2018	-9								-9	
	2017	-8								-8	
Segment result	**2018**	**-13**									
	2017	**-15**									

Other Notes

(72) Assets and liabilities in foreign currency

Foreign currency assets

€ mn	31 Dec 2018	31 Dec 2017
USD	13,096	10,851
GBP	4,408	4,019
CAD	908	715
SEK	608	538
CHF	400	458
DKK	323	411
Other	94	27
Total	**19,837**	**17,019**

Foreign currency liabilities

€ mn	31 Dec 2018	31 Dec 2017
USD	13,084	10,829
GBP	4,340	3,932
CAD	905	719
SEK	584	518
CHF	401	454
DKK	322	436
Other	91	27
Total	**19,727**	**16,915**

(73) 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 € 0 million of subordinated assets in the financial year 2018 (2017: € –).

(74) Leases

A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or a series of payments the right to use an asset for an agreed period of time. In accordance with IAS 17, leases where a material part of risks and rewards incidental to ownership of the leased assets remains with the lessor are classified as operating leases. Where substantially all risks and rewards are transferred to the lessee, the lease is classified as a finance lease. The provisions of IFRIC 4 were complied with as regards the application of IAS 17. Aareal Bank Group acts both as lessor and lessee. All rental contracts are classified as operating leases. They mainly refer to rented or let property.

Properties leased by the Group are reported under other assets.

Payments received or made under operating leases are recognised in income, on a straight-line basis over the term of the lease.

Maturity of minimum lease payments under operating leases

€ mn	31 Dec 2018	31 Dec 2017
Aareal Bank Group as lessee		
up to 1 year	15	13
longer than 1 year, and up to 5 years	37	34
longer than 5 years	13	11
Total minimum lease payments	**65**	**58**
Aareal Bank Group as lessor		
up to 1 year	9	13
longer than 1 year, and up to 5 years	24	35
longer than 5 years	7	16
Total minimum lease payments	**40**	**64**

In the financial year, lease payments of € 16 million (2017: € 14 million) were recognised as expenses.

(75) Contingent liabilities and loan commitments

€ mn	31 Dec 2018	31 Dec 2017
Contingent liabilities	158	124
Loan commitments	1,480	1,749
of which: irrevocable	1,035	1,355

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 € 109 million (2017: € 51 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.

(76) 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 in relation to property and equipment and investments in equity instruments and equity investments as well as from investment properties. Cash flows from financing activities include cash flows from transactions with providers of equity and subordinated capital.

In connection with the assets acquired and liabilities assumed, as well as the purchase price paid within the context of the acquisition of Düsselhyp, please refer to our statements in the section "Consolidation".

(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 forecast countercyclical buffer) of at least 10.6 % of its risk-weighted assets in 2019 (2018: 10.0 %). Risk-weighted assets must be backed by Tier 1 capital of at least 8.6 % (2018: 8.0 %). 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 2019, the SREP total capital requirement of the ECB amounts to 12.87 % (2018: 11.74 %) 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 forecast countercyclical buffer. In 2019, the SREP-CET 1 requirement is 9.37 % (2018: 8.24 %), including the abovementioned 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 CET1 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 2018[1]	31 Dec 2017
Tier 1 capital (T1)		
Subscribed capital and capital reserves	900	900
Eligible retained earnings	1,590	1,580
Accumulated other comprehensive income	-54	-50
Amounts to be deducted from CET 1 capital	-195	-125
Total Common Equity Tier 1 (CET1) capital	**2,241**	**2,305**
AT1 bond	300	300
Amounts to be deducted from Additional Tier 1 capital	–	-5
Sum total of Additional Tier 1 (AT1) capital	**300**	**295**
Sum total of Tier 1 capital (T1)	**2,541**	**2,600**
Tier 2 (T2) capital		
Subordinated liabilities	830	886
Profit-participation certificates	–	1
Other	48	51
Amounts to be deducted from Tier 2 capital	–	-2
Sum total of Tier 2 capital (T2)	**878**	**936**
Total capital (TC)	**3,419**	**3,536**

[1] When calculating own funds, annual profits including negative goodwill were taken into account, based on the Management Board's proposal for appropriation of profits for the 2018 financial year. 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 ECB's NPL guidelines (NPL stock), were taken into account for determining regulatory capital for 2018. Due to the fact that the ECB has not yet approved the application for inclusion of profits (including negative goodwill) as at 31 December 2018, the corresponding regulatory report did not incorporate attributable annual profits (including negative goodwill), nor the effects of the TRIM exercise. CET1 amounted to € 1,994 million, with T1 at € 2,294 million and TC at € 3,172 million. Assuming the ECB's approval, the regulatory report as at 31 December 2018 would incorporate annual profits including negative goodwill, but excluding the TRIM effects. CET1 would amount to € 2,263 million, with T1 at € 2,563 million and TC at € 3,442 million.

The regulatory measurement of risk-weighted assets (RWAs) in the area of credit risks is based on both the Advanced Internal Ratings-Based Approach (AIRBA), and on the standardised approach (CRSA). The regulatory reports as at 31 December 2018 quantified RWAs (excluding TRIM effects) at € 10,778 million. Especially due to the incorporation of the expected relevant impact of the TRIM exercise on commercial property financings, and of the SREP recommendations concerning ECB's NPL guidelines (NPL stock), RWAs as at 31 December 2018 were broken down as shown in the following table (p. 217).

	EAD	Risk-weighted assets (RWA)			Regulatory capital requirements	EAD	RWA	Regulatory capital requirements
		AIRBA	CRSA	Total				
	31 Dec 2018	31 Dec 2018	31 Dec 2018	31 Dec 2018	31 Dec 2018	31 Dec 2017[1)]	31 Dec 2017[1)]	31 Dec 2017[1)]
€ mn								
Credit risks	**44,722**	**10,347**	**925**	**11,272**	**902**	**44,142**	**10,009**	**801**
Companies	28,674	8,546	314	8,860	709	27,394	7,159	573
Institutions	2,711	301	80	381	30	2,642	386	31
Public-sector entities	11,915	0	312	312	25	12,295	291	23
Other	1,422	1,500	219	1,719	138	1,811	2,173	174
Market price risks				**97**	**8**		**134**	**11**
Operational risks				**1,455**	**116**		**1,433**	**114**
Credit Valuation Adjustment				**215**	**17**		**209**	**17**
Total	**44,722**	**10,347**	**925**	**13,039**	**1,043**	**44,142**	**11,785**	**943**

[1)] The presentation of exposure classes was adjusted to the methodology of the regulatory report, and previous year's figures were adjusted accordingly.

(78) Additional disclosures to the Remuneration Report

Management Board

In the financial year 2018, the Management Board's total remuneration amounted to € 10 million (2017: € 10 million), of which € 5 million (2017: € 5 million) referred to variable components.

Payments to former Management Board members and their surviving dependants totalled € 3 million in 2018 (2017: € 3 million).

The pension obligations to former members of the Management Board and their surviving dependants amounted to a total of € 33 million as at 31 December 2018 (2017: € 33 million).

Supervisory Board

The total remuneration of members of the Supervisory Board for the financial year 2018 amounted to € 2 million (2017: € 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	3 Dec 2018	31 Dec 2017
Short-term benefits	7,349	7,214
Post-employment benefits	3,026	3,031
Other long-term benefits	1,441	1,577
Termination benefits	–	–
Share-based remuneration	2,402	2,628
Total	**14,218**	**14,450**

Provisions for pension obligations concerning key executives totalled € 19 million as at 31 December 2018 (2017: € 16 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 share-based payment arrangements changed as follows:

Quantity (number)	2018	2017
Balance (outstanding) at 1 January	**691,546**	**688,668**
Granted during the reporting period	211,421	226,777
Expired during the reporting period	–	–
Exercised during the reporting period	246,067	223,899
Balance (outstanding) at 31 December	**656,900**	**691,546**
of which: exercisable	–	–

The fair value of the virtual shares granted during the reporting period amounted to € 6 million (2017: € 9 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 € 39.08 (2017: € 35.61).

The virtual shares outstanding at 31 December 2018 have a limited contract term. The weighted average remaining contract term of these virtual shares amounts to 427.31 days (2017: 434.93 days).

Impact on financial performance

The total amount expensed for share-based payment transactions was € 1 million during the financial year 2018 (2017: € 9 million). The portion of the total amount expensed attributable to members of the Management Board amounted to € 0 million (2017: € 3 million) and can be broken down to the individual members of the Management Board as follows:

€	2018	2017
Hermann J. Merkens	-157,261	1,018,900
Marc Hess[1)]	100,822	–
Dagmar Knopek	-176,781	593,432
Christiane Kunisch-Wolff	122,941	413,174
Thomas Ortmanns	-155,427	604,019
Christof Winkelmann	159,461	410,542

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

In addition, € 0 million (2017: € 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 (2017: € 0 million), since there were no exercisable virtual shares at that date. The obligation from share-based payment transactions as at 31 December 2018 amounted to € 28 million (2017: € 36 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 86 ”List of Shareholdings” as well as the companies attributable to the related persons within the meaning of IAS 24.9 (b)(vi).

The following list provides an overview of the balances of existing transactions with related parties:

€ mn	31 Dec 2018	31 Dec 2017
Management Board	–	–
Supervisory Board	–	–
Other related parties	18	76
Total	**18**	**76**

The item ”Other related parties” includes a loan of € 18 million which was provided to our investee Mount Street Group Limited on an arm's length basis.

In addition, there were no further significant transactions within the meaning of IAS 24.

(80) Events after the reporting date

There have been no material events subsequent to the end of the period under review that need to be disclosed at this point.

(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 2018, 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
VBL	Karlsruhe	6.50 %	3 February 2015
Blackrock	Wilmington	5.39 %	4 October 2018
Dimensional Fund	Austin	5.00 %	3 August 2018
Allianz Global Investors	Frankfurt	4.80 %	28 November 2018
JPMorgan Investment Management Inc.[2]	Wilmington	3.07 %	13 November 2018
JPMorgan Chase Bank[2]	Columbus	3.07 %	13 November 2018
JPMorgan Asset Management (UK)[2]	London	3.07 %	13 November 2018
iShares Trust	Wilmington	3.05 %	15 June 2018
State of Norway (through Norges Bank)	Oslo	3.05 %	26 February 2018
DFA International Small Cap Value	Baltimore	3.01 %	7 August 2018

[1] Direct and indirect holdings of voting rights
[2] Holdings of these three entities are mutually allocated to each other, leading to an aggregate holding of 3.07 %.

(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 2018[1)]	Average 1 Jan-31 Dec 2018[2)]	31 Dec 2017[1)]	Average 1 Jan-31 Dec 2017[2)]
Salaried employees	2,593	2,612	2,644	2,600
Executives	155	152	156	158
Total	**2,748**	**2,764**	**2,800**	**2,758**
of which: part-time employees	569	548	544	531

1) This number does not include 47 employees of the hotel business (31 December 2017: 57 employees).
2) This number does not include 191 employees of the hotel business (1 January to 31 December 2017: 198 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 interacts with structured entities such as open-ended property funds and leased property companies. The Group's business relationships are restricted to the provision of financings to structured entities in the form of loans or guarantees. 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 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 of total assets for leased property companies.

31 December 2018

€ mn	Open-ended property funds	Leased property companies	Total
Assets			
Loan receivables	159	30	**189**
Size range of structured units	**€ 160 million – € 734 million**	**€ 5 million – € 44 million**	

31 December 2017[1)]

€ mn	Open-ended property funds	Leased property companies	Total
Assets			
Loan receivables	270	29	**299**
Size range of structured units	**€ 104 million – € 5,908 million**	**€ 10 million – € 28 million**	

1) Comparative amounts reclassified according to the new classification format

(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.

2018

	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	**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	0	0	–
Sweden	3	1	0	3
United Kingdom	8	5	0	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	0	-2	0	7
Sweden	7	-1	0	79
United Kingdom	12	1	0	117
Consolidation	–	–	–	–
Total	**850**	**316**	**90**	**2,546**

Government assistance was not received in the financial year 2018.

Aareal Bank Group's return on assets, calculated as the ratio of net profit to total assets, was 0.52% as at the record date.

2017

	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	**724**	**351**	**123**	**1,024**
Belgium	0	0	–	–
France	7	3	2	5
Germany	554	248	113	932
Ireland	4	2	0	2
Italy	58	22	-1	31
Poland	10	7	1	6
Singapore	2	0	0	5
Spain	2	2	0	–
Sweden	4	2	0	3
United Kingdom	6	3	1	7
USA	82	63	7	33
Consolidation	-5	-1	–	–
Consulting/Services segment	**197**	**-23**	**-8**	**1,382**
France	30	5	1	177
Germany	108	-33	-11	752
Netherlands	36	6	1	252
Norway	1	0	–	8
Sweden	10	-1	0	79
United Kingdom	12	0	0	114
Consolidation	–	–	1	–
Total	**921**	**328**	**115**	**2,406**

(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 2018

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
1	Aareal Bank AG	Wiesbaden			
	I. Fully-consolidated subsidiaries				
2	1st Touch Ltd.	Southampton	100.0	GBP 2.4 mn	GBP -0.2 mn [2]
3	Aareal Bank Asia Ltd.	Singapore	100.0	SGD 18.7 mn	SGD 1.2 mn [1]
4	Aareal Beteiligungen AG	Frankfurt	100.0	227.8	0.0 [3]
5	Aareal Capital Corporation	Wilmington	100.0	USD 507.7 mn	USD 48.0 mn [4]
6	Aareal Estate AG	Wiesbaden	100.0	2.5	0.0 [3]
7	Aareal First Financial Solutions AG	Mainz	100.0	3.2	0.0 [3]
8	Aareal Gesellschaft für Beteiligungen und Grundbesitz Erste mbH & Co. KG	Wiesbaden	94.9	2.6	0.1 [1]
9	Aareal Holding Realty LP	Wilmington	99.8	USD 190.6 mn	USD -17.4 mn [4]
10	Aareal Immobilien Beteiligungen GmbH	Wiesbaden	100.0	462.2	0.0 [3]
11	Aareon AG	Mainz	100.0	136.6	24.6
12	Aareon Deutschland GmbH	Mainz	100.0	34.7	0.0 [3]
13	Aareon Finland Oy	Helsinki	100.0	0.0	0.0
14	Aareon France S.A.S.	Meudon-la Forêt	100.0	10.6	3.5 [2]
15	Aareon Nederland B.V.	Emmen	100.0	26.2	2.5 [2]
16	Aareon Norge AS	Oslo	100.0	NOK 0.6 mn	NOK -4.2 mn [2]
17	Aareon Sverige AB	Mölndal	100.0	SEK 30.7 mn	SEK -8.0 mn [2]
18	Aareon UK Ltd.	Coventry	100.0	GBP 4.4 mn	GBP -0.3 mn [2]
19	AV Management GmbH	Mainz	100.0	0.4	0.0 [3]
20	BauContact Immobilien GmbH	Wiesbaden	100.0	8.6	0.0
21	BauGrund Immobilien-Management GmbH	Bonn	100.0	0.5	0.0 [3]
22	BauGrund Solida Immobilien GmbH	Frankfurt	100.0	0.1	0.0
23	BauGrund TVG GmbH	Munich	100.0	0.1	0.0 [1]
24	BauSecura Versicherungsmakler GmbH	Hamburg	51.0	3.6	3.5
25	BVG – Grundstücks- und Verwertungsgesellschaft mit beschränkter Haftung	Frankfurt	100.0	217.3	0.0 [3]
26	DBB Inka	Dusseldorf	100.0	100.7	0.5
27	Deutsche Bau- und Grundstücks-Aktiengesellschaft	Berlin	100.0	1.2	-0.3 [1]
28	Deutsche Structured Finance GmbH	Wiesbaden	100.0	4.3	-1.6
29	DSF Flugzeugportfolio GmbH	Wiesbaden	100.0	0.0	0.0 [3]
30	Düsseldorfer Hypothekenbank AG	Dusseldorf	100.0	227.7	-90.4
31	Facilitor B.V.	Enschede	100.0	1.2	0.8 [2]
32	FIRE B.V.	Utrecht	60.0	0.0	0.0 [2]

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[1] Preliminary figures as at 31 December 2018; [2] Equity and results as at 31 December 2017;
[3] Profit and loss transfer agreement / control and profit transfer agreement; [4] Disclosures in accordance with IFRSs; [5] Joint operation

No.	Company name	Registered office	Shareholding	Equity	Results
			%	€ mn	€ mn
33	GEV Besitzgesellschaft mbH	Wiesbaden	100.0	30.0	0.0 [3]
34	GEV Beteiligungsgesellschaft mbH	Wiesbaden	100.0	0.1	0.0
35	GVN-Grundstücks- und Vermögensverwaltungs-gesellschaft mit beschränkter Haftung	Frankfurt	100.0	0.5	0.0 [3]
36	IV Beteiligungsgesellschaft für Immobilieninvestitionen mbH	Wiesbaden	100.0	2.5	0.0 [1]
37	Izalco Spain S.L.	Madrid	100.0	13.9	-0.8 [1]
38	Jomo S.p.r.l.	Brussels	100.0	25.4	0.6 [1]
39	Kalshoven Automation B.V.	Amsterdam	100.0	0.5	0.5 [2]
40	La Sessola Holding GmbH	Wiesbaden	100.0	86.6	0.0 [1]
41	La Sessola S.r.l.	Rome	100.0	108.0	-7.6 [1]
42	La Sessola Service S.r.l.	Rome	100.0	2.7	-0.9 [1]
43	Manager Realty LLC	Wilmington	100.0	USD 0.0 mn	USD 0.0 mn [4]
44	Mercadea S.r.l.	Rome	100.0	7.3	0.1 [1]
45	Mirante S.r.l.	Rome	100.0	7.4	-2.9 [1]
46	mse Augsburg GmbH	Augsburg	100.0	0.1	-0.3 [1]
47	mse Immobiliensoftware GmbH	Hamburg	100.0	1.1	0.4 [1]
48	mse RELion GmbH	Augsburg	100.0	0.6	0.4 [1]
49	Northpark Realty LP	Wilmington	100.0	USD 109.0 mn	USD 4.7 mn [4]
50	Participation Achte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
51	Participation Elfte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
52	Participation Neunte Beteiligungs GmbH	Wiesbaden	100.0	149.0	0.0 [3]
53	Participation Zehnte Beteiligungs GmbH	Wiesbaden	100.0	0.0	0.0 [3]
54	phi-Consulting GmbH	Bochum	100.0	1.9	0.2
55	Sedum Grundstücksverwaltungsgesellschaft mbH & Co.Vermietungs KG	Wiesbaden	94.9	-5.5	-1.2 [1]
56	Square DMS B.V.	Grathem	100.0	1.2	0.2 [2]
57	Terrain-Aktiengesellschaft Herzogpark	Wiesbaden	100.0	4.7	0.0 [3]
58	Terrain Beteiligungen GmbH	Wiesbaden	94.0	56.6	1.9 [1]
59	Westdeutsche Immobilien Servicing AG	Mainz	100.0	50.1	0.0 [3]
60	WP Galleria Realty LP	Wilmington	100.0	USD 96.5 mn	USD 2.0 mn [4]
	II. Joint Arrangements				
61	Konsortium BauGrund/TREUREAL [5]	Bonn	50.0	0.0	-0.1 [1]
62	Rive Défense S.A.S.	Paris	50.0	-125.2	-3.4
	III. Associates				
63	DSF PP Justizzentrum Thüringen GmbH & Co. KG	Frankfurt	48.4	0.3	0.0 [2]
64	Mount Street Group Limited	London	20.0	GBP -0.4 mn	GBP -2.9 mn [1]
65	Mount Street US Group LLP	Wilmington	20.0	USD -0.2 mn	USD -0.2 mn [1]
66	Westhafen Haus GmbH & Co. Projektentwicklungs KG	Frankfurt	25.0	-0.1	-0.1 [2]
67	Westhafen-Gelände Frankfurt am Main GbR	Frankfurt	33.3	0.1	0.1 [2]
	IV. Other enterprises				
68	BrickVest Ltd.	London	9.9	GBP 2.0 mn	GBP -1.8 mn [2]

[1] Preliminary figures as at 31 December 2018; [2] Equity and results as at 31 December 2017;
[3] Profit and loss transfer agreement / control and profit transfer agreement; [4] Disclosures in accordance with IFRSs; [5] Joint operation

(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	
Instone Real Estate Group N.V.	Member of the Supervisory Board	(since 13 February 2018)
Nomura Financial Products Europe GmbH	Member of the Supervisory Board	(since 15 November 2018)
(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 until 31 March 2018

Aareal Bank AG	Deputy Chairman of the Supervisory Board	
Howaldt & Co. Investmentaktiengesellschaft TGV	Chairman of the Supervisory Board	
DePfa Holding Verwaltungsgesellschaft mbH (liquidation planned)	Member of the Supervisory Board	(until 31 March 2018)

York-Detlef Bülow*, Deputy Chairman of the Supervisory Board (until 31 March 2018)
Aareal Bank AG

Aareal Bank AG	Deputy Chairman of the Supervisory Board

Thomas Hawel*
Aareon Deutschland GmbH

Aareal Bank AG	Member of the Supervisory Board
Aareon Deutschland GmbH	Deputy Chairman of the Supervisory Board

Petra Heinemann-Specht* (since 1 April 2018)
Aareal Bank AG

Aareal Bank AG	Member of the Supervisory Board

Dieter Kirsch*, Deputy Chairman of the Supervisory Board (from 31 March 2018 to 31 December 2018)
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 planned)	Member of the Supervisory Board (not active)	
(Non-commercial mandates)		
EAPSPI (European Association of Public Sector Pension Institutions)	Member of the Board of Directors	(until 30 September 2018)
VBLV e.V.	Chairman of the Management Board	

Dr Hans-Werner Rhein		
German Lawyer (Rechtsanwalt)		
Aareal Bank AG	Member of the Supervisory Board	
Gothaer Allgemeine Versicherung AG	Member of the Supervisory Board	(until 7 December 2018)
(Offices held at other listed companies)		
Deutsche Familienversicherung AG	Chairman of the Supervisory Board	
(Non-commercial mandates)		
Müller-Matthieu Stiftung	Chairman of the Supervisory Board	
ARIAS Deutschland e.V.	Chairman of the Supervisory 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, Bank of England, Prudential Regulation Authority		
Aareal Bank AG	Member of the Supervisory Board	
(Offices held at other listed companies)		
TLG Immobilien AG	Member of the Supervisory Board	(until 29 January 2018)
Korian SA	Member of the Supervisory Board	

Hans-Dietrich Voigtländer		
Senior 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	(since 30 June 2018)
DEMIRE Deutsche Mittelstand Real Estate AG	Chairman of the Supervisory Board	(until 27 June 2018)

Beate Wollmann*		
Aareon Deutschland GmbH		
Aareal Bank AG	Member of the Supervisory Board	

* Employee representative member of the Supervisory Board of Aareal Bank AG; ** For banks subject to the CRR, assumption of more than four Supervisory Board offices requires the separate approval by the competent supervisory authority. This approval had been granted for the composition of the Supervisory Board until 27 June 2018. Following a change to this composition, the Bank applied for this approval to be reconfirmed, which the supervisory authority has not yet granted to date.

Composition of Supervisory Board's committees

Executive and Nomination Committee	
Marija Korsch	Chairman
Prof. Dr Stephan Schüller	Deputy Chairman
Dieter Kirsch	
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
Dieter Kirsch	
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	

Committee for Urgent Decisions (until 31 Dec 2018)
Sylvia Seignette
Elisabeth Stheeman
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

(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	
SoftS IT Solutions AG	Deputy Chairman of the Supervisory Board	(until 20 April 2018)

Marc Hess, Member of the Management Board (since 1 October 2018)
Finance & Controlling, Treasury

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)		
Aareon AG	Member of the Supervisory Board	(until 31 December 2018)
Westdeutsche Immobilien Servicing AG (formerly Westdeutsche ImmobilienBank AG)	Chairman of the Supervisory Board	

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

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	
SoftS IT Solutions AG	Chairman of the Supervisory Board	(until 20 April 2018)

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, 5 March 2019

The Management Board

Hermann J. Merkens **Marc Hess** **Dagmar Knopek**

Christiane Kunisch-Wolff **Thomas Ortmanns** **Christof Winkelmann**

Independent Auditors' Report [1)]

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 2018, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows for the financial year from 1 January to 31 December 2018, 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 2018. 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 (Handelsgesetzbuch: 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 of 31 December 2018, and of its financial performance for the financial year from 1 January to 31 December 2018, 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") and in compliance with German Generally Accepted Standards for Financial

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[1)] Translation of the independent auditor's report issued in German language on the consolidated financial statements prepared in German language by the executive directors of Aareal Bank AG. The German text is authoritative.

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 2018. 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 First-time consolidation of Düsseldorfer Hypothekenbank AG
❹ Measurement of financial instruments in connection with the initial application of IFRS 9

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 2018. As of 31 December 2018, the allowances for credit losses for the Italian mortgage loan portfolio amounts to a total of € 402 million. Italy's difficult macroeconomic situation has in past years, in part, led to financial difficulties and restructuring proceedings for Aareal Bank AG's borrowers. The realisation period of the properties on which the Italian mortgage loan portfolio is based generally takes a number of years 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 pledged 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, realisation and completion 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 are subject to uncertainties in this regard, this matter was of particular significance during our audit.

② As part of our audit we evaluated, inter alia, the existing documents relating to the financial circumstances of the borrowers and the recoverability of the pledged collateral in a risk-focused sample of exposures. We evaluated the valuations performed by the appraisers 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 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 specific cases, we carried out our own property inspections. In addition, we based our assessment of the executive directors' assumptions concerning cash flow, realisation and completion 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 system 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 processes implemented are appropriate.

③ The Company's disclosures regarding the risk allowances are contained in notes 7, 29 and 40 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 2018 in the amount of € 134 million in the property and equipment balance sheet line item in accordance with IAS 16 "Property, Plant and Equipment" and in the amount of € 209 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 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 during 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, 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 17, 19, 45 and 48 in the notes to the consolidated financial statements.

❸ First-time consolidation of Düsseldorfer Hypothekenbank AG

① With effect from 31 December 2018, Aareal Bank AG acquired 100 % of the shares in Düsseldorfer Hypothekenbank AG. The total purchase price for the acquisition was € 149 million. The acquisition was accounted for as a business combination using the acquisition method in accordance with IFRS 3. In the context of the purchase price allocation, the identified assets and assumed liabilities and contingent liabilities of the company acquired were recognized at their fair values. Taking into account the acquired net assets of € 204 million that are to be allocated to the Company, this resulted in negative goodwill from capital consolidation of € 55 million, which was recognized in profit or loss pursuant to IFRS 3.34 in 2018. Due to the uncertainties in the estimations made in connection with the measurement of assets and liabilities as part of the purchase price allocation, and the overall material impact of the amounts involved in the acquisition on the assets, liabilities, financial position and financial performance of the Aareal Bank Group, this matter was of particular significance in the context of our audit.

② In auditing the acquisition of Düsseldorfer Hypothekenbank AG, we initially inspected and assessed the corresponding contractual agreements and reconciled the purchase price paid as consideration for the acquired business operations received with the supporting payment documentation provided to us. Based on that, we evaluated the balance sheet underlying the acquisition based on the fair values at the time of first-time consolidation. This involved assessing the appropriateness of, among other things, the models on which the valuations were based as well as the valuation parameters and assumptions used. Given the special features relating to the calculation of the fair values within the context of the purchase price allocation, we received support in our assessment from our valuation specialists. We also checked the calculation of the negative goodwill from capital consolidation and the further verification of the carrying amounts of the acquired assets and liabilities that has to be performed under IFRS 3.36 prior to the recognition of the negative goodwill through profit or loss. We also evaluated the disclosures in the notes to the financial statements that are required under IFRS 3. Overall, we were able to satisfy ourselves that this acquisition was presented appropriately in the financial statements and that the estimates and assumptions made by the executive directors are comprehensible and adequately substantiated.

③ The Company's disclosures on the first-time consolidation are contained in note 3 of the notes to the consolidated financial statements.

❹ Measurement of financial instruments in connection with the initial application of IFRS 9

① Aareal Bank has been applying the accounting standard IFRS 9 "Financial Instruments" since 1 January 2018. The classification of financial assets is now split into three categories, resulting in differences in measurement for the purposes of subsequent recognition in each case. The business model in which the financial instruments are held and the contractual structure of these financial instruments are decisive factors in their classification under IFRS 9. Taking market-related modifications into account, the initial application of the provisions governing the classification of financial instruments had a positive effect of € 22 million after tax, which was recognized in reported equity. For those financial instruments that are measured at amortized cost or at fair value through other comprehensive income, the new impairment provisions (expected credit loss model) replace the previous incurred credit loss model. Risk provisions are now presented in a 3-stage model, with financial instruments being recognized in stage 1 as a general rule. Expected twelve-month losses are to be recognized for these financial instruments. If the default risk increases considerably compared with the time of initial recognition, the amount of the expected losses over lifetime (stage 2) is recognized under risk provisions. The same applies to financial instruments that are credit-impaired (stage 3). Within this context, the bank has adjusted its internal models and processes for the calculation of the expected loss pursuant to IFRS 9. The initial application of the rules governing risk provisions had an effect of € -49 million after taxes in reported equity as of 1 January 2018. Due to the scope for judgment and uncertainties in the estimations made in connection with the initial application of IFRS 9 and subsequent measurement, and given the overall material impact of the amounts involved on the financial performance of the Aareal Bank Group, these matters were of particular significance in the context of our audit.

② As part of our audit, we evaluated the technical and procedural implementation of the requirements for the classification and measurement of financial instruments pursuant to IFRS 9. Among other things, we evaluated the technical concepts, the allocation of the financial instruments to business models, the models for calculating the expected loss and their implementation in the bank's processes in order to determine whether they were consistent with IFRS 9. In order to do so, we initially used sample testing to check whether the financial instruments had been classified to the various measurement categories in accordance with IFRS 9 and whether the models used by the bank to calculate the expected loss met the requirements set out in IFRS 9. We also assessed whether the data used was valid and complete. In addition, we checked whether significant increases in credit risk had been appropriately defined by the bank and used sample testing to analyze whether the classification within the bank's portfolio had been performed correctly. We also evaluated whether the assumptions used by Aareal Bank AG with regard to the realization scenarios, proceeds, periods and costs when calculating the stage 3 risk provisions fell within an appropriate range. We evaluated the relevant processes used in the classification and measurement of the financial instruments in terms of their appropriate design, and tested their functionality.

Based on our audit procedures, we were able to satisfy ourselves that the assumptions used by the executive directors to classify and measure financial instruments in connection with the initial application of IFRS 9 and subsequent measurement are appropriate overall.

③ The Company's disclosures on the initial application of IFRS 9 are contained in note 2 of the notes to the consolidated financial statements.

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 control.

- 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 23 May 2018. We were engaged by the supervisory board on 30 May 2018. We have been the group auditor of the 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 Ralf Schmitz.

Frankfurt / Main, 5 March 2019

PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Ralf Schmitz	**Lukas Sierleja**
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 two restrictions set out below – since the last Declaration of Compliance was issued in December 2017; and will continue to do so, subject to the same restrictions.

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.

So far, Aareal Bank has declared an exception to section 4.2.3 (2) sentence (6) of the Code, according to which the amount of Management Board compensation shall not exceed a maximum amount ("cap"), both overall and for variable remuneration components. In March 2014, against the background of changed regulatory requirements, and based upon a proposal by the Remuneration Control Committee, the Supervisory Board approved a new remuneration system for members of the Management Board, with effect from 1 January 2014. The new remuneration system complies with the recommendation in section 4.2.3 (2) sentence 6 of the Code. In this connection, a cap was resolved for the variable, performance-related remuneration component of the Management Board – for the 2013 financial year, and for subsequent financial years. As the only exception, no cap applies to virtual shares granted for the 2012 financial year or earlier financial years. Such virtual shares were automatically settled and disbursed for the last time in 2018, after expiry of the retention period and any applicable holding or blocking periods, based on the weighted average price (Xetra®) of the five exchange trading days following expiry of the period. As a consequence, Aareal Bank will no longer declare an exception to section 4.2.3 (2) sentence (6) of the Code.

Wiesbaden, December 2018

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, the public and the environment alike.

Disclosures regarding Corporate Governance standards

To discharge its responsibility, the corporate governance is guided by legal and regulatory rules, as well as by 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:

- An appreciation for the uniqueness of every individual and respect for their differences
- 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 2018, the share of female managers on this level was 22.6 %. 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 2018, the share of female managers on this level was 25.9 %.

Across Aareal Bank Group, the share of women in executive positions stood at 25.2 % (Aareal Bank AG: 25.2 %; Aareon: 24.3 %) as at 31 December 2017, with women accounting for 37.7 % of Aareal Bank Group's entire workforce (Aareal Bank AG: 44.4 %; Aareon: 32.6 %).

Severely disabled persons made up 4.8 % of Aareal Bank's staff base in 2018. 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 operations on the sustainable development of the Company. 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 sustainable interests (as set out in the Remuneration Report), and the effective supervision of this remuneration system.

The Supervisory Board has established six (since 1 January 2019: 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 Committee for Urgent Decisions (only until the end of 2018), 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/2018/.

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 discusses decision proposals regarding connected-party loans as well as other transactions between members of administrative, management and supervisory bodies and the Company or its subsidiaries.

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.

Committee for Urgent Decisions (until the end of 2018)

The Committee for Urgent Decisions was a subcommittee of the Risk Committee up until the end of 2018. Members were elected from amongst the parent committee. The Committee for Urgent Decisions took lending decisions which, pursuant to the internal rules of procedure for the Management Board, required Supervisory Board approval, and which were particularly urgent. Since the Committee passed its resolutions by way of circulation, it did not hold any meetings. Any decisions taken between meetings of the Risk Committee were discussed at the subsequent meeting.

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, and determining focal points of the audit. 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.

Communication

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 auditor for the Company.

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.

We are not currently broadcasting parts of the Annual General Meeting on the internet, nor is it currently possible to give instructions or cast votes online. This is because, given the low level of acceptance of such a service amongst our shareholders, the related efforts and costs would have been excessive. Aareal Bank will continue to review demand for such a service on a regular basis.

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, in its entirety, shall facilitate 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 cannot be considered 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. This could be the case, for example, if the general limitation to members' maximum three terms of office on the Supervisory Board is soon to be exceeded. Each term of office starts with the election (or re-election) by the Annual General Meeting. The Supervisory Board aims for a scenario whereby at least 50 % of the employee representatives and each chairman of a committee and the Supervisory Board should be independent. At present, the Supervisory Board believes 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.

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 managing and monitoring risks. Both committee chairmen may not hold the position of Chairman of the Supervisory Board.

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 % (2017: 33.33 %). 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 %, following the expansion of the Management Board (2017: 40 %).

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 therefore 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. Following the enlargement of the Management Board, the corresponding share of members is currently 33 % (2017: 40 %). For the Supervisory Board, the figure is 25 %, and has remained 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, among other things, if further training will be required to meet future challenges or new provisions.

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 Notes (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. In the financial year 2010, employee representatives were elected by the special negotiating body, a body representing employees following the merger of Aareal Bank France S.A. into its parent company Aareal Bank AG.

The committees typically comprise five 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 2018, 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 in accordance with International Financial Reporting Standards (IFRSs). 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 (35) 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 2018 financial statements – as elected by the Annual General Meeting 2018 and instructed accordingly by the Supervisory Board – have exercised their audit activities under the management of Messrs Ralf Schmitz and Lukas Sierleja. In accordance with internal regulations, all employees of the external auditors, including the responsible partners and lead auditors, rotate their assignment to specific audit assignments on a regular basis – in this case, every five years.

Mr Schmitz, PwC's responsible partner, has audited Aareal Bank since 2018; Mr Sierleja, the responsible lead auditor, since 2016.

Report of the Supervisory Board of Aareal Bank AG, Wiesbaden

Dear shareholders,

Aareal Bank Group remained on its positive trajectory in 2018, thus following on seamlessly from the previous successful years. In an environment that was shaped by numerous challenging developments, this involved taking further important steps on our way to a sustainable and successful future. 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, both orally and in writing, upon 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 also received comprehensive reports on the development of the business segments, and on operative and strategic planning, and was involved in all important decisions. 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 and a decision taken. In cases where resolutions needed to be passed in 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, both orally and in writing, 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.

Activities of the Plenary Meeting of the Supervisory Board

Eight plenary meetings of the Supervisory Board were held during 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. Dynamic changes in the markets, also considering the geopolitical developments, the large number of regulatory adjustments that are yet required and further progress in implementing the "Aareal 2020" programme for the future 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. 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.

The focal points of the individual meetings are outlined below.

During the January meeting, the Supervisory Board concerned itself with the target achievement level of the individual Management Board members and the impact of the amended German Regulation on Remuneration in Financial Institutions (Institutsvergütungsverordnung – "InstutsVergV"), as well as the discussion of core areas for the lending business.

In the March meeting, the Supervisory Board concerned itself in detail with the financial statements and consolidated financial statements presented for the 2017 financial year, and with the auditors' report. The relevant facts were presented in the Supervisory Board report for the previous year. In addition, the proposal regarding the selection and subsequent appointment of the external auditor for the Annual General Meeting was discussed. This also included the scope and focal points of the audit for the 2018 financial year, as defined by the Supervisory Board. Upon recommendation of the Audit Committee, the Supervisory Board also agreed to subject the non-financial report for 2018 to an audit, to obtain limited assurance. Other issues covered during the March meeting included the preparations for the Annual General Meeting in May 2018. This meeting also discussed the annual reports submitted by Internal Audit and by the Compliance Officer. Remuneration issues were also dealt with at the meeting, and the necessary advice provided on preparing for the adjustments required in the Supervisory Board following the resignation of York-Detlef Bülow as employee representative.

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.

The meeting in June exclusively comprised an extensive discussion of Aareal Bank Group's strategy, during which the Supervisory Board intensely discussed strategic initiatives with the Management Board.

The appointment of Marc Hess as Member of the Management Board was discussed and agreed on in two meetings held in June and August. Furthermore, at the first of these meetings, the Supervisory Board discussed the re-appointment of Mr Winkelmann, which was resolved in July.

During the September meeting, current questions concerning strategic initiatives and the latest changes to the regulatory requirements were presented and discussed, in addition to the regular reports.

In the December meeting, the Management Board reported on the Group's corporate planning, and submitted and explained the corporate planning in detail to the Supervisory Board. Corporate governance issues were discussed as well. The requisite resolutions were passed and implemented. Furthermore, the Supervisory Board adopted the regular Declaration of Compliance, pursuant to section 161 of the German Public Limited Companies Act (Aktiengesetz – "AktG"), which was subsequently published on the Bank's website. Following the regulations of section 25c and d of the German Banking Act (Kreditwesengesetz – "KWG"), the Supervisory Board carried out the required evaluations. The Supervisory Board discussed the results of the evaluations in detail, and will incorporate these findings into its work.

Strategy documents were regularly discussed, in accordance with the Minimum Requirements for Risk Management in Banks (MaRisk). The Company's remuneration systems were also subjected to a scheduled review, with the reports submitted to the Supervisory Board. The Supervisory Board determined that the Company's remuneration systems are appropriate.

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 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. The members of the Supervisory Board have declared in writing that no conflicts of interest pursuant to section 5.5.2 of the Corporate Governance Code arose during the financial year under review.

In addition to its regular meetings, the Supervisory Board convened for a separate informational meeting, during which auditors PricewaterhouseCoopers provided very detailed information on current changes and deliberations in the regulatory and legal framework, as well as on the potential impact of such trends upon Aareal Bank.

Activities of Supervisory Board Committees

The Supervisory Board has established six committees in order to perform its supervisory duties in an efficient manner: the Executive and Nomination Committee, the Risk Committee, the Committee for Urgent Decisions (as a sub-committee of the Risk Committee), the Audit Committee, the Remuneration Control Committee, and the Technology and Innovation Committee. At its December meeting, the Supervisory Board resolved to adjust its Internal Rules of Procedure as well as its organisational structure to changed requirements. The adjusted structure no longer provides for a Committee for Urgent Decisions.

The Executive and Nomination Committee of the Supervisory Board convened for five meetings. During its meetings, the Executive and Nomination Committee prepared the plenary meetings of the Supervisory Board, concerned itself with the efficiency of the Supervisory Board and its committees, as well as with corporate governance issues. Within the scope of a regular dialogue with the Management Board, the Committee informed itself on the strategic development of Aareal Bank Group. The resolutions that were necessary upon the resignation of York-Detlef Bülow as employee representative and the appointment of Petra Heinemann-Specht as his successor were also prepared.

The Risk Committee held five meetings during the year under review. The committee 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. The committee was also engaged with the analysis of Aareal Bank's risk-bearing capacity and its capital ratios. Also, detailed reports were given 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 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, and also concerned themselves with the banking and regulatory environment.

The Committee for Urgent Decisions was a subcommittee of the Risk Committee, which approved loans subject to approval requirements by way of circulation. For this reason, it did not hold any meetings. Any decisions which were taken between meetings of the Risk Committee were presented again at the subsequent meeting, whereby the Management Board provided supplementary information on current implementation progress.

The Audit Committee held six meetings during the year under review. During its meeting in February 2018, the Audit Committee received and discussed the preliminary results for the 2017 financial year. During its March meeting, the committee received the external auditors' report on the 2017 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. In accordance with its duties under the Memorandum and Articles of Association, the Audit Committee also discussed the selection of external auditors and the focal aspects of the audit for 2018 during the same meeting.

During its meeting in May 2018, the Audit Committee also concerned itself with Aareal Bank Group's Sustainability Report and the audit undertaken to obtain limited assurance for this report.

In accordance with the requirements of the German Corporate Governance Code, during its meetings in May, August and November 2018, the Audit Committee discussed with the Management Board the quarterly results to be published.

The meetings also allowed the committee to deal with additional topics, such as a current overview of the services of the external auditors requiring approval in accordance with the EU Audit Regulation and Directive. It approved such services where necessary. Furthermore, the committee was informed about the review of the Internal Control System, in accordance with legal requirements; it duly acknowledged the report, following discussion. 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 2018 financial year. Furthermore, the Audit Committee initiated the requisite tender process for the change in external auditors for the 2021 financial year.

In its meetings, the committee also received reports submitted by Internal Audit, and the Compliance Report, requesting and receiving detailed explanations, and duly noting both reports.

During its eight meetings, the Remuneration Control Committee discussed issues related to 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. Moreover, the Remuneration Control Committee supported the Supervisory Board with all issues related to the remuneration of the Management Board. In particular, the committee provided support for determining the Management Board's targets for the current year, and for assessing target achievement by the Management Board, as a basis for determining variable remuneration for the members of the Management Board for the year 2018. As a rule, support was provided to the Supervisory Board by preparing the corresponding recommendations.

The Technology and Innovation Committee convened for four scheduled meetings, during which the committee discussed 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 its subsidiaries responsible for the development, among other things. Further key aspects of the regular discussions were issues related to the security and flexibility of IT systems provided and used within the Bank, as well as the realignment of the banking systems, against the background of numerous new requirements in terms of accounting, regulation, and cybersecurity. The Committee invited external experts to discuss current developments concerning selected topics.

Where members of the Supervisory Board were unable to attend a meeting, they had announced their absence in advance, giving reasons. Attendance of Supervisory Board members at meetings is shown in the table below.

Member of the Supervisory Board	Number of meetings attended / number of meetings (plenary and committee meetings)		
Marija Korsch	36	of	36
Prof. Dr Stephan Schüller	27	of	27
York-Detlef Bülow* (until 1 April 2018)	9	of	9
Thomas Hawel*	12	of	12
Petra Heinemann-Specht* (since 1 April 2018)	10	of	10
Dieter Kirsch*	20	of	20
Richard Peters	23	of	23
Dr Hans-Werner Rhein	16	of	18
Sylvia Seignette	13	of	13
Elisabeth Stheeman	17	of	17
Hans-Dietrich Voigtländer	26	of	26
Prof. Dr Hermann Wagner	19	of	19
Beate Wollmann*	12	of	12

* 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 2018, 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 audit results. The representatives of the external auditor participated in 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 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, and the consolidated financial statements prepared in accordance with IFRSs, and 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 26 March 2019, the Supervisory Board approved the results of the audit. The Supervisory Board thus confirmed the annual 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 the 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 22 March 2018, and 5 and 12 December 2018.

Moreover, during its meeting on 21 March 2019, the Audit Committee of the Supervisory Board discussed the Combined Separate Non-financial Report for 2018 and the result of PwC'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 PwC's audit results, and presented its assessment of the non-financial report (and its analysis of PwC's audit results) to the Supervisory Board. The Audit Committee also issued a recommendation to the Supervisory Board to concur with the results of PwC's audit. The Supervisory Board followed this recommendation; in its meeting on 26 March 2019, it summarised its examination by stating that it had no objections against the non-financial report and the results of PwC's audit.

Special transactions

In September, Aareal Bank Group reached an agreement with the Association of German Banks (Bundesverband Deutscher Banken e.V. – "BdB") on the acquisition of all shares in Düsseldorfer Hypothekenbank AG. The Supervisory Board approved this transaction, as it represents the successful continuation of an approach that creates added value for our shareholders. This approach enables us to examine opportunities, as well as using the expertise gained in the orderly, value-preserving run-down and the swift, responsible integration of Düsseldorfer Hypothekenbank AG. The transaction was finalised at year-end 2018.

Aareal Bank continued to make advances in its digitalisation campaign; in this context, it acquired a stake in BrickVest, one of the leading European online platforms for commercial property investment, in December 2018. This transaction was also approved by the Supervisory Board. The Supervisory Board is convinced that by participating in a company that pursues a digital model of the future, Aareal Bank is strengthening and promoting a key aspect of the "Aareal 2020" programme for the future.

Personnel matters

Various changes were made to both the Management Board and the Supervisory Board in the past financial year. These are reported on once again below.

York-Detlef Bülow, who served for many years on the Supervisory Board as employee representative, retired as at 31 March 2018. Mr Bülow, who joined Aareal Bank 40 years ago, was the long-standing Chairman of the Group Works Council and Deputy Chairman of the Supervisory Board during this period. He always served his role dutifully and with great commitment, where he provided both critical and constructive advice to the Management Board. In doing so, he made an important contribution to the Bank's efforts in dealing with the changes it encounters in the banking environment. The Supervisory Board would like to thank York-Detlef Bülow for his long-standing commitment and for the outstanding work he carried out in this context.

The Supervisory Board is pleased to welcome Petra Heinemann-Specht as successor to the employee representative. Petra Heinemann-Specht has been with Aareal Bank for nearly 20 years and has held various positions in this time, including in Credit Management and in Treasury. The Supervisory Board is certain that she will also play an active role on the Supervisory Board as employee representative.

Moreover, Mr Kirsch, who had represented employees on the Supervisory Board, retired from his office, effective at the year-end, since he will enter retirement during the first half of 2019. Having worked for Aareal Bank since 1983, he represented employee interests as a full-time Works Council member since 2002, and was appointed as an employee representative to the Supervisory Board in 2010. Most recently, he succeeded Mr Bülow as Deputy Chairman of the Supervisory Board. Through his commitment and his experience in the banking business, Mr Kirsch contributed to a dialogue between employee representatives and the Management Board which was always constructive and critical, supporting the manifold changes the Bank has seen in recent years. The Supervisory Board would like to thank Mr Kirsch for his long-standing commitment and for the outstanding work he carried out in this context.

The Supervisory Board welcomes Klaus Novatius who will succeed Dieter Kirsch as employee representative as well as Deputy Chairman of the Supervisory Board. The members of the Supervisory Board are certain that these members' long-standing service and activities in the Works Council will ensure a good changeover of staff in the Supervisory Board.

The Supervisory Board wishes the two new members every success in their new roles.

The Supervisory Board extended the contracts of three members of the Management Board in the past financial year and made one new appointment. It first extended the Management Board contract of Hermann J. Merkens ahead of schedule and appointed him as Chairman of the Management Board for a further five years, one year before his contract was due to expire. The ordinary re-appointment will be effective 2 April 2019, with his new term of office running until 1 April 2024.

Besides the re-appointment of the CEO, the Supervisory Board also extended the contract of Christiane Kunisch-Wolff. Her ordinary re-appointment will be effective 15 March 2019, with her new term of office running until 14 March 2024. Christiane Kunisch-Wolff has been a member of the Management Board since 2016; as Chief Risk Officer, she is responsible for risk controlling and for the Compliance, Regulatory Affairs and Information Security and Data Protection divisions.

The Supervisory Board also agreed to extend Christof Winkelmann's contract with effect from 1 July 2019 up to 30 June 2024. Mr Winkelmann has been a member of the Management Board since 1 July 2016; he is responsible for the Sales units in the Structured Property Financing business segment.

The Supervisory Board believes the renewed appointments will commit the three successful members of the Management Board to Aareal Bank Group for a further term of office.

It also appointed Marc Hess to the Management Board, with effect from 01 October 2018. Mr Hess assumes the position of Chief Financial Officer, which had been covered to date by Herman J. Merkens in his dual role of Chief Executive Officer and Chief Financial Officer. He will additionally assume responsibility for the Treasury division; going forward, he will thus also maintain relationships with debt investors. Marc Hess previously held the position of Chief Financial Officer of Deutsche Postbank AG.

The Supervisory Board of Aareal Bank is pleased to have attracted a very experienced Chief Financial Officer for the Bank. It is convinced that his expertise will provide a key contribution to maintaining Aareal Bank Group's perfectly healthy financial basis over the long term – in a challenging environment.

At the same time, the Supervisory Board would like to express its thanks to Hermann J. Merkens for having covered the dual roles of Chief Executive Officer and Chief Financial Officer throughout a phase of profound change and fundamental decisions for the future of our Company.

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 2018 financial year. All the employees have contributed to the Company's decisive success in overcoming the many challenges it faced. That enormous continued commitment – and strong motivation – demonstrated by all employees of Aareal Bank Group have once again made the Company's success possible.

Frankfurt/Main, March 2019

For the Supervisory Board

Marija Korsch

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 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 numbet 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

$$\text{EBIT margin} = \frac{\text{EBIT (operating profit before interests)}}{\text{Sales revenues}}$$

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;

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 Pfandbrief
Debt securities issued by Pfandbrief issuers (Pfandbrief banks), which are collateralised by mortgages with a maximum mortgage lending value ratio of 60 %.

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.

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 re-measurements of defined benefit plans, the reserve from the measurement of equity and debt instruments at fair value through other comprehensive income, the hedging reserves, the reserve from changes in the value of foreign currency basis spreads, and currency translation reserve.

Over the counter (OTC)
Financial markets term for off-exchange trading between market participants.

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).

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

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

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 variablerate 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

9 May 2019	Publication of results as at 31 March 2019
22 May 2019	Annual General Meeting – Kurhaus, Wiesbaden
13 August 2019	Publication of results as at 30 June 2019
12 November 2019	Publication of results as at 30 September 2019

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Corporate Responsibility Prime

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